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microNOTE 29

State-Owned Retail Banks in Rural and Microfinance Markets: The Case Of Banque Du Caire

A State-Owned Retail Bank Successful at Microfinance

Banque du Caire is a leading microfinance provider in Egypt, surpassing all other Egyptian microfinance institutions (MFIs) in active loans and gross loan portfolio and reporting a portfolio at risk as low or lower than most MFIs in the country. What explains Banque du Caire's success as a state-owned retail bank active in microfinance?

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Egypt has a relatively well-developed financial sector dominated by four state-owned banks, including Banque du Caire (BdC) and Banque Misr. Of the 62 banks in the country, only three have entered the microfinance market—BdC, Banque Misr, and the National Bank for Development (NBD), the bank that pioneered microfinance. However, it is BdC that dominates the large markets of Egypt's primary cities, Cairo and Alexandria. Founded in the 1950s, nationalized shortly thereafter under the socialist policies of Egypt's first president, and reformed into a competitive retail bank in 2000, BdC is now a leading microfinance provider, surpassing all other Egyptian microfinance institutions (MFIs) in active loans and gross loan portfolio and reporting a portfolio at risk (PAR) as low or lower than most MFIs in the country.

BdC's considerable accomplishments suggest a well thought-out strategy implemented by savvy managers, qualified staff, and sound advisors. But a look at BdC's implementation reveals that it did not follow or even attempt many of the traditional steps suggested when testing and rolling out a new product line. It conducted no market survey and had no expertise or experience in the microfinance market. It employed only five staff to monitor the program, none of whom had microfinance experience. Internal considerations—branch location and the need to absorb excess staff—drove BdC's roll-out strategy.

The bank entered markets that were already well-served by experienced MFIs and offered the same product at identical terms and conditions, with little effort at marketing. What, then, explains BdC's success as a state-owned retail bank (SORB) active in microfinance?

BdC did benefit from several fortunate external conditions, not the least of which was a large underserved market. Furthermore, BdC management and Environmental Quality International (EQI)—the U.S. Agency for International Development (USAID)-funded technical assistance provider contracted to support select MFIs in Egypt—made several good decisions when adapting microfinance to BdC and, to some degree, when adapting BdC to microfinance.

This microNOTE details these external and internal success factors, documents key lessons learned, and poses key considerations when analyzing SORB downscaling into microfinance.[1]

CRITICAL EXTERNAL SUCCESS FACTORS

Large Market. The market for microfinance in Egypt is immense. BdC did not need to look far for potential clients, even in the more competitive markets of Cairo and Alexandria.

Brand Recognition. Banks and bank staff (particularly branch managers) retain a level of prestige in Egypt, despite poor services and poor financial performance. When given a choice of the same product and terms from either a bank or a non-bank, the experience of BdC in Alexandria and Cairo suggests that clients prefer a bank. One branch manager from Alexandria estimated that 40–50 percent of his clients came from non-bank MFIs.

Technical Assistance. BdC benefited from EQI's decade of experience working with business associations and nongovernmental organizations (NGOs). BdC received (at no cost) a complete package of microlending technology, including a methodology, policies, procedures, training, monitoring, and a management information system that could connect BdC's entire branch network.

Liberalization of the Sector. Following banking sector liberalization and the shake-up of BdC by the government, the bank was willing to pilot-test microfinance. After years of poor results in the state and corporate sectors, most of Egypt's banks "discovered" retail banking, primarily for middle-class salaried employees, as a potential profit center rather than just a source of deposits.

CRITICAL INTERNAL SUCCESS FACTORS

Role of Champions. Since its inception, microfinance at BdC has been championed by a number of influential persons. The chairman understood the need to put the prestige of his office behind the program and did so not only by appointing a board member to oversee the pilot, but also by personally inviting branch mangers to participate. Throughout the rollout, the chairman and the board remained engaged.

Branch Network. The desire to open as many microfinance points of service—branches, agencies or outlets—as possible partially drove USAID/Egypt's microfinance strategy. BdC's 120 branches were exactly what USAID/Egypt and EQI needed: most branches had access to lower-income areas; most had full financial services; and BdC had access to a large number of individual account holders, mostly government employees. Rather than avoid served markets, BdC decided to compete directly with MFIs using prestige and quick disbursement to its advantage.

Funding. Despite its poor asset quality and (probable) negative equity position, BdC is

[1] This microNOTE is based on the Accelerated Microfinance Advancement Project (AMAP) Financial Services Knowledge Generation (FSKG) report *Banque du Caire of Egypt: A State-Owned Retail Bank Case Study*. The full report is available on http://www.microlinks.org

highly liquid. The additional cash, liquidity, and asset-liability management needed to operate the microfinance program is negligible. BdC was willing to commit funding to the project in terms of operational expenses (management, staff, and branches) as well as to finance the portfolio.

