

# ABA

## Egypt - April 2004

### Global Rating

**A-**  
**Trend: Positive**

The Alexandria Business Association (ABA) was created in 1983 under the auspices of the Chamber of Commerce and registered as an NGO in 1988. After signing the Cooperative Agreement with USAID in April 1989, ABA disbursed its first individual loan in January 1990 and its first group loan in late 1999. In March 2004, ABA had an outstanding portfolio of 8 million USD for 26,000 individual loan (SME) clients and 14,300 group loan (Blossoms) clients in Alexandria and surrounding governorates.

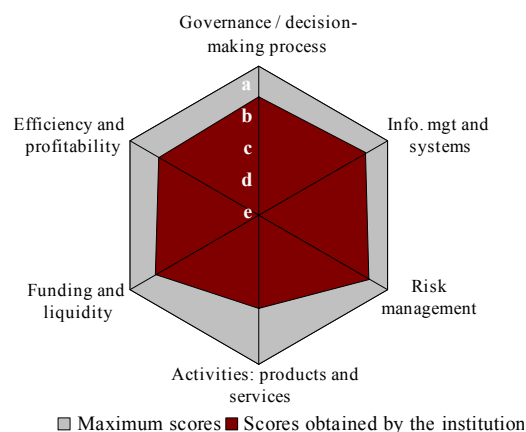
### Rating Plus Summary

Environment	Unfavorable legal environment, but large market and adequate infrastructure
Maturity	<b>Mature:</b> 14 years of operation
Scale	<b>Large:</b> Portfolio of 8 million USD
Target market	<b>Broad:</b> Avg. out. loan 20% GNP per capita

Rating scales and formulas may be found on the following page.

### Area Scores

<b>G</b> overnance and decision making	<b>a</b>
<b>I</b> nformation management and systems	<b>a</b>
<b>R</b> isk Management	<b>a</b>
<b>A</b> ctivities: products and services	<b>b</b>
<b>F</b> inancing and liquidity	<b>a</b>
<b>E</b> fficiency and profitability	<b>b</b>



	Dec. 2001	Dec. 2002	Dec. 2003		Dec. 2001	Dec. 2002	Dec. 2003
<b>ACTIVITY</b>				<b>PERFORMANCE</b>			
Total number of staff	322	519	615	ROE	6.1%	5.6%	2.8%
Total assets (K USD)	29,534	34,057	28,652	Liabilities / Equity <sup>(b)</sup>	31.3%	33.8%	16.3%
(K EGP)	135,856	158,366	177,161	ROA	4.4%	4.2%	2.3%
Outstanding portfolio (K USD)	9,118	11,185	8,287	Operational self-sufficiency	159.5%	166.6%	127.7%
(K EGP)	41,947	52,012	51,243	Financial self-sufficiency	154.5%	154.3%	116.8%
Number of active borrowers	25,432	34,882	43,256	Portfolio Yield	30.4%	29.4%	28.3%
Number of depositors	n/a	n/a	n/a	Operating expense ratio	8.7%	10.0%	11.5%
Annual effective interest rate	Note <sup>(a)</sup>			Staff productivity	79	67	70
PAR 31-365	4.2%	4.2%	8.8%	Funding expense ratio	9.4%	8.8%	8.2%
PAR > 365	4.6%	4.5%	6.3%	<b>GROWTH (local currency)</b>			
Write-off ratio	0.4%	0.2%	0.1%	Loan portfolio growth	(7.1%)	24.0%	(1.5%)
Risk coverage ratio	119.5%	206.3%	167.7%	Savings growth	n/a	n/a	n/a
<b>Exchange rate</b>	<b>4.60</b>	<b>4.65</b>	<b>6.18</b>	Asset growth	20.1%	16.6%	11.9%
<b>1 USD= x EGP</b>							

(a) The individual loan product has a nominal flat 16% annual rate (i.e. rate calculated on initial loan amount) or 28.3% annual effective interest rate and this product covers approximately 95% of the portfolio. The rate was lowered in January 2004 to 15% flat per annum or 26.6% effective. The group loan product has remained the same at a nominal flat 26% annual rate or 46% annual effective interest rate.

(b) It is to be noted that the amount of equity is larger than it would ordinarily be given that USD deposits exclusively used to guarantee overdrafts are part of the balance sheet rather than being off balance sheet items. Without these deposits the leverage ratio remains low but goes up to 47%.

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## Rating Scale

Area Rating	Global Rating	Explanation
a	A+	<b>Excellent</b>
	A	The institution excels in the evaluation area and is a model for the sector. There is a long-term vision for continual improvement. There are no risks in the short and medium term for operations. Long-term risks are well managed and monitored.
	A-	
b	B+	<b>Good</b>
	B	Procedures are well developed, effective, and incorporate a long-term perspective. Some improvements could be made. Long-term risks are identified in the strategic plan.
	B-	
c	C+	<b>Minimum required</b>
	C	Procedures are functional but with certain failings. There are minor risks in the medium term for operations, but these risks are being managed and monitored.
	C-	
d	D	<b>Insufficient</b>
		Procedures are in place, but with failings, and certain problems are only partially addressed. There are medium-term risks for operations.
e	E	<b>Immediate risk of default or very insufficient</b>
		There are immediate or underlying risks for operations or an unacceptable under performance.

## Rating Plus: MicroBanking Bulletin categories for Middle East North Africa (MENA)

Scale (Outstanding portfolio USD)	Target Clientele (Avg. out. loan / GNP per capita)	Maturity (Years of operation)
Large: > 8 million	Low-end: < 20% OR avg. out. loan ≤ 150 USD	New: 1 to 3 years
Medium: 2 to 8 million	Broad: 20% to 149%	Young: 4 to 7 years
Small: < 2 million	High-end: 150% to 249%	Mature: over 7 years
	Small Business: 250 %	

## Ratio Formulas

Personnel productivity	Active borrowers / Total personnel (end of period)
Loan officer productivity	Active borrowers / Total Loan Officers (end of period)
Return on assets	ROA: Net operating income before donations / Average assets
Adjusted return on assets	AROA: Adjusted net operating income before donations / Average assets
Return on equity	ROE: Net operating income before donations / Average equity
Adjusted return on equity	AROE: Adjusted net operating income before donations / Average equity
Leverage	Debt (savings + debts) / equity (end of period)
Portfolio yield	Portfolio revenue / 13-month average gross outstanding portfolio
Operating expense ratio	Operating expense / 13-month average gross outstanding portfolio
Funding expense ratio	Interest and fees paid on funding liabilities / 13-month average gross outstanding portfolio
Cost of funds ratio	Interest and fees paid on funding liabilities / Average funding liabilities (deposits + borrowings)
Loan loss expense ratio	Net loan loss expense / 13-month average gross outstanding portfolio
Adjustment expense ratio	Total adjustments / 13-month average gross outstanding portfolio
Net portfolio as % of assets	Net outstanding portfolio / total assets (end of period)
Operational self-sufficiency	Revenue from operations / (Financial expense + Loan loss expense + Operating expense)
Financial self-sufficiency	Revenue from operations / (Financial expense + Loan loss expense + Operating expense + Adjustments)
Risk coverage ratio	Loan loss reserves / Portfolio at risk (31-365 days)
Write-off ratio	Loans written off / 13-month average gross outstanding portfolio

# Executive summary

The microfinance industry started in Egypt in the early 1990s with support from several sources, notably the Social Fund for Development (SFD), the US development agency, USAID, and the Credit Guarantee Corporation (CGC). Most microfinance service providers operate as NGOs under a legal framework not adapted to microfinance. Egypt has the largest potential market for micro entrepreneurs in the Arab world with an estimated 1.5 to 2 million non-agricultural private businesses, but only a small percentage of this large market is being covered. Studies estimate that in 2003 approximately 200,000 micro entrepreneurs are being served, although this figure is an underestimate as it excludes SFD clients and other providers not reporting to the study.

The Alexandria Business Association (ABA) was created in 1983 under the auspices of the Chamber of Commerce and registered as an NGO in 1988. After signing the Cooperative Agreement with USAID in April 1989, ABA disbursed its first individual loan in January 1990 and its first group loan in late 1999. In March 2004, ABA has an outstanding portfolio of 8 million USD for 26,000 individual loan (SME) clients and 14,300 group loan (Blossoms) clients in Alexandria and surrounding governorates.

## Overall summary:

- ❑ **Key strengths:** ABA is a leading microfinance institution in the region with a very strong Board, successful management, an effective MIS, appropriate internal control and internal audit procedures (both recently improved after a major fraud in 2002/2003), more than sufficient funding sources for the next few years, and stable profitability that dipped in 2003 with the fraud and expansion but should rebound in the future.
- ❑ **Areas for improvement:** ABA could improve its low staff and loan officer productivity and mediocre portfolio quality, well below regional averages (both of which had a negative impact on ABA's overall rating), loan officer retention, formality with respect to business planning and financial analysis, and sophistication in the accounting software and financial statement presentation. Several of these needed improvements are already in progress.
- ❑ **Principal risks:** ABA faces risks related to the general macroeconomic environment, fluctuations in the EGP/USD exchange rate (although this exposure is minimized given the overwhelming excess capacity on the USD-backed overdrafts), and risks of political interference that have been successfully avoided thus far.

## ABA received a final rating of A- with a Positive trend.

### Governance and decision-making received the rating a:

- ❑ ABA has achieved a highly successful balance between the role of the Board, which provides true strategic direction and value-added advice, and management, that successfully oversees operations independently. The Board has also effectively prevented outside political interference. The regular and reliable management information provides an accurate picture of performance.
- ❑ Although not recorded in a formal business plan, ABA has a future strategy of increasing market penetration in the existing branch network with a will to expand in neighboring governorates where there is an appropriate opportunity. The lack of a formal plan has not been a serious handicap given the clear branch opening procedures, the vast market, ample funds, and financially successful operations.

- ❑ The management team has played a role in developing the products that are being used in other Businessmen's Associations, and therefore has cultivated its ability for innovation. The team has an interesting combination of staff with microfinance experience through years of working with ABA complemented by professionals from the banking sector. The upcoming departure of the visionary Director is being managed to ensure an appropriate transition.
- ❑ ABA has a professional approach to HR management to prevent hiring based on personal relationships. To address problems of high staff turnover, which go beyond problems with the group loan coordinators as faced by all the Businessmen's Associations, ABA is developing an innovative recruitment procedure to test motivation upfront and puts a high priority on training.

**Information management and systems** received the rating **a**:

- ❑ ABA has a well conceived information flow with an internally developed loan tracking software commercially marketed and supported by its own professional MIS team. The internally developed accounting software is being upgraded.
- ❑ There is a wealth of portfolio information that is reliable and available regularly with numerous indicators, although ABA follows most closely certain indicators atypical for microfinance. Planned improvements will include greater analysis of client business data and the market.
- ❑ The accounting and finance information is accurate and up-to-date with monthly statements on cash expenses and complete quarterly statements. Given its financial success, the team has not focused on refined financial analysis but is seeking to formalize and devolve this responsibility to the branch level.

**Risk analysis** received the rating **a**:

- ❑ After an elaborate and substantial fraud in 2003, ABA has recently strengthened its internal control system to combine quality procedures with improved verifications.
- ❑ ABA has a clear understanding of risks and plans accordingly. After staffing changes in the internal audit following the discovery of fraud, ABA now has a capable team of nine auditors led by a very experienced manager that serves a true internal audit function.

**Activities: Products and Services** received the rating **b**:

- ❑ ABA has appropriate portfolio management procedures, credit committees, and authority levels to limit credit risk. The financial analysis would need to be improved for larger loan amounts.
- ❑ Although the procedures are strong, they have not lead to strong portfolio quality, with a PAR31-365 over 4% in 2001 and 2002. The PAR31-365 of 8.8% in Dec. 2003, higher than prior years, was reduced in 2004 after the write-off of loans attributable to the fraud. These figures underestimate somewhat the PAR relative to other institutions given a practice of rescheduling known as "shifting" that, with HQ approval, allows clients to defer principal loan payments up to three months, and even more in very specific cases. As with several Businessmen's Associations, the group-lending product has virtually no arrears, due to a strong repayment system and strict incentive policy for group loan coordinators.
- ❑ Credit risk coverage is appropriate, with over 100% of loans in arrears covered by provisions and a system of guarantee checks recognized by the courts.

**Funding and Liquidity** received the rating **a**:

- ❑ ABA has more than sufficient funding available through its own retained earnings and local bank overdrafts backed by USAID provided USD fixed deposits. Given that those facilities are only at 30% of their capacity, ABA has sufficient funding for growth over the next few years and is not exposed to risks related to fluctuations in the EGP/USD exchange rates.

- Given the tremendous excess capacity in existing financing sources, ABA has not needed to perform detailed cash flow projections and may maintain low cash balances.

