

MI-BOSPO

Bosnia and Herzegovina

February 2004

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

Global Rating

A
Trend: Stable

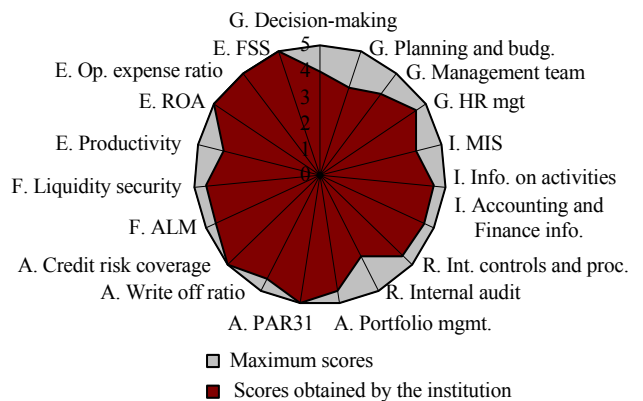
After starting microcredit activities in 1996, the local NGO BOSPO founded MI-BOSPO in Dec. 2000. MI-BOSPO has been a participant of the World Bank Local Initiatives project for several years and an affiliate of Women's World Banking since 1999. MI-BOSPO is headquartered in Tuzla and serves clients both in the Federation of Bosnia and Herzegovina and in the Republika Srpska through a network of 8 offices. MI-BOSPO has a portfolio of over 5.6 million EUR to over 7,000 women of all ethnic origins.

Rating Plus Summary

Environment Competitive; changes soon to legal environ.
Maturity **Mature:** 8 years of operations
Scale **Medium:** Portfolio of 5.6 million EUR
Target market **Broad:** Avg. out. loan 80% of GNP per capita

Area Scores

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



	2001	2002	2003
ACTIVITIES			
Number of employees	28	37	39
Total assets (K EUR)	3,723	5,093	6,732
(K BAM)	7,282	9,961	13,167
Outstanding loans (K EUR)	2,995	4,185	5,636
Active borrowers	4,460	5,499	7,162
Annual effective interest rate ^(a)	36%	32%	30%
PAR _{30 days}	0.3%	0.2%	0.2%
Risk coverage ratio	433.2%	571.8%	638.2%
Write-off ratio	1.0%	0.8%	0.8%
GROWTH			
Portfolio growth	52.6%	39.8%	34.7%
Asset growth	76.9%	36.8%	32.2%

	2001	2002	2003
PERFORMANCE			
Staff productivity	159	149	184
ROA	10.0%	7.8%	9.2%
AROA	2.9%	2.9%	5.8%
ROE	45.0%	23.1%	23.4%
AROE	13.0%	8.6%	14.8%
Portfolio yield	35.9%	34.8%	32.6%
Operating expense ratio	18.3%	18.7%	16.5%
Operational self sufficiency	156.5%	140.6%	148.8%
Financial self sufficiency	111.7%	112.0%	126.1%
FINANCING			
Leverage	2.9	1.5	1.6
Exchange Rate BAM/EUR	1.96	1.96	1.96

(a) These ratios are averages: interest rates vary from one product to another and are lowered for clients renewing a loan at MI-BOSPO.

Rating Scale

The rating method includes 19 factors that are rated using the system described below from “0” (lowest score) to “5” (highest score). A weighting system applied to these scores produces a rating for each of the six GIRAFE domains as well as the overall rating.

Area Rating	Global Rating	Explanation
a	A+	Excellent 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	
	A-	
b	B+	Good 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	
	B-	
c	C+	Minimum required Procedures are functional but with certain failings. There are minor risks in the medium term for operations..
	C	
	C-	
d	D	Insufficient Procedures are in place, but with failings, and certain problems are only partially addressed. There are medium-term and even short-term risks for operations.
e	E	Immediate risk of default or very insufficient There are immediate or underlying risks for operations or an unacceptable under performance.