Bureaucracy and Controls. Government ownership of BdC resulted in a large staff and bureaucracy. The excess staff were largely assigned to different control functions. Even though the microfinance rollout was costly, it benefited from having several branch control functions overseen by staff members who lacked a financial interest in the microfinance programs.

Management Information System. During the pilot project, EQI implemented its El Mohassil system. This system has functioned adequately since the pilot project. With respect to branch networking, the system was more advanced than BdC's own portfolio and management systems and has allowed the bank to monitor the microfinance portfolio on a daily basis. For example, headquarters has real-time access to all of its branches and inputs are verified daily against the bank's branch accounting system, which includes all teller transactions.

REMAINING CHALLENGES

Despite its accomplishments to date, BdC faces formidable challenges in the future. Continued progress depends on recognizing and addressing these challenges.

Profitability Measurement and Product Costing. It is currently impossible to accurately measure the sustainability of BdC's microfinance program. As is the case with other commercial banks involved in microfinance, BdC's cost information is gathered from different sources and its cost allocation is done mostly through assumptions.

Product Development. BdC's notable shortcoming is the lack of product development. While several new products are being discussed, none have been designed or implemented. Even necessary changes to the existing product are seemingly difficult to implement. In addition, BdC has not taken advantage of its capacity to cross-sell products or automate transactions.

Merger. BdC faces a pending merger with the larger state-owned bank, Banque Misr. In 2005, Banque Misr embarked on a microfinance pilot-test of its own, with the same technical assistance package from EQI (though financed by the International Finance Corporation). The new (merged) board and management appear to share BdC's commitment to microfinance as a product line and have expressed interest in introducing microlending in as many of Banque Misr's 480 branches as possible. However, it is still not clear who will run the department in the merged entity or how the merger will take place. The merger will create significant redundancies in the large markets, and some type of rationalization of the branch network and staff will be needed.

State Ownership. Banque Misr is likely to remain state-owned for some time. The merged bank should be in a stronger financial position than BdC was on its own. However, the track record of Egyptian state-owned banks is not good. There exists the risk that the government will take a more active role in microfinance at Banque Misr, and that future asset quality problems or poor performance could negatively impact the microfinance program's access to the necessary staff or resources.

LESSONS AND CONCLUSIONS

The State-Owned Retail Bank Research Framework developed for USAID under the Financial Services Knowledge Generation project poses a number of key questions for consideration when analyzing SORB downscaling into microfinance. The specific experience of BdC provides useful insight when answering these questions.

WHAT MARKET FACTORS JUSTIFY SORB DOWNSCALING?

Size of the Market. In the case of BdC, the size of the Egyptian microenterprise market has played a crucial role in its success. Despite the market having already been served by business associations, NGOs, local cooperatives, the Social Fund for Development, and the Principal Bank for Development and Agricultural Credit for some time, there was still much room for growth. Pursuing unserved or underserved portions of the market may be a more politically acceptable justification, but these markets are often less attractive than those served by the private sector and therefore present a more difficult business case, particularly for start-up operations. In addition, SORBs' can successfully compete against NGOs and other MFI providers for clients. From the SORBs institutional perspective, there may be value in doing this in order to gain experience, expand quickly, and establish a presence. Although there are cost associated with doing this (for example, BdC's entry into the Cairo and Alexandria markets may have displaced existing providers, squeezing out the private sector), BdC's competition may have forced other MFIs to streamline procedures, cut interest rates, and diversify into other products—to the benefit of clients.

Fragmented Microfinance Service Provision with Limited Ability for Significant Market Penetration. Many of the Egyptian service providers have limited prospects to scale up their funding for microfinance beyond what they have or can receive through grants. BdC on the other hand, has excess liquidity and has already put over US$30 million of its own resources at risk. It also has a branch network that will allow for greater penetration of the market than any other existing provider, as well as the ability to continue mobilizing deposits, which enjoy an implicit government guarantee, to fuel expansion.

SORB is the most attractive provider. Most private commercial banks in Egypt are still absent from the microfinance sector, viewing it as too risky, too costly, or both. They also lack the branch network of the state-owned banks. Despite recommendations in Egypt's National Strategy for Microfinance to create a legal and regulatory environment to allow NGOs to transform into specialized deposit-taking institutions, NGOs are probably not ready and the central bank shows little appetite to take on more prudential risk, increase the number of banks, or create a new class of licensed financial institutions.