**Efficiency and Profitability** received the rating **b**:

- ABA has achieved financial and operational self-sufficiency for many years and continues to perform well. The compounded impact of the lowered interest rates, measures taken to strengthen the organization, expansion and fraud is visible in 2003 as the ROA, typically over 4%, dropped to 2.3%. The upward and downward pressures on the profit margin should compensate each other in the future, resulting in continued stable profitability
- ABA, like several other Businessmen's Associations, has the strange position of having poor productivity ratios (staff productivity at 70 and loan officer productivity at 105) yet a low operating expense ratio, (only 11.5%) which is attributable in large part to a relatively lower salary scale in Egypt.

**Funding needs:**

- ABA is able to fund expected growth through 2006 with internal resources.
- Planet Rating believes that ABA is a very strong organization with stable profitability, significant retained earnings, and a vast market and therefore could support additional external commercial rate debt if ever needed.

**The opinions expressed within this report are valid for one year after the rating mission. Beyond one year, or in case of a major change during this period affecting the institution's performance, that change due to the institution itself or its operating environment, Planet Rating does not guarantee the validity of the opinions contained herein, and recommends that a new rating evaluation be undertaken. Planet Rating cannot be held responsible for investments/financings that are made based on this report.**

# Rating Plus

The GIRAFE rating evaluates the financial sustainability of an institution regardless of its operating context (economic and political environment, infrastructure) or its development as measured by MicroBanking Bulleting (MBB) indicators such as maturity, scale, and target clientele. Rating Plus serves to highlight those potential internal and external impediments to achieving financial sustainability.

## Operating Context

### Economic and Political Environment: Stable

- After a period of heavy borrowing, Egypt increased its domestic production (GDP growth rate reached 5.2% annually for the 1995-2000 period). Agriculture accounts for 17% of GDP, industry for 34% and services for 49%. The internal political situation is stable. Population growth continues at almost 2% annually.
- Egypt received a Coface rating of B given expectations that weaknesses in the political and economic environment will likely affect an already poor debt repayment record.
- Egypt is ranked 120 out of 175 in the 2003 UNDP Report, with a net primary school enrollment at 88% and adult illiteracy nearly 35%.
- The legal framework for microfinance does not exist, rather MFIs operate as NGOs under the Ministry of Social Affairs, are not permitted to collect savings, have difficulty accessing bank funding without excessive collateral given their legal status, and have governance structures not well suited to microfinance.

### Infrastructure: Favorable

- Transportation infrastructure is adequate in the Delta and along the Nile corridor where population density is high, while travel outside of the Nile corridor is more difficult.
- The telecommunications infrastructure is sufficient for MFIs to be able to work via telephone and leased lines for fluid data communication with only minor exceptions.

	Dec. 2001	Dec. 2002	Dec. 2003	June 2004
Exchange rate: 1 USD = X EGP	4.60	4.65	6.18	6.21
GDP/capita (USD)	1,490	1,300	1,174	n/a
Inflation	2.4%	2.5%	3.4%	n/a
Coface rating				B

Source: IMF / World Bank / oanda.com.

## Institutional Development (MBB Indicators)

### Maturity: Mature Scale: Large

- ABA disbursed its first loan in 1990 resulting in 14 years of operation. The Association was initially created in 1983 to provide support to the private sector more generally.
- EQI, a USAID contractor, worked with ABA to establish the loan activities by helping to define branch opening plans, operations manuals, loan tracking software, and a standard chart of accounts.
- ABA has relied on both USAID funding and retained earnings to reach its current portfolio.

### Target clientele: Broad Other Activities: Yes

- ABA is between the MBB Low-end (<20%) and Broad (20% to 120%) categories, as the average outstanding loan as a % of GNP per capita is 20.8% Dec. 2003.
- The individual loan clients fall in the Broad category with an average loan outstanding of 35% of GNP per capita (1,800 EGP, 290 USD) whereas group loan clients are at the very low end of the market at 2.6% of GNP per capita (220 EGP, 36 USD).
- In addition to the group loan product targeted exclusively to women, predominantly poor, 18.3% of loans disbursed to individual clients in March 2004 were also for women.
- ABA also provides non-financial support for micro entrepreneurs willing to expand or formalize their business activities, including management training, library access, and legal support.

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# Acronyms

ABA	Alexandria Business Association
ALM	Asset/Liability Management
ASBA	Assiut Businessmen Association
BdC	Banque du Caire
BoD	Board of Directors
CBE	Central Bank of Egypt
CGC	Credit Guarantee Corporation (Egypt)
CIDA	Canadian International Development Agency
DBACD	Dakahlya Businessmen's Association for Community Development
EIR	Effective interest rate
ED	Executive Director
EGP	Egyptian Pound
EQI	Environmental Quality International
ERSAP	Economic Reform and Structural Adjustment Program (Egypt)
ESED	Egyptian Small Enterprise Development Foundation
EU	European Union
FY	Fiscal Year
HQ	Headquarters
HR	Human Resources
GNP	Gross National Product
IAS	International Accounting Standards
ITC	Information Technology Center
KfW	German Development Finance Agency
LO	Loan officer
MBB	MicroBanking Bulletin
MIS	Management Information System
MFI	Microfinance institution
NA	Not Applicable
NBD	National Bank for Development
NGO	Non Governmental Organization
PAR	Portfolio at risk
ROA	Return on assets
ROE	Return on equity
SBACD	Sharkeya Businessmen's Association for Community Development
SEDAP	Small Enterprise Development Foundation of Port Said
SFD	Social Fund for Development
SME	Small and medium sized enterprise
TA	Technical Assistance
UNDP	United Nations Development Program
USAID	United States Agency for International Development
USD	United States Dollar

# Microfinance Environment

## Overview

*Social Fund for Development and USAID two of the leading funders of microfinance*

The microfinance industry started in Egypt in the early 1990s with support from several sources, notably the Social Fund for Development (SFD) and the US development agency, USAID. The Credit Guarantee Corporation (CGC), a private joint-stock company founded by nine local banks and an insurance company, also promotes the development of micro, small, and medium-sized enterprises through loan guarantees for loans provided directly through banks or other providers such as NGOs. Several of its programs are also supported by USAID. Other actors supporting the sector include CIDA, KfW, Danida, Ford Foundation, and the Egyptian Swiss Development Fund. MicroStart Egypt, a small microfinance sector support project, will be implemented by UNDP and SFD.

The SFD, a quasi-governmental agency, was created to mitigate the negative effects of the IMF and World Bank supported Economic Reform and Structural Adjustment Program (ERSAP) in Egypt. SFD has two programs that provide small and microloans through partner banks and NGOs respectively, with financing from the Egyptian government, the EU, IDA, Arab Fund, Kuwait Fund, KfW and UNDP.

USAID developed a microfinance model through several businessmen associations registered as NGOs with off-site technical assistance from Environmental Quality International (EQI), the local partner of the National Cooperative Business Association. The Alexandria Business Association was the first to disburse loans in 1990, and the program has been replicated in five additional associations covering their respective governorates and, in some cases, neighboring governorates. A program with the National Bank for Development (NBD) was started in 1991 and in 2000 USAID and its contractors began providing technical assistance to the public sector Banque du Caire (BdC). In both cases, the bank units handling microfinance had entirely different procedures than other bank units.

*Generally, banking sector not serving the microloan market*

Egypt has more than 60 banks with a network of approximately 2,000 branches although they do not meet the vast needs of micro entrepreneurs. The latter figure includes about 1,200 branches of the Principal Bank for Development and Agricultural Credit (PBDAC) that provides micro and small loans focused on agriculture and rural needs, among others, through village banks all over Egypt. Otherwise, Egyptian banks do not typically offer loans below 25,000 EGP. Banks that do offer loans less than 25,000 EGP include the USAID initiated program with the Banque du Caire, NBD, and the SFD partners. With liberalization of the financial sector as part of the ERSAP, the Central Bank of Egypt (CBE) no longer sets a ceiling on the interest rates a bank may charge its borrowers, leaving an opportunity for banks to consider serving this market segment in the future.

## Legal and Regulatory Environment for Microfinance

*NGO microfinance unregulated, limited MFI financing opportunities*

Most microfinance service providers are NGOs that operate in a legal framework not adapted to microfinance. The NGOs are not permitted to collect savings, have difficulty accessing bank funding without excessive collateral given their legal status, and have governance structures not well suited to microfinance given the prescribed roles of Board members. The Ministry of Social Affairs supervises NGOs but does not have special regulations or norms with regards to microfinance. It may inspect the NGOs periodically and, if deemed necessary, replace the Board of Directors.

*Bank operators not subject to interest rate caps with a couple of exceptions*

For those microfinance providers operating as banks, the bank is subject to the rules and regulations of the CBE. Although there are no CBE-imposed interest rate caps, there are two major microfinance programs subject to special regulations. The PBDAC is occasionally subject to interest rate reductions by sovereign decrees and SFD loans channelled through banks are subject to similar sovereign decrees and have lower interest rates than non-SFD bank loans. PBDAC and SFD are also subject to occasional decrees that affect their collection policies through debt forgiveness and/or debt rescheduling.

*Vast market with unmet demand*

### The Microfinance Market

Egypt has the largest potential market for microentrepreneurs in the Arab world with an estimated 1.5 million non-agricultural private businesses.<sup>1</sup> The current providers serve only a small fraction of the effective demand for such services. Microloans are typically characterized as being under 10,000 EGP or for businesses with fewer than five employees. In a recent survey of MFIs, excluding the SFD and other local actors who did not report their data, it was estimated a total of 140,000 clients at the end of 2002, over 200,000 by the end of 2003, with an expectation to more than double in the next five years. Female borrowers constituted about a third of these clients being served. Data on the programs supported by USAID are presented below, as they account for a significant amount of the microfinance loans provided outside of the SFD.

<b>USAID supported microfinance programs in Egypt (as of September 2003)</b>			
<b>Institution</b>	<b>Total active borrowers</b>	<b>% of clients in group loans</b>	<b>Outstanding portfolio (USD)</b>
ABA	43,532	35%	8,714,762
ESED	31,267	32%	7,333,575
SEDAP	3,980	40%	904,892
ASBA	35,452	54%	8,191,254
SBACD	12,470	22%	2,514,476
DBACD	16,322	28%	3,411,479
Banque du Caire	38,757	0%	11,754,791
Other institutions	3,928	0%	1,035,344
<b>Total</b>	<b>185,708</b>	<b>29%</b>	<b>43,860,573</b>

<sup>1</sup> Central Agency for Public Mobilization and Statistics, Census of Establishments, 1996. Some recent studies estimate the number at over 2 million.

# Institutional Presentation

**Mission** The mission of the ABA Small and Micro Enterprise Project is to develop and promote existing small and micro enterprises, to raise the income of SMEs, to help them transform from the informal to formal sector, and to increase employment. As its main focus, ABA provides financial and technical services to small and micro enterprises. Additionally, it provides business development services through the Alexandria Small Business Center (ASBC). Other projects managed by ABA are described later in this section.

**Legal form and supervision** The Alexandria Business Association (ABA) began its activities in 1983 under the auspices of the Chamber of Commerce to provide support for the private sector, and was registered as an NGO in 1988 under the Ministry of Social Affairs. The Ministry may at any time inspect the NGO and in the event of unsatisfactory results, the Ministry has the authority to change the Board and management. This has happened in 2004 to another Foundation in Cairo. The Ministry covers NGOs generally and does not have microfinance-specific knowledge to supervise the quality of these activities.

The governance structure of the Businessmen's Associations, based on local NGO law, is not adapted to lending activities. The NGO law requires Boards to play a very active role in management, including the signature of all checks and hiring approvals, although certain duties may be delegated to an Executive Committee that includes Board members. The nature of these Associations requires strong relationships with the leaders of the local governorates which could prove challenging to the Association, such as requests to assign Board members or recommend staff for hiring.

**Ownership** ABA is governed by a General Assembly of 350 members that are either long-time members of the Association or members more recently invited by the Board. The General Assembly elects a fifteen-member Board of Directors. Members of the Board have a six-year mandate with one-third up for re-election every two years. The Board has no legal claims to income of the Association. In the event of liquidation by the government, the funds will become government property and may or may not be allocated to support other NGOs. The current Board is presided by Mr. Mohamed Ragab, who is the founder of ABA and has been a member of the Board since inception and was elected president in 2003. Other Board members include owners of companies in different fields of industry, trade, pharmaceuticals, services, etc. who have on average three years of experience on the Board.

## **Services** **Loan Product Features**

The SME individual lending program accommodates micro and small enterprises that have up to 5 and 6-15 employees respectively. Loan sizes range from 1,000 to 25,000 EGP repayable in monthly installments over 6 to 18 month loan terms. On a small scale, larger loans of about 30,000 EGP are disbursed, but this only applies to clients who have had several successive loans with ABA. The average loan size is about 2,700 EGP.

The group-lending program is mainly for women with 3-6 members per group. Loan sizes range from 100 to 500 EGP repayable in weekly installments over 10 to 40 weeks. The average loan size is about 220 EGP.