Rating Plus: MicroBanking Bulletin categories for ECA (Eastern Europe and Central Asia)

Scale	Target Clientele	Maturity
(Outstanding portfolio USD)	(Avg. out. loan / GNP per capita)	(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	ARO: Adjusted net operating income before donations / Average assets
Return on equity	ROE: Net operating income before donations / Average equity
Adjusted return on equity	ROE: 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 a % 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 sector in BiH, launched after the war with strong support from the World Bank, is highly professional with most institutions adopting best practices since inception. The bulk of funds to the sector has been channeled through the World Bank financed Local Initiatives Project (LIP), the goal of which is to support and enable the development of financially strong microcredit programs. The rounds of LIP financing for fewer and fewer MFIs have spurred consolidation within this sector through takeovers/mergers, a trend that will likely continue according to many local actors. Other actors such as KfW and USAID have been funding MFIs in addition to numerous other national development agencies.

After starting microcredit activities in 1996, the local NGO BOSPO founded MI-BOSPO in Dec. 2000. MI-BOSPO has been a participant of the World Bank LIP program for several years and an affiliate of Women's World Banking since 1999. MI-BOSPO is headquartered in Tuzla and serves clients both in the Federation of Bosnia and Herzegovina and in the Republika Srpska, through a network of 8 offices. MI-BOSPO has a portfolio of over 5.6 million EUR to over 7,000 women of all ethnic origins.

MI-BOSPO received a final rating of A with a stable trend.

Governance and decision making received the rating **b**:

- ❑ After significant Board turnover in mid 2003, MI-BOSPO has reconstituted its Board which is off to a strong start. As the new Board members get accustomed to their position, they will be able to play a stronger role in strategy setting and management oversight.
- ❑ The planning process includes clear budgeting and an identification of key risks, although the openness to mergers or other collaborations in the strategy should be further clarified. Planned expansion in 2004 and beyond is very modest, and the projected constant portfolio yield may be difficult to maintain in a competitive environment.
- ❑ The management team is highly motivated and has learned its skills on the job, which has proven successful thus far. Management continually seeks to update the technical sophistication of its skills as the demands of the market grow increasingly challenging.
- ❑ MI-BOSPO has a professional approach to human resource management and a salary structure satisfactory to staff. Formal staff evaluations to complement the existing loan officer incentive policy are being implemented this year.

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

- ❑ The fully computerized internally developed information system facilitates an efficient loan processing, helps ensure a good level of control and provides all needed information. The system is improved on a regular basis. The MIS Manager is the only person knowledgeable of the MIS structure, which creates a key person risk for that position.
- ❑ Portfolio information is accurate and up-to-date. The system provides rich information by product, loan officer, etc. and is widely disseminated both internally and externally.
- ❑ Accurate and up-to-date financial information, with financial statements available each month, allow for a close monitoring of financial performance.

Risk management received the rating **a**:

- ❑ MI-BOSPO has a solid internal control system and has eliminated many potential risks of fraud and cash handling by using partner banks.
- ❑ Having reached sufficient size, MI-BOSPO added in 2003 the position of Internal Controller. In 2004, this position will change to that of an Internal Auditor reporting directly to the Board of Directors. The progress thus far has been positive but needs formalization with regards to methods and procedures.

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

- ❑ MI-BOSPO has positioned itself as a regional provider serving women with both group and individual loans and has achieved a strong market share for its target. MI-BOSPO seeks to compete based on client loyalty as well as easy and fast service, and given that MI-BOSPO will not be able to compete over the long-term on price, it will need more aggressive marketing tactics and/or need to ensure significant competitive advantages.
- ❑ Portfolio management is appropriate with adapted loan analysis and specialized loan officers for the group and individual loan products.
- ❑ Like many MFIs in Bosnia, MI-BOSPO has consistently strong portfolio quality, 0.2% PAR31. This risk is fully covered by a conservative loan loss provision policy.