Excess Labor. BdC's decision to enter microfinance was based on its inability to release redundant staff. As a state-owned enterprise, its staff members are civil servants, unionized, and not easily fired. BdC saw opportunity in this constraint to absorb its excess labor in a labor-intensive activity. Nearly 8 percent of all staff are currently occupied by microfinance, and BdC is achieving respectable caseloads as compared to its competitors. Management at BdC and Banque Misr agree that, based on loan officer productivity and cost, it would be better to hire new loan officers than to retrain existing staff. The adjusted cost ratios support this conclusion. The lesson is that while utilizing excess labor may not be a good reason to go into microfinance, it can be done.

WHAT LEVEL OF GOVERNMENT COMMITMENT IS REQUIRED?

Environment Supporting Financial Liberalization. The removal of government restrictions on things such as interest rates, and more recent efforts on the part of the government to promote more private sector-oriented management at BdC and other SORBs, supported BdC's move into microfinance. To varying degrees, the other SORB downscaling case studies reviewed under FSKG also experienced increased liberalization of the financial sector prior to downscaling into microfinance.

Commitment to SORB Reform. BdC's and Banque Misr's entry into the microfinance market was not catalyzed by government initiatives or privatization. Rather it was enabled by financial sector liberalization and SORB reform. BdC's new chairman was free to make decisions, driven by internal considerations, market opportunities, and profitability. BdC's new management team has been given virtual autonomy in reorienting BdC toward retail banking, including the decision to pilot microfinance.

Acceptance/Support of Microfinance. The Ministry of Investment and the Ministry of Finance are effectively Banque Misr's shareholders and ultimately have the most influence. Both ministers are interested in SME promotion, and the Minister of Investment was part of the National Strategy discussion. It is notable that the central bank approved BdC's request to open new microfinance units at a time when it had been rejecting other requests for new licenses or branch openings. The Central Bank of Egypt may not be interested in creating a new class of licensed microfinance institutions at this point, but sees microfinance as an acceptable business line for banks.

Deposit Security. For better of for worse, the perception that BdC and Banque Misr are too big for the Government of Egypt to allow them to fail will help them continue to raise deposits used to fund microfinance. This is effectively a form of deposit insurance that provides these SORBs with access to large amounts of relatively inexpensive funding liabilities.

Competition. There is concern among other MFIs that the merger will create a microfinance provider that will grow to have a virtual monopoly. BdC's and Banque Misr's combined client base will exceed that of all of the other major players combined. Their combined branch network will be nearly 10 times that of the rest of competition. This could hurt the long-term development of the industry, if formidable competitors do not (or are not allowed to) develop.

Credit Information. In the long term, the growth of microcredit is likely be hindered by a lack of mechanisms to share client credit information. This should be considered by SORBs, other MFIs, government agencies, and donors in thinking about the long-term prospects of the sector. What characteristics and internal capacities should a SORB demonstrate to have a successful microfinance focus?

Commitment and Champions. Having the commitment of Chairman Al Baradei (and other members of the Board and management) to microfinance was particularly important, given that BdC, like most SORBs, is a large and bureaucratic organization. The chairman and others used the hierarchy of the bank and the prestige of their positions to demand and honor the participation of branch managers in microfinance. Position and prestige helped win converts in the beginning, before the actual results were convincing.

Infrastructure, Decentralized Authority, and Standardization. Rather than try to centralize the decision making and management of microfinance, branch managers were integrated into microfinance in a manner that was well-defined by headquarters. Incorporating the branch managers into a standardized process ensures consistency and efficiency while still making them ultimately responsible and accountable for final decision making.

Bureaucratic Controls. The microfinance department discovered ways to use the bureaucracy to its advantage by utilizing existing branch staff in simple and limited control functions, such as reviewing documents and disbursing funds. Ultimately, the use of branch staff has strengthened controls and further integrated microfinance into the branch without delaying the process.

Appropriate Information Systems. The El Mohassil system sparked the interest of the bank's information technology manager and led him to take initial responsibility for the pilot. The system also provides a method for the microfinance department to maintain a managerial and control role over the branches by having real-time access to data.

Integrated Strategy. Any downscaling SORB, including BdC, needs an understanding of and a coherent strategy for how microfinance fits into the bank's overall operations and how the clients fit into the bank. There is a need to proactively drive innovation and the development of new products. Furthermore, microfinance staff within the bank need a clear career path to ensure integration and staff interest and commitment.

HOW IMPORTANT IS LONG-TERM TECHNICAL ASSISTANCE?

BdC's microfinance products, systems, procedures, and training all came from EQI through USAID/Egypt funding. While the monetary value of EQI's assistance is minor compared to the resources committed by BdC to fund the portfolio and staff of the program, the value of technical assistance for initiating microfinance at BdC should not be underestimated, nor should it have continued. What BdC now needs is assistance to develop new and innovative products and services.