	Individual Lending (SME)	Group Lending (Blossoms)
Minimum / Maximum loan amount	750 to 25,000 EGP	100 to 500 EGP
% of total outstanding portfolio	95.3%	4.7%
Nominal interest rate	15% p.a. since Jan. 2004 (formerly 16%)	26% p.a.
Fees	No fees	No fees, no penalties
Repayment frequency	Monthly	Weekly
Term (without grace period)	4 to 18 months	10 to 40 weeks
Grace period	None	None
Guarantees	Guarantee checks for the full loan amount, relative guarantors for older clients, third party guarantors for businesses registered in other names, and bank checks for larger amounts	Group solidarity, guarantee checks for the full loan amount
Effective interest rate	26.6% (used to be 28.3%)	46%

### The Other Services

*Grants for businesses* Towards Self-Employment Program was recently introduced at ABA. ABA provides a 100 EGP grant, from ABA members funds, to jobless individuals who are willing to start an activity at home or as mobile traders. A second grant of 100 EGP is made after three months and then the beneficiary becomes eligible to participate in the group lending program. Total beneficiaries now exceed 3,100 and the retention rate of beneficiaries between the first and second phase is 74%.

*Medical lending program* The medical lending program provides loans to medical doctors or pharmacists for the purchase of fixed assets. Loan amounts can go up to 200,000 EGP. The average outstanding loan is 26,000 EGP and loan terms are usually of 12-48 months. These loans are 100% guaranteed by the Credit Guarantee Corporation (CGC) and are financed by bank overdrafts backed by CGC's guarantee. Because of contractual disputes and unsatisfactory results in terms of portfolio quality, ABA decided to stop this program in 2002 and since then has only been collecting the unpaid installments on older loans. In March 2004, the medical program had 136 clients for an outstanding portfolio of 3.6 million EGP, 58% of which is late by more than one year, had a staff of 5 persons and had generated a surplus of 686,000 EGP for the year 2003. **This program is not considered under the present rating, and performance of this product is not taken into account in the quantitative factors of this evaluation as all elements related to this program have been removed from the balance sheet and income statement. The program is being terminated and risks related to unpaid loans are borne by the CGC. The responsibility for coverage of accumulated operating losses, if any, would be borne by the institution.**

*Business center ASBC* The ASBC Business Center provides business development services for micro entrepreneurs willing to expand or formalize their business activities. The Center provides training to improve managerial and technical skills, has a library, and offers legal support.

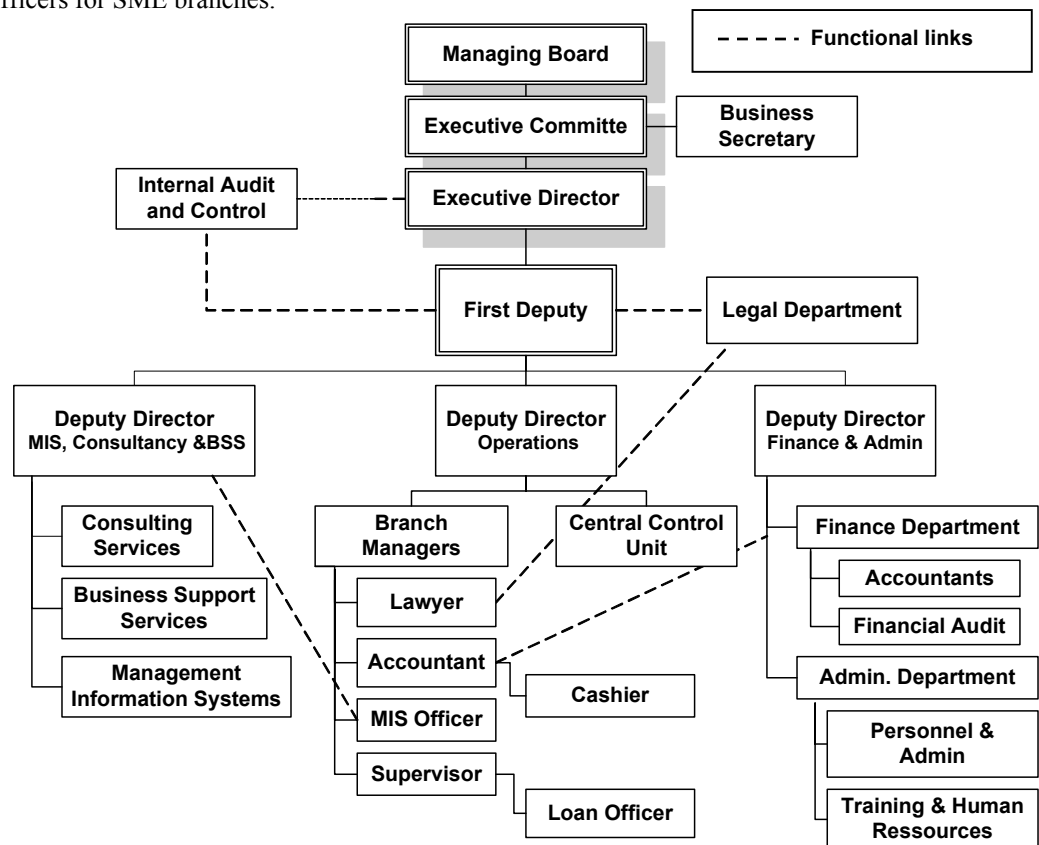
*Consulting services* ABA provides technical assistance and consulting services to other microfinance programs with product design, sustainable credit schemes, staff incentive policies and performance measurement. Past assignments have included technical assistance to the UNDP Microstart program in Yemen and Bahrain. Per the USAID Cooperative Agreement, ABA is to provide training and technical assistance to most operating MFIs in Egypt.

**ABA Loan Tracker Software**

ABA's internally developed MIS Loan Tracker has been marketed to 75 other MFIs and includes customer support. The product may be easily adapted to other MFIs' needs as it can be configured for different languages, product types, provision polices, etc.

**Human resources and branches**

ABA has a headquarters (HQ) and 27 branch offices to cover the governorates of Alexandria and, since 1997, other governorates including now Kafr El Sheikh, Behira, Matrouh and Menoufia. Blossoms and SME loans for a given area are managed from two separate branches usually located in separate premises. Loan approval is decentralized for loans up to 10,000 EGP. Disbursements are made by check and repayments in cash directly at the branch for SME loans, whereas group loans are transacted all in cash. Branches manage data entry for loan data, loan repayments, and accounting. Each branch has a full staff: a Manager, Accountant, Cashier, MIS officer, Lawyer, Deputy Branch Manager, Supervisors and group loan coordinators for Blossoms branches or individual loan officers for SME branches.



Human resources	Dec. 2001	Dec. 2002	Dec. 2003	Apr. 2004
Number of branches	18	24	27	27
Number of personnel	322	519	615	601
% Loan officers	67.1%	67.1%	67.2%	68.9%
Turnover (exits/ period average number of personnel)	30.7%	36.9%	39.5%	n/a

*External audits*

A local audit firm, managed by Dr. Zakaria M.E. Ismail and using Egyptian auditing standards has been the MFI's external auditor since inception. On a monthly basis, a team of ten auditors validates the financial statements with document verification that includes reconciliation of loan information with bank statements for a sample of 80% of the loans. Dr. Zakaria always certified ABA's accounts without reserve but does not issue reports on the relevance of the institution's internal control procedures. Grant Thornton Mohammed Hilal, the auditor appointed by USAID, also audited the financial statements for the duration of the two Cooperative Agreements (1990-1994, 2001-2005) and always certified without reserve the proper utilization of USAID funds.

# Governance and Decision Making

## Decision-making

**Decision-making process**

*Skilled and independent Board of Directors* As described in the Institutional Presentation, the governance of the Businessmen's Associations is not adapted to microfinance activities and subject to political risk. In the case of ABA, the Board and Executive Committee members have valuable business backgrounds, diversified skills, and strong community relations and share as well the same vision and goals for the institution. The Executive Director and Board carefully protect their independence from political influence.

*Successful balance of responsibilities between Board and management* The design of the decision-making process ensures a successful balance between the Board's added-value guidance on strategic issues and the efficiency of a high level of delegation to the Executive Director guaranteeing his autonomy for management decisions. Given the Board members' busy schedules, most Board duties have been delegated to a five-member Executive Committee that meets on a monthly basis to discuss the institution's performance and strategic issues. To avoid the high level of Board involvement in day-to-day operations implied by Egyptian NGO law, ABA obtained approval of the Ministry of Social Affairs to grant the Executive Director signature power for all operational matters, including check signing and recruitment.

**Management information**

*Monthly up-to-date quantitative information; no narrative analysis* Up-to-date financial and portfolio information is available for the monthly Executive Committee meetings. This information provides a clear picture of ABA's financial position. The management information is restricted to quantitative data and does not include narrative analysis on performance or the market.

## Planning

**Relevance of the current strategy**

*Clear strategy, even if not formalized in a written document* ABA does not have a formal strategic plan, but has a clear goal of further penetrating the market in both the SME and group loan products through the existing branch network. ABA will consider expansion to additional governorates if they receive reasonable assurance that local politicians will not interfere with the operations. In lieu of a formal business plan, ABA has performance standards for existing branches, a roadmap for the opening of new branches (number of staff to be recruited, operational goals, budgeting of set-up costs, etc.), and conducts pre-branch opening market surveys. The lack of a formal plan has not been as detrimental as would have been in a different context for several reasons, including a structurally profitable business model with a sustainable interest rate and low level of operating expenses. Furthermore, the start-up costs of expansion were funded by USAID grants and ABA has limited competition.

*Formal plan expected in 2005* The outreach of 27 branches and current market conditions make operations management and internal control increasingly complex. ABA now needs to be more formal in its business planning approach to achieve optimal performance and think more systematically about both internal and external risks. ABA's goal is to develop its first formal business plan for 2005.

*Goal for 2004 to strengthen existing operations before minor expansion and product development in 2005*

ABA plans to use 2004 as a year to strengthen existing operations and therefore has only modest plans for portfolio growth and plans for 3 new branch openings. After sustained growth over the past 10 years, more than 20% per year on average, and several incidents of frauds discovered in 2003, ABA seeks to improve internal controls through a revised set of procedures and greater branch management supervision. Additionally, improvements are planned for the MIS such as implementation of the final version of the accounting software and the installation of an electronic archive system for client files. New products are being studied to better serve the existing client base and achieve greater penetration in its existing market. Funding is not an issue for ABA since the institution currently only uses 30% of its negotiated credit facilities. In 2005, ABA is considering the opening of three new branches and the possible implementation of new products under development in 2004.

*Conversion to bank no longer under consideration*

ABA has pursued the idea of converting the Association to a bank to have a stronger legal status and to mobilize deposits. After pursuing the idea with government officials, the benefits were not deemed sufficient to warrant the heavy costs. The non-transformation does not jeopardize the future of ABA given the current significant surplus in funding capacity and strong governance through a stable and competent Board.

#### **Budgeting Process**

*First formal budget expected in 2005, close monitoring of performance*

Until now, ABA did not have a formal budget, but the timeliness of information enabled ABA to monitor the actual operational and financial performance on a monthly basis and readjust operations if necessary. The budgeting process should start in July 2004 to produce a detailed budget by branch and by month for 2005.

For 2004, a rough annual budget has been issued with operational targets, defined by Branch Managers and revised by HQ, with very general hypotheses on revenue and expenses (10% increase on all items). The Finance Department provides a thorough quarterly analysis of actual performance vs. targets.

## **Management Team**

#### **Skills and experience of management team**

*ABA worked with USAID to establish USAID-funded microfinance in Egypt*

The Cooperative Agreement between USAID and ABA started USAID-funded microfinance activities in Egypt. Staff had to create and experiment, along with the USAID technical service provider, to develop a system replicable throughout Egypt. This system included product definition, core manuals, a basic organizational structure, control systems, and other tools. ABA management was therefore required since inception to innovate and have a critical eye on the systems they were building.

*Exceptional Executive Director supported now by management with either significant ABA experience or banking experience*

ABA also had the good fortune since starting its microfinance activities to have an Executive Director with strong technical and management skills as well as powerful vision of ABA's mission and future. As he now prepares for retirement, he is progressively transferring responsibilities and expertise to a recently hired First Deputy with extensive banking experience who will also attend best practices international trainings to gain microfinance-specific knowledge. The management team has been strengthened after the discovery of frauds in 2003 that revealed some weaknesses in the internal control system. ABA therefore replaced the Internal Control and Operations managers. The management team is now an interesting mix of staff with many years of ABA experience, and thus extensive microfinance background, and recently hired staff with a banking background. All members of the management team have business experience and technical skills appropriate for their respective areas.