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

- ❑ MI-BOSPO has been very actively and successfully seeking financing since its inception. Even if the institution is unlikely to be included in the next round of LIP funds, a key source of subsidized funding in Bosnia, the 2004 funding needs are secured and fruitful contacts have already been established with potential funders. However, the average funding cost of 5% per year is likely to increase and places MI-BOSPO at a disadvantage with regards to those competitors who have access to cheaper sources of funds.
- ❑ Liquidity management is well mastered with the definition of security margins to limit the risk of illiquidity and accurate weekly cash flow projections.

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

- ❑ MI-BOSPO is a profitable institution (ROA 9.2%), financially self-sufficient after adjustments, and has achieved a low operating expense ratio (16.2%).
- ❑ Strong competitive pressure to decrease interest rates coupled with increases in the cost of funds and personnel will contribute to a decrease in the level of profitability in the coming years. In the medium term, improved productivity and greater economies of scale might compensate for these negative trends if MI-BOSPO achieves sufficient portfolio growth (either through internal growth or via a merger).

Overall summary:

- ❑ **Key strengths include:** A strong presence in the Tuzla region with good penetration of the market and client recognition; well-implemented procedures to limit most operational risks now complemented by an Internal Controller; very good portfolio management resulting in excellent portfolio quality; an efficient and flexible MIS; and a strong international reputation.
- ❑ **Areas for improvement include:** Developing the strategic capability of the newly appointed Board and clarifying goals with respect to a possible merger/collaboration.
- ❑ **The principal risks include:** Continued growth in light of increasing market competition; structurally higher costs than its competitors due to limited access to subsidized sources of funding and a smaller scale of operations.

Funding needs:

- ❑ Per the latest projections, MI-BOSPO is seeking additional financing of 2.6 million EUR for the 2005-2007 period (1,6 million BAM to complement the 1 million BAM already secured in available or committed financings).
- ❑ Planet Rating believes that MI-BOSPO is a highly organized and profitable institution with solid operations and a proven track record to support commercial rate debt.

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 sustainability of an institution. However, it is difficult for an institution that is young, in a challenging environment, or targeting hard-to-serve populations to achieve this level of sustainability. Rating Plus serves to clarify the institution's context.

Environment

	Dec. 2001	Dec. 2002	Dec. 2003
Exchange rate: 1 EUR = X BAM	1.96	1.96	1.96
GDP/ capita (EUR)	1,476	1,556	1,611
Inflation	0.9%	0.3%	0.9% ⁽¹⁾

Source: Central Bank of Bosnia and Herzegovina

Nine years after the Dayton Agreement ended the conflict, Bosnia and Herzegovina (BiH) still relies on foreign aid. BiH is still undergoing the transition from a centrally planned system to a free market economy. Only a few of the privatization initiatives have created the conditions needed for sustained business development. Much needs to be done to improve the legislative environment or eliminate administrative barriers to investment. BiH has just been rated B3+ by Moody's Investors Service, which makes Bosnia more secure for foreign investments.

Post-war per capita incomes have recovered from USD 456 at end-1995 to USD 1,270 by 2002, just over half its level in 1991. However, by 2000 economic growth has slowed down considerably, with real GDP growth levelling off at 10% in 1998 and 1999 but dropping to 5% in 2000 and 2.3% in 2001.

The country ranks 60 (out of 175 countries) in the UNDP 2003 Human Development Report and the population below the national poverty line is estimated around 20%. 27% of adults can be considered "education poor", health poverty affects 16% of the population and 29% of it can be called "rights-poor" (belonging to households without established property rights for their housing). Employment in the formal sector is substantially below its pre-war level. The last years of economic growth has had little impact on employment and labor market participation is still below the level needed to have a decisive impact on poverty.

Since the war, critical infrastructure has been rebuilt under the "1996-1999 Priority Reconstruction and Recovery Program" (PRRP), covering public buildings, houses, water and energy. There have also been countrywide projects in the transport, telecommunications, energy, and water sectors. Despite the success of the emergency transport reconstruction program, a significant part of the main road network is still in poor condition.