*Goal to transform branches into profit centers*

ABA seeks to transform branches into true profit centers by developing the planning, budgeting and management skills of branch managers during 2004. Typically, branch managers are promoted from the field and therefore do not necessarily have the requisite skills for this transition. The Operations manager will be closely supervising the process and ABA has planned trainings later in the year. Those branch managers already not deemed of sufficient skill to take on this new role are no longer branch managers and others are subject to detailed performance reviews based on very specific objectives.

*Management team covers all key areas*

**Organization of the management team**

The core management team is composed of an Executive Director, a First Deputy Director, a Deputy in charge of Finance and a Finance Manager, a Deputy in charge of Operations, a Deputy in charge of Information Systems and Consulting Services and a Human Resources Manager. An Internal Auditor and a Lawyer further support the team. The team's work has resulted in satisfactory field operations and covers all key positions without duplication of tasks. Monthly management team meetings and frequent informal exchanges ensure fluid information sharing and collaboration across departments.

## Human Resource Management

*HR centralized at HQ*

**Organization of Human Resource management**

ABA has centralized all Human Resource (HR) management to headquarters with a Human Resource Manager to monitor recruitment as well as salary and benefits and staff training needs. A team of managers from several departments (HR, Operations, Finance and MIS) forms the recruitment committee that sets recruitment plans and reviews all candidates. Although there are no stated goals with regards to HR in a strategic plan nor fully documented procedures (a manual should be finalized soon) the HR management is efficient and professional and the general vision is to create a workforce of high performers.

*Professional HR management*

**Skills management and performance evaluation**

ABA has built an efficient team thanks to a professional approach to hiring. Although it is not uncommon in Egypt for hiring to often be based on personal relations, the Executive Director has laid clear guidelines to prevent ABA from hiring unqualified staff<sup>2</sup>.

*ABA working to address very high staff turnover*

- ABA is actively working to address the very high turnover concentrated in first year SME loan officers and group lending coordinators (the latter accounting for 34% of the turnover). This is why ABA now focuses considerably on motivation during the recruitment process. It should be noted that several of the Egyptian foundations have difficulty retaining the female group loan coordinators.
- ABA has a strong culture of performance with variation in the nature of this evaluation based on position. Staff members are evaluated using quantitative and/or qualitative factors on either a monthly, quarterly or annual basis.
- In addition to base salary pay, field staffs receive incentive pay. The field staff bonus is calculated according to productivity and repayment rates. ABA recently acknowledged that their prior system had a negative impact on staff motivation and provided an incentive for LOs to use either their own funds or funds from clients repaying in the following month to artificially inflate the repayment rate for the prior month. They lowered the minimum

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<sup>2</sup> Recruitment begins with information sessions to candidates responding to public advertisements. Candidates who continue in the process are reviewed by the recruitment committee, and those hired participate in a basic training class for ten days in addition to on-the-job field experience with senior LOs who have "Train the Trainer" experience. Successful completion of the three-month probation period results in permanent hire. A University degree is required for SME LOs, with a preference for Sociology or Social Service Faculties. Blossoms LOs are not required to have a university degree but must have good knowledge of the region in which they will work.

*Well-developed  
internal training  
programs*

repayment rate from 97% to 95% for the SME program, while for Blossoms the rate remains 100%<sup>3</sup>. Branch manager incentive scheme has also been revised to become quarterly instead of monthly and to increase the importance of management skills with respect to quantitative performance. Lawyer bonuses are linked to the collected amounts from sued cases. For other administrative staff, there are specific incentives based on the number of clients/groups in the respective branches they are serving.

- ❑ Additional employee benefits include medical support on critical surgeries, subsidized summer holidays premises in Matrouh, grant payments on marriage and/or death of parents and retention payment at the end of service with the project.
- ❑ The trainings offered are already well developed with plans for further improvements. Several formalized in-house trainings include: initial LO training, three-day refresher trainings for experienced LOs, six-day leadership training for newly hired or promoted deputy and branch managers, two-day trainings upon introduction of new loan products or operating procedures, and additional trainings upon request, typically for computing and English language. ABA plans to give increasingly focus to the capacity building of middle management, branch managers and senior LOs.
- ❑ ABA's internal rules stipulate that low performers may be fired after three successive warnings in writing. Before firing, ABA is now considering refresher training for poorly performing LOs.

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<sup>3</sup> ABA also reduced the share of the bonus with respect to total compensation from 70% to 50%.

# Information Management Systems

## Management Information System (MIS) and Equipment

### Description of the MIS

<b>Infrastructure</b>	<ul style="list-style-type: none"><li>• HQ and branches are linked through dial-up connections for the loan tracking system allowing input and consultation based on access rights.</li><li>• Computers are in sufficient number (approx. 4 per branch and 36 in HQ) and of appropriate quality to run the operations efficiently.</li></ul>
<b>Accounting</b>	<ul style="list-style-type: none"><li>• Software: General Ledger (internally developed), manual accounting</li><li>• Branch accountants are in charge of all data input; reconciliations with bank statements and portfolio information are made on a daily or weekly basis in the branches.</li><li>• HQ accountants manually consolidate data using Excel.</li><li>• Basic financial statements are produced every month at the branch level and consolidated. Full financial statements including depreciation and loan loss reserve calculations are produced on a quarterly basis.</li></ul>
<b>Activity information</b>	<ul style="list-style-type: none"><li>• Software: Loan Tracker (internally developed)</li><li>• Branch MIS officers input client information and disbursement data and cashiers input repayment data.</li><li>• Data updates are sent daily to HQ for consolidation via dial-up connections.</li><li>• Client information is shared among all branches (updates are sent by HQ on a weekly basis) and the system automatically checks if a new client is already with ABA elsewhere.</li><li>• Complete consolidated performance reports are produced every month by the MIS team at HQ.</li></ul>

### Security

*Adequate security system with password protections, regular back-ups and secure document storage*

ABA has an adequate security system. Passwords are needed to enter the system, even if no minimum number of digits has been set, reducing the effectiveness of the password protection. Regular backups of all data are performed in the branches and at headquarters. Valuable documents, such as guarantee checks and loan contracts, are adequately kept in safe or locked fire proof metal closets. An audit trail integrated in the MIS permits checks for potential data manipulation.

### Ease of system use

*Fluid information flow with efficient infrastructure and MIS*

The computer stock and software allows for a clear flow of information that is easy for users at headquarters and in the branches, even if the accounting information production is complicated a manual bookkeeping for supervisory bodies.

- The internally developed loan tracking software facilitates an efficient loan handling process, provides rich information for branch managers and LOs, and automates the calculation of LO bonuses. The consolidation of data for all branches is automated on a daily and weekly basis. There is an extensive and flexible reporting tool for management analysis.
- The internally developed accounting software provides all needed information. The consolidation of data and creation of financial statements are not yet automated since the rollout of the enhanced version of the software has been postponed to 2004 given changes

in the financial management team. In the meantime, consolidation is based on manual data entry and numerous Excel files with less flexibility for analysis and reporting. Accountants in the branches also maintain a manual version of the accounting books for the supervisory bodies.

- ❑ The MIS team chose not to transfer data automatically from the loan tracking system to the accounting system but rather to have two sources of data entry as an internal verification. Reporting tools build reports by pulling data from both databases for ratio calculations.
- ❑ The MIS team developed several other software tools, such as the staff database, pay-roll, fixed assets inventory, client file archive, business planning, legal department activity follow-up, etc.

#### **MIS plan and future improvements**

*ABA provides ongoing updates to loan tracking software*

There is no formal MIS plan but the MIS department, also a service provider for other MFIs who bought the loan tracking system, is continually improving the system. The transition towards a Wide Area Network instead of dial-up connection with branches is now facilitated by improvements with Egyptian telecommunication service providers and is planned for 2004.

#### **Skills of MIS managers**

*Strong MIS team a profit center for ABA*

The MIS team is a profit center for ABA and their skills can be compared to that of a commercial software company. Staff has all the necessary training and skills to provide all the needed technical support.

## **Information on Activities**

#### **Information quality**

*Rich and reliable information*

The efficient loan tracking system and data consolidation at HQ provides ABA management with regular, rich and reliable portfolio and client information by type of business activity, geographic region, address, age/gender, etc. Numerous useful reports or indicator calculations are already developed in the MIS or could easily be developed internally. Client business data and impact data are being gradually added to the system. Data analysis performed at HQ will become the responsibility of branch managers when their transformation into "profit center managers" becomes effective (2004/2005). ABA does not collect regular information on the market but does track the business sector and sub-sector of its clients.

*Unusual choice of key indicators*

Although the loan tracking system generates rich information, including commonly used ratios internationally, and can easily generate any needed indicators, ABA tracks most closely indicators that do not provide the clearest picture of performance. For example, monthly reports indicate the total disbursed amount of active loans instead of the principal outstanding of active loans, some reports include the total interest to be collected in the loans outstanding, and repayment rate is frequently preferred to PAR in the summary reports.

#### **Information dissemination**

*Information readily accessible and adequately disseminated*

Information may be accessed by all those who need it, according to pre-specified access rights. Branch performance is compared and discussed during the monthly meetings of branch managers with top management.

## Financial and Accounting Information

### Information quality and financial analysis

*Accurate and complete financial information*

ABA has accurate monthly accounting information by branch, governorate, product and consolidated with frequent bank reconciliation. Full financial statements with calculation of depreciation and provisions are produced on a quarterly basis but will become available monthly after consolidation is automated. The new finance team is working to add more detail in the presentation of annual financial statements.

*Financial analysis recent; soon to be the responsibility of branch managers*

ABA has a monthly spreadsheet developed for USAID reporting purposes that calculates profitability ratios. Given its financial success, the institution did not feel a great need for detailed financial analysis and does not really use this information. Branch managers will be trained in 2004/2005 to perform this analysis since network expansion requires increasing financial analysis to allow for better monitoring of operations. ABA is already preparing for a more accurate analysis of branch performance by allocating financial costs according to branch portfolio size. Allocation of HQ costs for analysis purposes is also planned for 2004.

### Skills of finance department

*Finance team has necessary financial analysis skills*

The finance team is sufficiently independent and manages well the accounting work. Next year they will be able to apply their financial analysis knowledge to more formalized business planning.

# Risk Management

## Procedures and Internal Controls

*Recently discovered weaknesses in internal control now remedied with more sophisticated system*

### Internal Controls

Fraud of various natures discovered since 2003 have revealed several weaknesses of the internal control system<sup>4</sup>. Since then, appropriate measures have been taken to better control such risks. The internal control system is now very sophisticated and ABA successfully managed to avoid using excessive controls.

- ❑ The already well-defined existing procedures for the SME and Blossoms programs with updates in the form of circulars are being compiled by external consultants in manuals to be completed by mid-2004.
- ❑ The system includes an appropriate separation of tasks and levels of control that each have specific added value. The system includes verifications by branch managers, pre-disbursement control by HQ or another branch, surprise audits by the internal audit team, control points in the MIS, and rotation of staff in key control points such as branch managers, accountants, and MIS clerks.
- ❑ Given the availability of financial and portfolio data, ABA can easily identify problems and under-performance. ABA plans to add systematic checkpoints on client data to the control system, such as client turnover and loan cycle progression.
- ❑ The remuneration system encourages strong portfolio performance as described in the section on Human Resource Management.

*Internalized cash handling but numerous controls and insurance to mitigate risks*

### Liquidity security

ABA has internalized all cash handling through cashiers for SME loans and group coordinators (Blossoms LOs) for the group loans. Cash-handling risk is covered by multiple controls in accounting transactions, an adequate separation of tasks, insurance policies for cash collectors, and daily remittance of cash to banks. The cashier is the only individual with access to the branch safe.

ABA has taken into account the fact that it is very difficult to avoid direct cash collection by SME LOs despite wishes to the contrary. They have therefore adapted procedures to acknowledge this by recording it in the MIS to measure its frequency and getting clients to sign a disclaimer to not hold ABA liable for funds given directly to the SME LO that are lost or stolen. For group loans, ABA discovered that group loan coordinators would keep partial

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<sup>4</sup> **Disbursements to fictitious clients** were organized by a branch manager who recycled the money in loans with higher interest rates in regions not covered by ABA. The branch manager was thus able to repay the fictitious loans on time. When the fraud was discovered, the outstanding amount of fictitious loans was 1,900,000 EGP (300,000 USD). The system relied on:

- ❑ The complicity of a bank clerk who did not check the ID of the clients before cashing the disbursement checks;
- ❑ Violation of procedures by credit committee members who accepted, out of trust, to issue loans to people that had only been seen by the branch manager; and
- ❑ The relative weakness of the audit team that did not visit a sufficient number of clients.

**Misuse of the loan shifting procedure:** Fake loan shifting requests were issued by some LOs who would forge their client's signature. LOs used this system to hide late payments and keep their bonuses.

**Data manipulation:** At the beginning of a new month, and before the closing of the next, some payments would be used to fill in for some missing payments of other clients for the previous month in order to improve the repayment rate.

payments at home awaiting the rest of the payment since partial payments were prohibited. Now group loan coordinators may submit partial payments to reduce cash-handling risk.

## Internal Audit

### Risk identification

*Clear risk identification with strategy to address these risks*

The synergy between the Board and management results in a clear understanding of overall risks and the development of strategies to appropriately address those risks. To address slow economic growth, ABA seeks to innovate new products. To ensure sufficient internal controls for an increasingly wide branch network, ABA is strengthening the control system. To cover increasing operational costs, ABA seeks to increase the percent of the portfolio in the more profitable higher loan sizes. To protect ABA from potential government interference with the departure of the ED, the team has been working on a smooth transition.

*Increased attention on operational risks after fraud discoveries with detailed analyses*

ABA's analysis of the operational risks has become more refined given the discovery of several cases of fraud. Over the past year, the new Deputy in charge of Operations and the Internal Auditor have been actively researching all potential sources of frauds or other procedure violations. The resulting remedies were not limited to the addition of greater layers of control but also included a deeper analysis of the factors that might entice staff to cheat so as to change the underlying incentive problem. To further develop the awareness of the operational risks among the new Internal Audit team, the First Deputy recently proposed that internal auditors serve as LOs during an LO's annual vacations and write a report describing key findings.

### Internal audit quality

*Independent audit department performs verifications and recommends changes*

The head of the internal audit department monitors compliance with procedures and proposes policy improvements when weaknesses are identified. The audit reports are sent to the ED where they are closely studied and trigger corrective measures when deemed necessary. A financial audit team reviews the financial data in HQ with a specific focus on the control of procurement policies. The internal audit department is independent in the sense that it reports directly to the Board of Directors' Executive Committee with only a functional reporting to the ED and his First Deputy.

*Audit department strengthened in 2003*

The internal audit department is now fully functional after ABA replaced the manager in 2003. The new manager has over 20 years of business experience, mostly in bank credit but also in accounting and audit firms. The six experienced auditors and three junior auditors, who joined ABA one year ago, visit each branch two or three times a year in teams of three to four auditors. ABA has plans to hire two or three additional auditors in the near future. The auditors conduct both the review of documents and field visits to a sample of clients that varies from 10-15% of clients for the group loans and a minimum of 30% for SME loans in addition to all clients either late or who have had a "shift" in a monthly installment repayment, a form of minor loan rescheduling. If a problem is discovered in a branch, then the audit team may visit 100% of the clients. The ED defines the schedule of visits each month. ABA worked since inception with the same auditing firm and that level of control might be more efficient if the external auditor was changed periodically.

# Activities: products and services

## Marketing and competition

*Large market with competition only recently from banks with similar SME product*

ABA's potential market is vast with a population of more than 18 million in the current service areas. ABA did not experience any notable competition until Banque du Caire in 2002 began offering the same SME loans, having received the same product prototype and technical assistance from USAID and EQI as the Foundations did. The differences between ABA and the bank are that bank loans have a higher minimum loan size (3,000 EGP versus 750 EGP at ABA), have a higher interest rate (16% flat versus 15% flat at ABA), but much faster disbursement (first loans within two days versus 10 to 15 days for ABA). ABA management believes that client relationship, quality of service, and the additional business development services they offer provide a strong competitive advantage. ABA hopes that these additional services will encourage clients to formalize their businesses, as they gradually require more legal documents with increasing loan sizes, although only 10% of clients have loans requiring tax registration.

*ABA seeking to intensify marketing and client retention through product development*

To drive expansion, ABA is seeking to increase its marketing efforts and focus more on product development, a responsibility of the newly hired First Deputy. ABA is considering increasing the maximum loan size and term and developing products for fixed asset purchasing and consumer loans. To better retain existing clients, ABA has asked branch managers to prepare quarterly reports on reasons for client dropout on a case-by-case basis. ABA is able to track such clients using the MIS that categorizes clients by the quality of their repayment history. Branch managers may then contact those dropout clients with good repayment histories.

## Portfolio Management

*Strong lending methodology and procedures but portfolio quality should be stronger*

### Lending methodology

ABA has developed strong loan methodologies for both SME and group loan products that are well adapted to their target clientele. They limit somewhat credit risks and help develop a reimbursement culture among clients with appropriate loan application evaluations, limits in loan amounts according to maturity of client or of business, efficient guarantees and regular follow up. A new manual for credit policies and procedures is being finalized. However, these measures have not resulted in very strong portfolio quality (please see next Section).

*Client business information not always recorded in applications*

- To select group loan clients, ABA focuses on client morality, group solidarity and the existence of clients businesses, which is sufficient given the small loan sizes.
- The SME LO evaluation of client's business and debt repayment capacity is adequate for the amounts of loans provided but are not sufficiently documented for new loans, and not documented at all for renewals which are often for larger loan sizes. More sophistication in the business cash flow analysis will be required if ABA seeks to offer more loans of higher amounts.
- The recently enhanced control procedures help to limit the credit risk via a good separation of tasks and levels of lending authority. The five-person Credit Committees (branch manager, two senior loan officers, lawyer, and accountant) have authority for loans below 10,000 EGP while loans from 10,000 to 20,000 EGP may be approved via fax by the Operations Director, above 20,000 EGP by the Executive Director. Furthermore, there are ceilings on lending amounts by the degree of business formalization. To ensure the quality

of business analysis and limit the risk of fictitious clients, branch managers visit both new and repeat borrowers prior to disbursement and a HQ control unit 'COP' visits the new borrowers. The MIS officer and lawyer also review loan documents.

- ❑ ABA's policy does not allow for full rescheduling of loans but does accept one-month "shifts" in schedule, provided that the client is at least in his third loan with ABA, has suitable justification such as a serious illness, and warns ABA before being late in his repayment. The client therefore shifts the installment payment to the end of the loan term but continues to pay monthly interest. Three shifts per loan can be approved by the Operations manager, whereas additional shifts require ED validation. This shifting practice is used also as a de facto grace period, as grace periods are not available.
- ❑ Repayment discipline forms an essential element of ABA's culture as promoted by the incentive system. LOs are very active in conducting follow-up visits and repayments are closely monitored by the LO, branch manager, and branch lawyer. The yearly planning of disbursement days is wisely designed to distribute repayments over the month or week so that LOs can better organize their work. HQ is currently designing a 'field visit format' to better track LOs' follow-up efforts.
- ❑ ABA has a very swift delinquency management. After two days of delay LOs may visit the client accompanied by the branch manager or lawyer. After one week, written warnings are sent to the client. The next step, if repeated warning were not effective within 60 days, is for ABA to take the client to court using the guarantee checks. Client delays of up to five days per month with full penalty repayment are now tolerated without eliminating eligibility for larger successive loans with longer maturity so as to reduce client dropout.

#### **Loan Officers skills**

*Loan officers specialized by product with the requisite skills*

LOs are dedicated either to SME or group lending and after the initial classroom training and on-the-job training have sufficient skills for their work and benefit from refresher trainings every two or three years. LOs are well acquainted with the basics of credit analysis but the high level of turnover does not promote further development of LO skills. Senior LOs receive 'Training of Trainers' course to best train the newly hired LOs and ABA plans to provide additional Senior LO training to strengthen its teams.

#### **Global portfolio management rules**

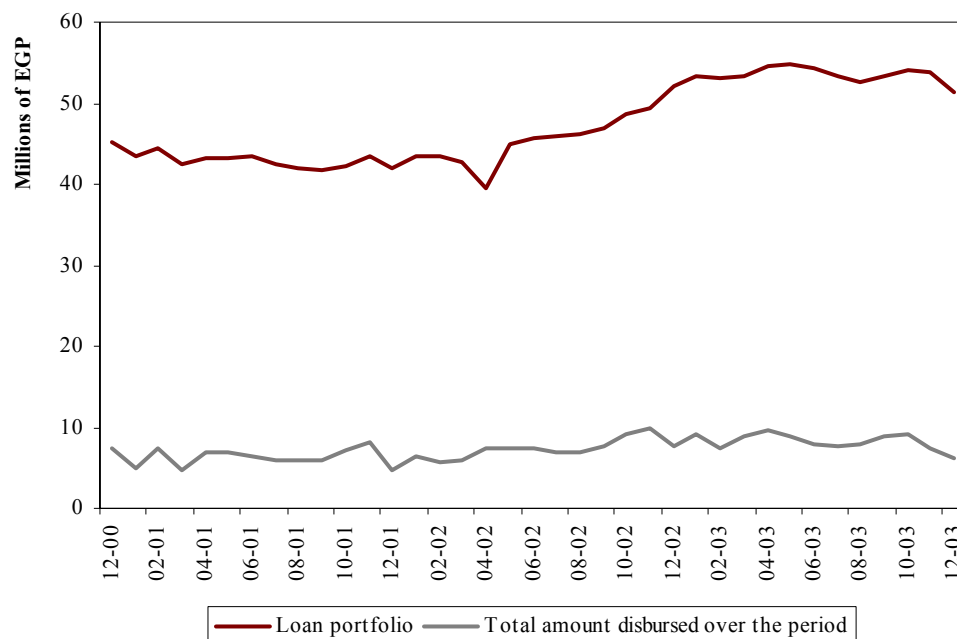
*No formal policies, some diversification across some regions with varying activities*

There are no general rules on portfolio composition but the development of the branch network ensures some diversification, as there are different activities along the coast, inland, in the cities, etc. ABA tracks data on client business sector and sub-sectors and plans to study performance by sector or sub-sector to identify riskier businesses and advise loan officers.

## Portfolio at risk (PAR)

### Write-off ratio

Outstanding loan portfolio evolution



*Steady growth over five years halted in 2003*

ABA's regular and comfortable portfolio growth of over 20% per year over the past five years was interrupted by an abrupt slow down in 2003 for the SME product. From 2002 to 2003, the portfolio shrank by 4% whereas the group loan portfolio increased by 143% over the same period<sup>5</sup>. This slow down could be explained in part by a number of factors: economic growth has slowed and in early 2003 the EGP was devaluated by 38%; ABA has also grown stricter in its control measures after the discovery of the "2003 fraud" (See Section R); finally, competition from Banque du Caire did not really begin until 2003. The group loan portfolio is growing exponentially as the branch network expands but growth of the group loan portfolio in existing branches has also slowed in 2003.

USD, unless otherwise stated	Dec. 2001	Dec. 2002	Dec. 2003
Loan portfolio	9,118,823	11,185,300	8,287,581
Loan portfolio (EGP)	41,946,587	52,011,644	51,242,941
% change	(7.1%)	24.0%	(1.5%)
Average outstanding portfolio	9,347,877	9,774,142	8,630,126
Average outstanding portfolio (EGP)	43,000,234	45,449,761	53,360,934
Number of active borrowers	25,432	34,882	43,256
% change	--	37.2%	24.0%
Average outstanding loan per client	359	321	192
% of GDP per capita	31.8%	27.5%	20.8%
Average amount disbursed	505	382	206
% of GDP per capita	44.8%	32.8%	22.4%
PAR 31-365	4.2%	4.2%	8.8%
PAR > 365	4.6%	4.5%	6.3%
Write-off ratio	0.4%	0.2%	0.1%

<sup>5</sup> Part of the growth between 2001 and 2003 for the SME product has been artificially inflated by fictitious loans granted by the Amrya branch manager (Amrya growth between 2002 and 2001 was of 38% compared to 14% for the other branches of the same generation). These loans have only been written off in April 2004 and are thus included in the data we analyze.

## Performance by product

<b>SME</b>			
Loan portfolio	41,691,959	51,027,174	48,848,746
% Change	--	22.4%	(4.3%)
Number of active borrowers	23,627	27,634	26,999
PAR 31-365	4.2%	4.2%	9.2%
PAR > 365	4.6%	4.6%	6.6%
Write-off ratio	0.4%	0.2%	0.2%
<b>Blossoms</b>			
Loan portfolio	254,628	984,470	2,394,195
% Change	--	286.6%	143.2%
Number of active borrowers	1,805	7,248	16,257
PAR 31-365	0.2%	0.0%	0.0%
PAR > 365	0.0%	0.1%	0.0%
Write-off ratio	0.0%	0.0%	0.0%

*PAR statistics exclude practice of "shifting"* The policy for "shifting" loans (see Portfolio Management) leads to an underestimation of the PAR since loans that are "shifted" by ABA are kept in the healthy portfolio and not considered as late or rescheduled, as they would be in other MFIs. Loans with more than two "shifts", the equivalent of 30 days, represent 5.6% of the portfolio in April 2004, which gives an estimation of the PAR31-365 for all loans of over 14% in April 2004. However, it is assumed that a significant number of clients would find solutions to repay if "shiftings" were not permitted in order to maintain a good credit record with ABA.