Maturity and Scale

MI-BOSPO is in the Eastern Europe and Central Asia Medium peer group of the MBB given its portfolio size of 5.6 million EUR. MI-BOSPO was locally registered in 2000, as soon as the Federation law on microfinance activities was enacted, but the operations have been in place since the March 1996. Therefore MI-BOSPO has an extensive experience of microfinance operations and very mature procedures. The procedures for individual lending, that was launched in 2001 are now finalized.

Target Clientele

Average loan at disbursement is 80% of GDP per capita and average outstanding loan at 50%, placing it in the Broad category for the MBB. Orientation towards the lower-end of the market is still strong even if the individual loan broadened MI-BOSPO's target clientele:

- MI-BOSPO made the choice to only serve women.
- Of disbursed loans, 8% are for displaced persons and 6% for returnees.
- MI-BOSPO is the only provider of group loans in the area, and this product still represents 78% of active clients with an average loan at disbursement at 57% of GDP per capita (1,787 BAM).

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Acronyms

ALM	Asset/Liability Management
AMFI	Asocijacija Mikrofinansijskih Institucija (BiH Association of Microfinance Institutions)
BAM	Konvertibilna Marka (local currency, also called BAM)
BiH	Bosnia and Herzegovina
BPRM	Bureau of Population, Refugees and Migration
CGAP	Consultative Group to Assist the Poor
CWS	Catholic World Services
DRC	Danish Refugee Council
EBRD	European Bank for Reconstruction and Development
EIR	Effective interest rate
EU	European Union
EUR	Euro
EURIBOR	Euro Interbank Offered Rate
HR	Human Resources
GNP	Gross National Product
GDP	Gross Domestic Product
HO	Head Office
HQ	Headquarters
HR	Human resources
IAS	International Accounting Standards
IFAD	International Fund for Agricultural Development
IFC	International Finance Corporation
IRC	International Rescue Committee
KfW	Kreditanstalt für Wiederaufbau (German Development Bank)
LAMP	Linking Agricultural Markets to Producers
LID	Implementing agency for LIP, now Odras Foundation in the Federation
LIP	Local Initiatives Project of the World Bank
LIP II	Local Initiatives Project of the World Bank Round II
LO	Loan officer
MBB	MicroBanking Bulletin
MIS	Management Information System
MFI	Microfinance institution
MFC	Microfinance Center for Central and Eastern Europe and the Newly Independent States
MFI	Microfinance institution
NGO	Non Governmental Organization
PAR	Portfolio at risk
ROA	Return on assets
ROE	Return on equity
RS	Republika Sprska
SME	Small and medium sized enterprise
UMCOR	United Methodist Committee On Relief
UNDP	United Nations Development Program
UNHCR	United Nations High Commissioner for Refugees
USAID	United States Agency for International Development
USD	United States Dollar
WWB	Women's World Banking

Microfinance Environment

The country

In December 1995, the Dayton Agreement defined Bosnia and Herzegovina's international boundaries and created a joint multi-ethnic and democratic government. BiH's national government is charged with conducting foreign, economic and fiscal policy. A second tier of government composed of two entities includes the Bosniak/Croat Federation of Bosnia and Herzegovina (FBH) and the Bosnian Serb-led Republika Srpska (RS) - each presiding over roughly one-half the territory. The Federation and RS governments are charged with overseeing internal functions. There is a significant imbalance between the two entities, as GDP per capita in RS is estimated to be only 75% of the countrywide average.

History of the sector

Microfinance sector highly organized

The microfinance sector launched after the war with strong support from the World Bank is highly professional, and most institutions adopted best practices since inception.