*Portfolio quality worsening due to 2003 fraud, problems concentrated in SME program* The PAR 31-365, concentrated in SME loans, was strongly impacted by frauds discovered in 2003. The PAR 31-365 increased from 4% in 2002 to a more worrying 8.8% in 2003 because the 2,900,000 EGP of fictitious loans representing 5% of the Dec. 2003 portfolio suddenly stopped being reimbursed. The group lending PAR has constantly been 0%, which was certainly encouraged by the very strict LO incentive scheme that cancels all bonus if the LO repayment rate is not 100%. Recent increase in controls, including more visits to clients, has shown that some LOs repay on behalf of their clients in order to keep their bonus.

*Write-offs rarely done* ABA does not have a real accounting write-off policy given the reticence of the Board to declare a loan unrecoverable and write-off is only used in case of death or severe incapacity to repay. A rough estimate of the impact of a standard write-off policy based on PAR>365<sup>6</sup> would result in a write-off ratio of approximately 1%.

## Credit risk coverage

### Coverage by provisions

	Dec. 2001	Dec. 2002	Dec. 2003
Risk coverage ratio	57.3%	98.9%	97.5%
PAR 31-365 net of loan loss provision / Equity	1.5%	0.0%	0.1%

ABA applies a standard provisioning methodology that provides sufficient coverage of risk by provisions (details on the provisioning methodology can be found in the appendix).

### Coverage by guarantees

*Guarantee checks main incentive for client repayment* Guarantee checks are the main incentive for clients to repay given that checks not honored can entail jail sentence or civil action. This system of post-dated guarantee checks includes one for the total loan amount of principal and interest. ABA requires additional guarantees for special

<sup>6</sup> Assumption that additions to the PAR365 in the year should in fact have been written off.

circumstances. Loans above 15,000 EGP require a bank check as security. A third party guarantee is needed if the business is not in name of the borrower himself. A personal guarantee by a first degree relative is needed for clients who are aged. In fact, at the time when the rating took place in the second quarter of 2004, most legal cases raised during 2003 were already settled and overdue amounts repaid. For group loans, women borrowers are very much concerned about their reputation and are even more afraid of court action than individual loan clients.

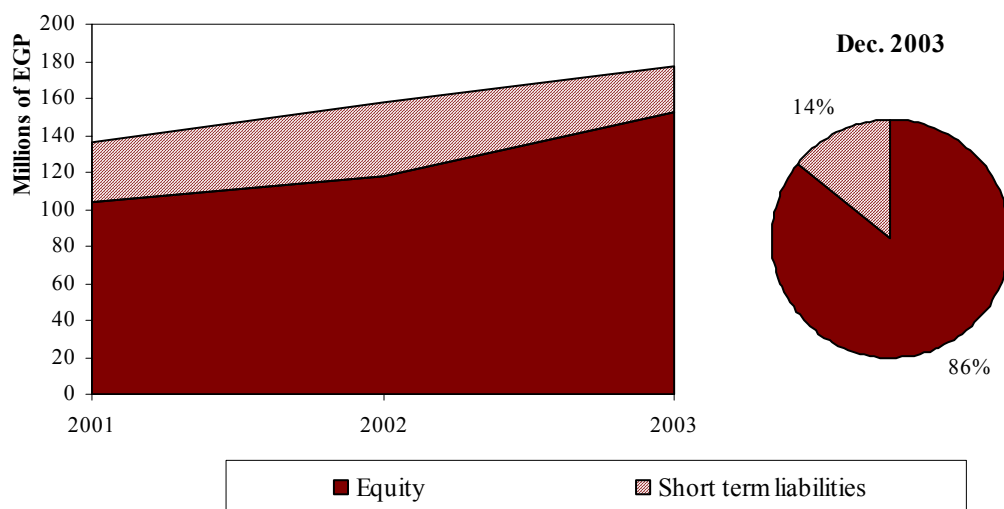
*Implementation of  
law to eliminate  
guarantee checks  
extended*

The Foundations in Egypt responded to the risk of the new government law that could be implemented in two years: according to the new law, the guarantee checks will no longer be useable. The law has already been postponed three times and its implementation is expected in October 2006. After a consultation with EQI in 2000, some Foundations were able to obtain a memo from the Central Bank that after the implementation of the law, these checks would still be upheld if they were stamped and registered officially. Trust receipts may be a possible alternative which has already been in use by ABA since 2000.

# Financing and liquidity

## Financing Strategy

### Description of the funding structure



#### *ABA funded mainly by donated equity*

ABA has been funded mainly by donated equity, in the form of USAID subsidies for operating expenses and collateral deposits, and bank overdraft facilities obtained using these collateral deposits. Retained earnings represent 28.8% of equity and have long been a source of portfolio funding for ABA. USAID funds were received through two Cooperative Agreements (10 million USD in 1988 and 9.3 million USD in 2001 of which only 0.7 million has been received to date). Today these amounts total approximately 66 million EGP. Interest earnings on the collateral deposits are only between 1% and 2% and per agreement must be capitalized on these deposits.

#### *Asset size overstated with fixed deposits on balance sheet*

It is to be noted that the amount of equity and thus the amount of total assets is larger than it would ordinarily be given that USD deposits are part of the balance sheet rather than off balance sheet items. Without these deposits, the total assets for ABA would be 76 million EGP (instead of 177 million EGP) and the capital structure of ABA 53% retained earnings, 15% donations, and 32% bank overdrafts (instead of 23% retained earnings, 63% donations, and 14% bank overdrafts).

#### *No formal procedures, ALM based on Cooperative Agreement*

#### **Asset & Liability Management Procedures**

ABA does not have any formal ALM policies but per the Cooperative Agreement must finance the portfolio funded by USAID with the bank overdrafts. ABA has negotiated well its overdrafts with several banks,<sup>7</sup> although it could further increase its leverage effect on collateral deposits.

- **Interest rate level:** The interest rates of between 9% and 10.5% per annum in addition to interest earnings on the collateral deposits of between 1% and 2%.

<sup>7</sup> The bank overdrafts are from several banks, including Bank of Alexandria, National Bank of Egypt, National Bank Of Abu Dhabi, Suez Canal Bank, and CIB.

- ❑ **Overdraft leverage:** Leverage on USD backed overdrafts ranges from 100% to 150% of the fixed deposit amount. ABA is the first Foundation to be granted leverage on its USD deposits significantly above 100%.
- ❑ **Exchange rate:** The exchange rate applied to USD collateral deposits has been renegotiated to approach market conditions, therefore in current agreements the exchange rate exceeds 6 EGP per USD.
- ❑ **Excess overdraft capacity:** As of March 31, 2004, the excess capacity on deposits is more than 67 million EGP.
- ❑ **Foreign exchange risk exposure:** In the event that the EGP appreciates with respect to the dollar, ABA's overdraft limit might be lowered but, given the level of the current excess capacity, this would have minimal impact for ABA. All borrowing and loans to clients are denominated in EGP.
- ❑ **Maturity matching:** Daily overdrafts are used to finance the portfolio of loans ranging from a few months to up to 18 months, the long-term part of loans representing only 0.5% of total assets, however it is unlikely that the banks would revoke these agreements given the collateral backing.
- ❑ **Interest rate type:** Although both borrowings and loans to clients are fixed rate, the bank may change the overdraft rates without prior approval in some cases.

### **Financing Strategy**

*All financing needs met through the USAID Cooperative Agreement*

ABA has thus far been able to meet all its financing needs with equity, retained earnings and overdraft facilities obtained through the USAID Cooperative Agreement and will be able to do so for several years. The excess capacity on deposits has reached as high as 67 million EGP, bolstered by an increase in capacity by 32% with the 2003 devaluation.

*ABA working actively to lower finance costs; opportunities for additional leverage on existing overdrafts*

A slower portfolio growth and downward profitability trends (see E) served as incentives for ABA to seek more actively to reduce its financing expenses. ABA used its EGP time deposits to reimburse overdrafts and managed to reduce interest rates on the overdrafts thanks to efficient negotiations (from a range of 11% to 12% to a range of 9% to 10.5%). The addition of several managers with extensive banking experience will allow for more and more sophistication in ABA financing strategy. ABA will have, when needed, an opportunity to renegotiate the leverage on the current bank overdrafts to increase funding capacity but the level of any possible increased leverage has yet to be negotiated. Unsecured bank loans are not a realistic option at this point given bank reticence to lend to an NGO.

## **Liquidity Management**

### **Cash-flow projections**

*Precise cash-flow estimates not necessary given ample overdraft funds*

ABA does not perform precise cash-flow projections, in large part because there is ample capacity on the overdrafts and because there is not a formal institution-wide planning process to generate precise data. If needed, the MIS could provide all necessary information as soon as disbursements enter the validation process. Day-to-day cash flow planning is facilitated by the regular disbursement days on 3-5 days per month for the SME loans and 4 days per month for the Blossoms loans.

### **Resources optimization**

ABA maintains very little cash on hand. The Finance department manages the level of the various overdrafts according to their respective interest rates in order to minimize the financial cost for the institution.

# Efficiency and Profitability

<b>Profitability analysis<sup>8</sup></b>	<b>Dec. 2001</b>	<b>Dec. 2002</b>	<b>Dec. 2003</b>
ROE	6.1%	5.6%	2.8%
Liabilities / Equity	31.3%	33.8%	16.3%
ROA	4.4%	4.2%	2.3%
<b>Profit generation</b>			
Operational self-sufficiency	159.5%	166.6%	127.7%
Portfolio Yield	30.4%	29.4%	28.3%
Operating expense ratio	8.7%	10.0%	11.5%
Staff productivity	79	67	70
Loan officer productivity	118	100	105
Average outstanding loan per client (USD)	359	321	192
Funding expense ratio	9.4%	8.8%	8.2%
Loan Loss Provision expense ratio	3.2%	1.8%	5.9%
PAR 31-365	4.2%	4.2%	8.8%
Write-off ratio	0.4%	0.2%	0.1%
<b>Asset management</b>			
Outstanding Loan Portfolio / Assets	29.3%	30.0%	24.7%
<b>Adjusted ratios</b>			
Adjustment expense ratio	0.7%	1.6%	2.4%
AROE	5.8%	5.0%	1.8%
AROA	4.1%	3.7%	1.5%
Financial self-sufficiency	154.5%	154.3%	116.8%

## Overview of the profitability

ABA has covered operating costs for the last 12 years, with an operational self-sufficiency of more than 160% in 2001 and 2002 that declined to 127% in 2003. The profit margin has been halved from 40% down to 20% over the same period. This decline is due to several factors, notably a constant to slightly declining portfolio yield coupled with a higher operating expense ratio and loan loss provision expense ratio. This trend is related in large part to the strengthening of the management structure in 2003. In 2003, ABA performed better than its regional peers that had an operational self-sufficiency average of 113%. The ROA has declined from 4.4% in 2001 to 2.3% in 2003. The ROE has followed the same trend.

*Healthy profit margin temporarily lowered*

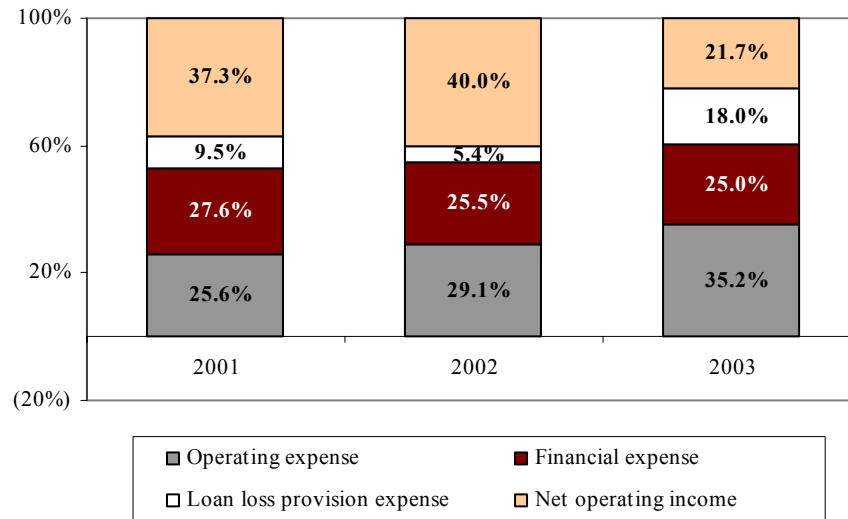
Leverage decreased from 30% in 2001 and 2002 to 16% in 2003 due to the combined effect of a decrease in the use of credit facilities to finance the portfolio and the increase of equity<sup>9</sup>. ABA's donated equity is 66% grants denominated in USD, therefore the 2003 devaluation of the EGP resulted in an important increase in ABA equity and a subsequent decrease in the leverage ratio. Leverage is limited in Egypt, as banks usually require considerable collateral to provide loans to MFIs.