World Bank LIP program the leading funder of microfinance in BiH

The bulk of funds for the microfinance sector has been channeled through the World Bank financed Local Initiatives Project (LIP), the goal of which is to support and enable the development of financially strong microcredit programs through two quasi-governmental implanting foundations, one in the Federation and one in the RS. The purpose of the program is to fund MFIs, to promote legal and regulatory reform, to build capacity, and to contribute to impact assessment and research and development. A total of 21.7 million USD was allocated under Phase I of this project (1996-2000), with financing initially to 17 and subsequently to only 9 NGOs. Under Phase II, LID (now Odraz Foundation) will provide 25 million USD total (2001-2004/2005) for both portfolio financing and other projects. Funding tranches from the program are contingent upon the implementation of pre-defined organizational and policy changes. It is expected that Phase III will restrict the financing of approximately 7.3 million USD (12 million BAM) to only the strongest few MFIs throughout the country. These two rounds of financing for fewer and fewer MFIs have spurred consolidation within the microfinance sector through takeovers/mergers. Many local actors believe that MFIs in the sector will continue to consolidate.

USAID and KfW also key lenders to MFIs

In addition to World Bank funds, bilateral aid for microfinance has come predominantly from US sources (USAID, USDA, and BPRM), the development agencies of England, Sweden, and Canada, as well as the Austrian, Italian, Dutch, Spanish, Swiss and Japanese Governments. Since 2002, KfW has refinanced seven leading MFIs in BiH through the European Fund programs to support rural and SME development. It is also expected that USAID will be adding approximately 8 million USD to the microfinance sector for agricultural loans via the LAMP (Linking Agricultural Markets to Producers) program. The USAID Business Finance program that previously lent 5 million USD to several microfinance programs has ended and will be making no new loans. IFAD may also support the development of credit and savings institutions. MFI funders are exploring ways to promote in the future loan guarantees to engage commercial banks in the refinancing process.

Banking sector

The banking sector continues to consolidate and grow stronger. Reforms in the banking sector have been more pronounced than reforms in other sectors of the economy according to the Central Bank. Competition in the sector has increased, including that of foreign banks, resulting in an overall decline in interest rates across the sector. Other improvements in the sector have included a gradual increase in capital requirements from 2.5 million to 15 million

BAM, the development of a deposit insurance system, and the privatization process of state-owned banks now completed in the RS and significantly advanced in the Federation. These reforms have contributed to sector consolidation with 38 registered banks in 2003 as opposed to 76 in 1997. The banking system had over 7 billion BAM in assets (end of 2003) and there has been a notable shift to financing via private local and foreign sources.

Many banks reticent to lend to MFIs

MFIs have had difficulty convincing some local banks to lend to them. Raiffeisen Bank has been the most active to lending to MFIs, and a couple of other banks are now becoming more interested in this market. This is due both to the lack of understanding regarding MFIs as well as a perceived competition for clients in some instances.

Microfinance regulatory environment

The LIP implementing bodies in the RS and the Federation along with the World Bank are engaged in a long-term effort to develop the legal and regulatory framework for different types of savings and loan institutional structures. Until now, only the law on microcredit organizations has been passed in both the Federation and the RS. The law is simple and provides for registration of specialized credit-only, non-government, non-profit institutions with minimal regulation and no formal government supervision. There are different local interpretations as to the latitude of the law to provide microcredit beyond development of entrepreneurship loans and there have been no actions taken against MFIs known to provide other types of loans.¹

Legal reforms under discussion to increase opportunities for MFIs

As a result of these initiatives, there is a goal to change the existing legal framework so as to expand legal options to microcredit organizations. It is expected that the legal changes will allow MFIs to register as a for-profit financial company subject to taxes but able to provide other non-savings financial products. Several MFIs are looking forward to a finance company structure to attract a wider range of financing sources, although the legal framework for such a company does not yet exist. The possibility to become a bank is already allowed under the current law on banking. Finally, IFAD is leading efforts for a new law to create membership-based savings and credit institutions, providing another alternative for MFIs. Legal reforms to promote a common economic space throughout the country and to improve use of collateral will also provide a more favorable context for MFIs operations.

Microfinance Providers

Competition among providers growing more intense; cross indebtedness a concern for the sector

Although there are over 40 registered microcredit organizations in BiH, most of the portfolio is concentrated in the largest 10 MFIs. By the end of 2003, the leading MFIs serve almost 82,000 clients with a total portfolio of approximately 81 million EUR. These top MFIs are characterized by strong portfolio performance and operational, if not financial, sustainability. With the increasing competition, local actors are concerned about the potential for client cross-indebtedness.

In addition to the list of MFIs below, banks are another source of loans to the sector. ProCredit Bank, formerly Micro Enterprise Bank, with international shareholders such as EBRD, IFC, and KfW serves formal micro and small enterprises. Commercial banks have entered the market as suppliers of funds to MFIs and also as direct lenders to the local population, notably

¹ Article 2 of the Federation law states “Microcredit organization in the sense of this law is a non-deposit and non-profit organization whose basic activity is the provision of the microcredit to the socially jeopardized with a view to the development of entrepreneurship.” Article 12 specifies that the activities of a microcredit organization include “provision of the microcredits to the socially jeopardized categories; provision of the credit consultation, business advice and the technical help which is consistent with the promotion of the credit activities of the microcredit organization; legal source of the financial and other means out of any legal source, including membership subscription, gifts, and the donations with microcredit provision.” Source: *Federal law, translation from local language by court certified translator.*

through consumer loans. The competition among the MFIs is intense and some urban markets are at or near saturation, therefore many MFIs are seeking to expand their rural outreach. Although portfolio quality remains strong, the entire sector is concerned about the potentially high level of client cross-indebtedness.

Partial List of Microfinance Providers in BiH				
Name of MFI	Number of Clients	Outstanding Portfolio (BAM)	% Women	% Market Share (portfolio)
EKI	13,550	29,803,200	35%	19%
MIKROFIN	7,426	28,462,938	37%	18%
PARTNER	11,935	23,725,958	53%	15%
SUNRISE	7,256	13,062,798	37%	8%
MI-BOSPO	7,162	11,023,398	100%	7%
Other MFIs	9,418	10,738,332	n/a	7%
LOK	3,834	10,439,444	38%	7%
PRIZMA	10,968	9,973,065	100%	6%
BENEFIT	4,906	9,000,158	39%	6%
SINERGIJA	2,972	8,957,858	28%	6%
BOSVITA	2,061	3,243,738	77%	2%
Total	81,488	158,430,887		

Source: LIP program and local estimates for December 31, 2003 data.

Institutional Presentation

Mission MI-BOSPO's mission statement is worded as followed in the latest business plan (2004):
"MI-BOSPO provides financial services to women entrepreneurs for the development of their economic activities because we believe that economically empowered women can have more proactive role in the development of their family and of society." This mission is accompanied by a clear orientation towards self-sustainability through pricing to cover costs.

Legal form, supervision MI-BOSPO inherited a strong social orientation from its initial Founder BOSPO (The Bosnian humanitarian organization Bosnia Committee for Help). The NGO started by the Danish Refugee Council (DRC) used to provide psychosocial and educational support for displaced women and children in addition to other services, and started its microlending activities in March 1996 with the help of the World Bank.

In December 2000, this program was transformed into a formal microcredit organization under the Federation law enacted July 2000, and MI-BOSPO was officially registered on December 18, 2000 with the Federation Ministry of Social Welfare, Displaced Persons, and Refugees. MI-BOSPO is not subject to any banking supervision.

Networks MI-BOSPO is a member of local, state, regional, and international networks. These include the NGO Reference Group, AMFI, the local association of MFIs in Bosnia Herzegovina, MFC, the Microfinance Centre for Central and Eastern Europe and NIS, and the Women's World Banking (WWB) network of associated MFIs.

Ownership As a local non-profit microcredit organization, MI-BOSPO has no owners. The Founder, BOSPO, set the general orientation, social mission and values that the institution should respect. Per the Founding Act in 2000 and the Memorandum of Understanding in 2003, BOSPO gave up all its rights, liabilities or responsibilities for MI-BOSPO operations.