*Leverage ratios declined with devaluation*

<sup>8</sup> Regional peers for the Benchmarking Arab Microfinance Bulletin produced by the MIX Market in December 2003 (2002 data) include: Alexandria Business Associate (ABA), Dakahlyia Businessmen's Association for Community Development (DBACD), and the Regional Association for the Development of Enterprises of Egypt (RADE) in Egypt, Al Amana and FONDEP of Morocco, Al Majmoua and AMEEN of Lebanon, FATEN of Palestine, Crenda of Tunisia, and Jordan Microcredit Company (JMCC) and Microfund for Women (MFW) of Jordan.

<sup>9</sup> Leverage is underestimated as explained in F section.

### Cost structure as a % of financial income



### Portfolio yield and effective interest rate

*Portfolio yield on the decline*

The portfolio yield gradually decreased from 30.4% in 2001 to 29.4% in 2002 and down to 28.3% in 2003. This is a consequence of the two successive 1% interest rate decreases on the SME loan product in 2003 and 2004. ABA Board and Management decided to implement these reductions so that clients would benefit from the interest rates reduction on the overdrafts used to finance the portfolio. The frauds and subsequent deterioration of the PAR are also a reason for the decrease between 2002 and 2003. The dip between 2001 and 2002 is due in large part to the very steep increase of the portfolio at the end of 2002. Interest rates on the SME loans are now 15% flat/26.6% effective. Interest rates on the group loans are notably higher at 26% flat/46% effective, but this has not led to a notable increase in portfolio yield given that it represents such a small percent of the outstanding portfolio. ABA's interest rates are now 1% flat lower than those charged by its main competitors, Banque du Caire, about the same or 1% less than similar MFIs in Egypt, but significantly less than regional peers outside of Egypt at 40%.

### Operating expense ratio

*Low operating expense ratios, although on the rise in 2003*

Operating expenses as a percent of the outstanding portfolio rose from a very low 8.7% in 2001 to 11.5% in 2003 with the addition of seven branches in 2002 and various measures taken to strengthen the organizational structure in 2003, such as the addition of new managers in HQ and new internal control staff. This ratio at its high in 2003 remains significantly less than the MBB peer group at 38.4% given the lower salary levels in Egypt, and is still low relative to other Egyptian MFIs given a larger portfolio size and hence greater economies of scale.

*Productivity ratios considerably lower than peers*

Due in part to the high turnover, loan officer productivity is low and dipped even further with the expansion in 2002 but is now trending upward, with a ratio of 118 end of 2001, to a low of 100 end of 2002, and back up to 105 in December 2003. Staff productivity has followed the same pattern, from 79 in 2001 to 70 in December 2003. These productivity ratios are significantly lower than regional peers (213 and 133 respectively) reporting to the MBB, although higher than some in-country peers. Given the population density in the region, expectations for productivity ratios could be much higher for both the group and individual loan products.

*Personnel and depreciation account for more than 80% of expenses*

Personnel expenses have remained stable at approximately 67% of operating expenses over the last three years and therefore have a preponderant impact on this ratio. With the purchase of several offices and the associated computer stock, depreciation has been a consistently high expense, for 14% of operating expenses in 2003. The remaining expense items are only 17% of operating expenses, which leaves less room for cost cutting.

*Portfolio increasingly financed by equity, lowering funding expenses*

#### **Funding expense ratio**

ABA finances its portfolio with equity and overdraft facilities from local banks backed by USD deposits. The funding expense ratio declined from 9.4% in 2001 to 8.2% in 2003, as the accumulation of retained earnings over the years allowed ABA to decrease the share of its portfolio that is financed by overdrafts from 77% in 2001 to 47% in 2003. The effect of the 2003 reduction of overdraft interest rates will be observed starting in 2004.

#### **Loan loss provision expense ratio (cost of risk)**

The loan loss provision expense ratio decreased from 3.2% in 2001 to a low 1.8% in 2002 given the relative stability of the PAR between these two years and then increased to 5.9% in 2003, following the steep increase of the PAR31 due significantly to the fraud problems.

**Movements in the loan loss reserve could not be reconciled, based on the information provided by ABA. The loan loss provision expense might thus be underestimated and could up to 5.3% in 2002 instead of 1.8%.**

*Portfolio 62% of unrestricted assets, 23% in EGP investments*

#### **Asset management**

ABA's low ratio of productive assets, with a portfolio only representing on average a third of total assets, is biased by the fact that assets include the USD deposits provided by USAID that can only be used as a collateral for the overdraft facilities negotiated with the banks. The portfolio in fact represents 62% of the unrestricted assets. The proportion of fixed assets increased over the last three years and accounts for a high 15% of these unrestricted assets since it has been ABA's strategy to purchase its premises with the important USAID initial funding. The rest of the available assets, 23%, are invested in time deposits in EGP. The structure of these deposits was reviewed in 2003, with short-term deposits being used to reduce the amount of the overdrafts and the remaining available amounts invested in a three-year savings scheme with better returns than the short-term time deposits.

*Limited but positive impact of non-financial services*

#### **Impact of non-financial services**

If included in our analysis the non-operating income resulting from non-microfinance activities would have a limited but positive impact on ABA profitability. The consulting services (commercialization of the Loan Tracking software or technical assistance to other MFIs) do not represent significant additional costs as they are mostly making use of existing resources. The Business Center that provides assistance to clients is working on a fee basis that is designed to cover its costs.

	<b>Dec. 2001</b>	<b>Dec. 2002</b>	<b>Dec. 2003</b>
ROE including "non-operating" income	6.7%	6.3%	3.4%
ROA including "non-operating" income	4.8%	4.7%	2.7%

#### **Adjusted performance**

*Details concerning the specific adjustments are included in the annexes.*

According to Planet Rating's adjustment methodology, ABA has achieved financial self-sufficiency for the 3 years of the evaluated period. The adjustment for inflation represent 100% of the adjustment expenses. The adjustment expense ratio, although on an increasing trend following the evolution of the Egyptian inflation rate, remains low over the period (less than 2.4%).

*Profitability outlook  
stable*

**Evolution of profitability**

ABA does not have any stated profitability goals other than to cover the costs of its operations but has proven its ability to cover such operational costs, even while undergoing a period of expansion. ABA profitability is likely to remain stable in the near future, as the upward and downward pressures on the profit margin should help compensate for each other.

- ❑ In December 2003, of the 27 branches, only those opened in 2002 and 2003 did not yet cover their costs (Damanhour, Matrouh, Menoufia governorate branches, Blossoms branches in Kafr-Ek-Sheikh and Behera). The others cover their own costs. These final branches are expected to cover all costs by the end of 2004 when they achieve sufficient economies of scale.
- ❑ The basic salary was recently increased on average by 25% to compensate for the high increase in cost of living consequent to the EGP devaluation, thus putting upward pressure on the operating expense ratio.
- ❑ The interest rate decline in 2004 will reduce the portfolio yield but this will be compensated by lower funding expense ratio thanks to lower interest rates negotiated on the bank overdrafts. The higher yielding Blossoms loans will not likely compensate for this decline.
- ❑ ABA is motivated to achieve greater growth in its portfolio to reach better economies of scale and invest in the higher yielding larger loan amounts.

# Appendices

## Financial statements and notes

The “Medical program” provided since 2002 by ABA was not in the scope of this rating. All revenues and expenses resulting from the Medical program have thus been excluded from the Income Statement. The elements of the Balance Sheet directly related to this program have also been removed (overdraft, loan portfolio, retained earnings, ...).

### General notes to financial statements per CGAP Disclosure Guidelines

The financial statements provided by the external auditor and the internal financial statements used by ABA included sufficient detail to obtain financial statements that follow CGAP disclosure guidelines.

1. The Financial Statements presented include a balance sheet, income statement, and accompanying notes.
2. The financial statements provided include 3 years of data.
3. Segment Reporting for Multiservice Microfinance Institutions: The non-financial services provided through the ASBC (ABA Service Business Center) and the Consulting Services Center, are listed as non-operating income and non-operating expenses in the income statement per Note 15. A breakout of the balance sheet by program would not change materially the information presented.
4. Portfolio reporting
  - (1) Loan loss provision expense: expenses related to actual or anticipated loan losses are shown separately from other expenses in the income statement (“loan loss expense”).
  - (2) The loan loss reserve is shown as a negative asset in the balance sheet. It is calculated every quarter by the finance department according to the methodology described in the table.

#### Provisioning Methodology SME program

Aging	Provision (% outstanding balance)
Rescheduled	0%
<30 days	0%
31-60 days	25%
61-90 days	50%
91-120 days	100%
>120 days	100%
Write off	Per Board approval

- (3) Loans are written off from the loan loss reserve and the loans outstanding upon Board approval. This is a very rare occurrence given the reticence to formally write-off loans.

- (4) **We were not able to reconcile the movements in the loan loss reserve except for 2003. The table below summarizes the information that was provided to us:**

	2001	2002	2003
Loan Loss reserve, beginning of year	1,163,468	2,114,952	4,468,335
Loan Loss expense during the year	1,466,812	855,557	3,140,674
Recovered amounts on provisioned loans	0	73,558	56,340
Write-off of delinquent loans	174,499	51,666	75,293
Unjustified expense	(340,829)	1,549,492	0
Loan Loss reserve, end of year	2,114,952	4,468,335	7,533,716

- (5) Accrual vs. Cash accounting: the MFI recognizes interest on a cash basis and therefore does not accrue interest.

## 5. Portfolio quality

- (1) Indicators: Portfolio quality and the calculations of such are displayed in the tables in Section A and the calculations are based on the standard portfolio at risk calculation of: (outstanding loan principal for loans in arrears over X days)/(total portfolio outstanding).
- (2) Renegotiation of loans: ABA allows partial rescheduling of loans through a procedure called “loan shifting”. The procedure is described in the Portfolio Management section.
- (3) Insider loans: the MFI does allow employees to borrow funds. In December 2003, these loans total 16,298 EGP. This amount is not included in the portfolio as it is recorded as an account receivable.

## 6. Donations

- (1) Revenue from donations is shown separately from income generated by operations in the income statement.
- (2) Current period donations: The detail of donations received to date is provided in the “F” section. A large proportion of the funds was destined exclusively for fixed deposits to back overdraft facilities.
- (3) Donations accounting methodology: Grants for operations to be used in the current operating period are recorded in the balance sheet. Grants for fixed assets were recorded directly in the balance sheet with amortization of such assets passing through the income statement. Grants for loan funds are recorded directly in the balance sheet.
- (4) In-kind donations: Please refer to the Appendix on Adjustments for details on in-kind donations that Planet Rating has identified.
- (5) Cumulative amount of all prior period donations: Please refer to note on current period donations.

## 7. Details of liabilities

- (1) The following table includes all bank liabilities as of December 2003.

Loan Provider	Overdraft capacity (EGP)	Overdraft amount (EGP)	Interest rate	Guarantee
National Bank Of Abu Dhabi	1,937,956	558,909	11.50%	EGP Collateral Fund
National Bank of Egypt	45,664,482	5,385,755	10.50%	USD Collateral Fund
Alexandria Bank	55,634,240	22,347,568	9.00%	USD Collateral Fund
<b>Total</b>		<b>28,292,232</b>	<b>28,292,232</b>	
Overdraft used to fund medical program		(3,950,818)	(3,950,818)	
<b>Total net of medical program</b>		<b>24,341,414</b>	<b>24,341,414</b>	

- (2) Deposits: ABA is prohibited from collecting deposits.

## 8. Other significant Accounting Policies

- (1) Accrual or deferral income/expense accounting: none.
- (2) Depreciation of fixed assets: The depreciation of fixed assets on a flat basis using the following schedule:

Asset Class	Useful Life	Depreciation Rate
Building and real estate	50	2%
Vehicles	5	20%
Fixtures, photocopiers, fixed tools, and equipment and stationery	5	20%
Furniture	10	10%

- (3) Inflation accounting: none
- (4) Currency mismatch: please refer to the F area. Note that all transactions are done in EGP except for the fixed deposits backing overdraft facilities.
- (5) Accounting treatment of unrealized gains or losses due to foreign currency fluctuations: All transactions are recorded in EGP. Foreign transactions are recorded based on the exchange rate in the

free market and re-evaluated at year-end based on the declared exchange rate at the date of preparing the financial statements. The differences, if any, are capitalized in equity.

### **Specific notes to the financial statements**

#### **Balance Sheet**

1. Mainly USD denominated deposits part of the USAID Cooperative Agreement used as collateral for local currency loans but also includes deposits in Egyptian Pounds. In 2003 EGP deposits represented 3.8% of total deposits.
2. This amount includes all loans, regardless of final term date. ABA grants loans of up to 24 months. The amount of principal falling due beyond 12 months is 0.5% of the total amount.
3. Interest is only recognized when collected.
4. Interest on deposits. Per the Cooperative Agreement with USAID, interest on the USD fixed deposits is capitalized and therefore ABA may not withdraw these interest earnings and recognize it as income.
5. This amount includes payments made in advance for 196,551 2002, and 302,934 in 2003.
6. 3-year saving scheme in EGP.
7. Short-term overdraft facilities.
8. Interest on the borrowings is payable daily so there is no accrued interest.
9. Includes grants from USAID for operating expenses, USD deposits to serve as loan collateral, interest earned on these USD deposits and donations from Gulf Prize (613,000 EGP) and Citycorp (275,850 EGP).
10. Accumulated retained earning and reserves.

#### **Income Statement**

11. Includes interest received on loans and additional interests collected on shifted loans (for only 556,221 EGP, i.e. 3.8% of interest received).
12. Penalty fees collected from clients who cancel a loan request when the disbursement check has already been issued.
13. ABA collects each month an additional 2% per month on each late installment.
14. ABA rarely writes off loans.
15. Revenue and expenses related to the Business Center and the Consulting services.

ABA		EGP			USD			% change	
Balance sheet	Notes	Dec. 2001	Dec. 2002	Dec. 2003	Dec. 2001	Dec. 2002	Dec. 2003	2002/2001	2003/2002
<b>ASSETS</b>		<b>135,856,834</b>	<b>158,366,537</b>	<b>177,161,357</b>	<b>29,534,094</b>	<b>34,057,320</b>	<b>28,652,514</b>	<b>16.6%</b>	<b>11.9%</b>
<b>Short Term Assets</b>		<b>128,700,795</b>	<b>148,388,020</b>	<b>154,538,545</b>	<b>27,978,434</b>	<b>31,911,402</b>	<b>24,993,700</b>	<b>15.3%</b>	<b>4.1%</b>
Cash and Due from Banks		242,443	69,807	285,626	52,705	15,012	46,195	(71.2%)	309.2%
Short Term Investments	1	85,020,194	99,960,558	109,879,031	18,482,651	21,496,894	17,770,864	17.6%	9.9%
Short Term Net Loan Portfolio		39,831,635	47,543,309	43,709,225	8,659,051	10,224,368	7,069,144	19.4%	(8.1%)
Short Term Gross Loan Portfolio	2	41,946,587	52,011,644	51,242,941	9,118,823	11,185,300	8,287,581	24.0%	(1.5%)
(Loan Loss Reserve)		2,114,952	4,468,335	7,533,716	459,772	960,932	1,218,437	111.3%	68.6%
Interest Receivable		0	119,900	203,092	0	25,785	32,846	-	69.4%
On loan portfolio	3	0	0	0	0	0	0	-	-
On investments	4	0	119,900	203,092	0	25,785	32,846	-	69.4%
Accounts receivable and other assets	5	3,606,523	694,445	461,572	784,027	149,343	74,651	(80.7%)	(33.5%)
<b>Long term assets</b>		<b>7,156,039</b>	<b>9,978,517</b>	<b>22,622,812</b>	<b>1,555,661</b>	<b>2,145,918</b>	<b>3,658,814</b>	<b>39.4%</b>	<b>126.7%</b>
Long Term Net Investments	6	0	0	11,404,000	0	0	1,844,382	-	-
Long Term Gross Loan Portfolio		0	0	0	0	0	0	-	-
Net Fixed Assets		7,156,039	9,978,517	11,218,812	1,555,661	2,145,918	1,814,432	39.4%	12.4%
Other Long Term Assets		0	0	0	0	0	0	-	-
<b>LIABILITIES AND EQUITY</b>		<b>135,856,835</b>	<b>158,366,537</b>	<b>177,161,357</b>	<b>29,534,095</b>	<b>34,057,320</b>	<b>28,652,514</b>	<b>16.6%</b>	<b>11.9%</b>
<b>Liabilities</b>		<b>32,380,312</b>	<b>40,046,821</b>	<b>24,872,234</b>	<b>7,039,198</b>	<b>8,612,220</b>	<b>4,022,616</b>	<b>23.7%</b>	<b>(37.9%)</b>
<b>Short term liabilities</b>		<b>32,380,312</b>	<b>40,046,821</b>	<b>24,872,234</b>	<b>7,039,198</b>	<b>8,612,220</b>	<b>4,022,616</b>	<b>23.7%</b>	<b>(37.9%)</b>
Short Term Borrowings	7	32,171,098	39,312,253	24,341,414	6,993,717	8,454,248	3,936,765	22.2%	(38.1%)
Interest payable	8	0	0	0	0	0	0	-	-
Accounts Payable and Other Short Term Liabilities		209,213	734,569	530,820	45,481	157,972	85,850	251.1%	(27.7%)
<b>Long term liabilities</b>		<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>-</b>	<b>-</b>
Long Term Borrowings		0	0	0	0	0	0	-	-
Other Long Term Liabilities		0	0	0	0	0	0	-	-
<b>Equity</b>		<b>103,476,523</b>	<b>118,319,715</b>	<b>152,289,122</b>	<b>22,494,896</b>	<b>25,445,100</b>	<b>24,629,898</b>	<b>14.3%</b>	<b>28.7%</b>
Paid-In Capital								-	-
Donated equity	9	77,801,719	83,886,036	111,316,279	16,913,417	18,040,008	18,003,312	7.8%	32.7%
Retained earnings without donations and reserves	10	25,674,804	34,433,679	40,972,844	5,581,479	7,405,092	6,626,586	34.1%	19.0%
Current year		6,022,605	6,954,782	4,548,292	1,309,262	1,495,652	735,601	15.5%	(34.6%)

ABA		EGP			USD			% change	
Income Statement	Notes	Dec. 2001	Dec. 2002	Dec. 2003	Dec. 2001	Dec. 2002	Dec. 2003	2002/2001	2003/2002
<b>Financial Revenue (a)</b>		<b>14,618,250</b>	<b>15,602,311</b>	<b>17,407,895</b>	<b>3,177,880</b>	<b>3,355,336</b>	<b>2,815,399</b>	<b>7%</b>	<b>11.6%</b>
Financial Revenue from Loan Portfolio		13,065,719	13,383,820	15,100,778	2,840,374	2,878,241	2,442,267	2.4%	12.8%
Interest on Loan Portfolio	11	12,766,695	13,058,117	14,755,874	2,775,368	2,808,197	2,386,485	2.3%	13.0%
Fees and Commissions on Loan Portfolio	12	8,303	8,611	9,334	1,805	1,852	1,510	3.7%	8.4%
Penalty Revenue on Loan Portfolio	13	290,722	317,092	335,570	63,200	68,192	54,272	9.1%	5.8%
Financial Revenue from Investments		1,459,837	2,207,802	2,277,635	317,356	474,796	368,365	51.2%	3.2%
Other Operating Revenue		92,693	10,689	29,482	20,151	2,299	4,768	(88.5%)	175.8%
<b>Financial Expense (b)</b>		<b>4,037,876</b>	<b>3,985,398</b>	<b>4,356,916</b>	<b>877,799</b>	<b>857,075</b>	<b>704,649</b>	<b>(1.3%)</b>	<b>9.3%</b>
Interest paid on borrowings		3,993,532	3,966,259	4,332,133	868,159	852,959	700,641	(0.7%)	9.2%
Interest paid on deposits		-	-	-	-	-	-	-	-
Net Inflation Adjustment Expense		-	-	-	-	-	-	-	-
Other Financial Expenses		44,344	19,140	24,783	9,640	4,116	4,008	(56.8%)	29.5%
<b>Financial income [c=a-b]</b>		<b>10,580,374</b>	<b>11,616,912</b>	<b>13,050,979</b>	<b>2,300,081</b>	<b>2,498,261</b>	<b>2,110,750</b>	<b>9.8%</b>	<b>12.3%</b>
<b>Net Loan Loss provision expense (d)</b>		<b>1,388,299</b>	<b>839,914</b>	<b>3,140,674</b>	<b>301,804</b>	<b>180,627</b>	<b>507,945</b>	<b>(39.5%)</b>	<b>273.9%</b>
Loan loss provision expense and write off		1,466,812	855,557	3,140,674	318,872	183,991	507,945	(41.7%)	267.1%
Recovery from Loans written off	14	78,513	15,643	0	17,068	3,364	0	(80.1%)	(100.0%)
<b>Operating expense (e)</b>		<b>3,736,581</b>	<b>4,537,622</b>	<b>6,133,380</b>	<b>812,300</b>	<b>975,833</b>	<b>991,959</b>	<b>21.4%</b>	<b>35.2%</b>
Personnel Expense (includes fringe)		2,494,602	3,077,471	4,183,067	542,305	661,822	676,532	23.4%	35.9%
Administrative Expense (non-staff operating expenses)		1,241,979	1,460,151	1,950,313	269,995	314,011	315,426	17.6%	33.6%
Depreciation and amortization		729,083	770,808	870,281	158,496	165,765	140,751	5.7%	12.9%
Consulting fees		56,174	52,619	132,542	12,212	11,316	21,436	(6.3%)	151.9%
Others		456,722	636,724	947,490	99,287	136,930	153,239	39.4%	48.8%
<b>Net Operating Income Before Taxes and Donations [f=c-d-e]</b>		<b>5,455,494</b>	<b>6,239,376</b>	<b>3,776,925</b>	<b>1,185,977</b>	<b>1,341,801</b>	<b>610,846</b>	<b>14.4%</b>	<b>(39.5%)</b>
Income Taxes (g)								-	-
<b>Net Operating Income Before Donations [h=f-g]</b>		<b>5,455,494</b>	<b>6,239,376</b>	<b>3,776,925</b>	<b>1,185,977</b>	<b>1,341,801</b>	<b>610,846</b>	<b>14.4%</b>	<b>(39.5%)</b>
Non Operating Revenue (i)	15	824,717	905,469	986,106	179,286	194,725	159,484	9.8%	8.9%
Non Operating Expense (including related taxes) (j)	15	257,606	190,064	214,739	56,001	40,874	34,730	(26.2%)	13.0%
<b>Net Income Before Donations [k=h+i-j]</b>		<b>6,022,605</b>	<b>6,954,782</b>	<b>4,548,292</b>	<b>1,309,262</b>	<b>1,495,652</b>	<b>735,601</b>	<b>15.5%</b>	<b>(34.6%)</b>
Donations (l)								-	-
<b>Net Income (after Taxes and Donations) [m=k+l]</b>		<b>6,022,605</b>	<b>6,954,782</b>	<b>4,548,292</b>	<b>1,309,262</b>	<b>1,495,652</b>	<b>735,601</b>	<b>15.5%</b>	<b>(34.6%)</b>

## Adjustments

Data in EGP unless otherwise stated	Dec. 2001	Dec. 2002	Dec. 2003
<b>Adjustment for the cost of funds</b>	<b>0</b>	<b>0</b>	<b>0</b>
Average amount of borrowings	34,096,852	35,741,676	31,826,833
Shadow price of borrowings			
Interest expense on borrowings	3,993,532	3,966,259	4,332,133
<b>Adjustment for inflation = (H + I - A - L) * N</b>	<b>296,556</b>	<b>748,108</b>	<b>1,274,028</b>
H. Avg. Equity <sup>(a)</sup>	18,681,094	38,491,613	48,070,082
M. Average fixed assets	6,324,573	8,567,278	10,598,664
N. Inflation rate	2.4%	2.5%	3.4%
<b>Adjustment for in-kind donations</b>	<b>0</b>	<b>0</b>	<b>0</b>
a. Staff and technical assistance			
b. Other			
<b>Adjustments for provisions</b>	<b>0</b>	<b>0</b>	<b>0</b>
Loan losses	0	0	0
Other risks			
<b>Other adjustments</b>			
<b>Total adjustments</b>	<b>296,556</b>	<b>748,108</b>	<b>1,274,028</b>
Net income before donations	5,455,494	6,239,376	3,776,925
Adjusted net income before donations	5,158,937	5,491,268	2,502,897
<b>Adjusted net income before donations (USD)</b>	<b>1,121,508</b>	<b>1,180,918</b>	<b>404,796</b>

(a) The average amount of USD denominated donations (deposits used to guarantee the overdrafts) has been deducted from the average equity.

The following adjustments were applied:

- **Adjustment for inflation** is performed to account for the effect of inflation on equity and fixed assets. In this case, the equity is composed of operating subsidies as well as fixed USD deposits provided by USAID for the sole purpose of guaranteeing bank overdrafts used to finance the portfolio. Therefore, this adjustment excludes the amount of equity attributable to such collateral deposits that in other cases could be considered an off-balance sheet item.
- **Adjustment for cost of funds** is performed to estimate the cost that the institution would pay if using commercial financing. This adjustment accounts for the cost savings received from donated funds or concessional loans. In this case, the portfolio is financed entirely from overdrafts offered by banks so no adjustment was performed.
- **Adjustments for in-kind donations** are performed to account for services that ordinarily would be a cost to the institution but are not reflected in the financial statements. In this case, no in-kind donation was recorded.
- **Adjustment for loan loss provisions** are performed to account for the cost of risk related to the portfolio if the institution's policy is not sufficient and to better compare performance across MFIs. In this case, the institution's loan loss policy was sufficiently conservative that no adjustment was made.