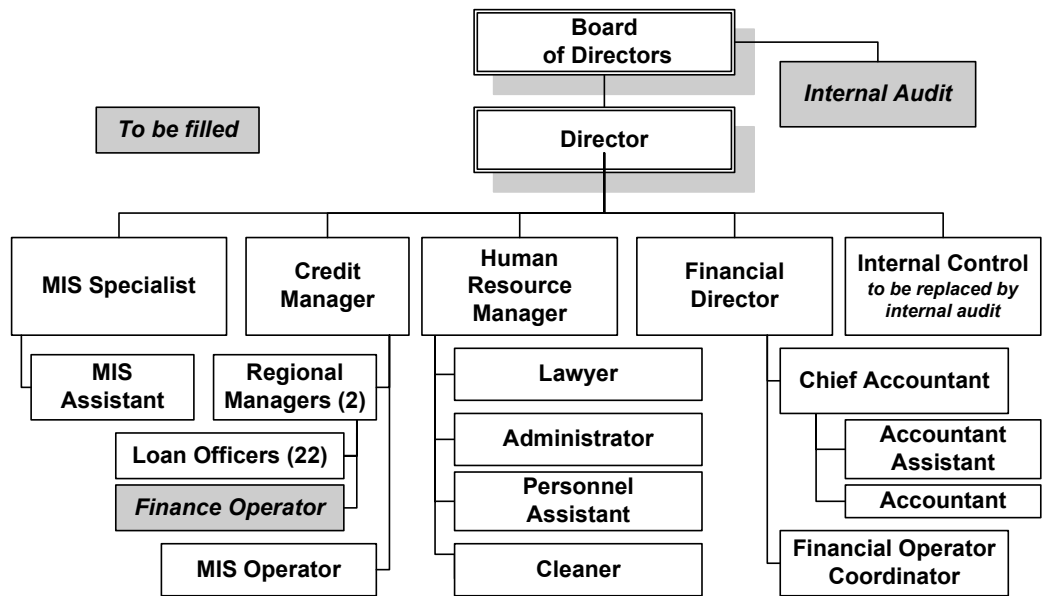
A Board of Directors has been in place since local registration. However, MI-BOSPO's Board experienced significant turnover in 2003 with three of six Board members resigning mid-year. The prior Board performed its basic duties and met regularly, but insisted on and received remuneration for their service. These Board members reported a lack of time and other personal reasons for their departure within a span of a few months.

An interim Board was created to manage the transition and included the Director of the Odras Foundation, the Board President of the Bosnian MFI association and three members remaining from the prior Board. Two new Board members were added in September 2003 and one more in February 2004, bringing the Board back to 6. In addition, as per the latest LIP agreement, MI-BOSPO has added funders to the Board. Including the Odras Foundation as an Associate Member without voting rights and since January 2004 a Raiffeisen Bank representative as a full Board member with voting rights. The current Board receives an honorarium per meeting.

Board of Directors	Position/ Focus	Since	Profession
Tahira Salihović	Board President	Dec. 2000	Insurance Agent
Admir Džumhur	Member	Dec. 2000	Auditor
Kadrija Hodžić	Member	Dec. 2000	Professor at Faculty of Economy, Tuzla
Dževad Šehić	Member	Sep. 2003	USAID, Professor at Sarajevo Economic Faculty
Sanja Hajdukov	Member	Sep. 2003	OHR Communications Officer
Mersija Jasarevic	Member	Feb. 2004	Attorney
Esad Sahinagic	Member	January 2004	Head of SME Department Raiffeisen Bank
Mirzet Ribic	Associate Member	Since inception	Odras Foundation

Team and structure

MI-BOSPO operates through a network of 8 offices across the Northern region of Bosnia, with headquarters in Tuzla centralizing all management and administrative staff (general management, accounting and finance, human resources, credit manager, internal control). Offices outside Tuzla only handle loan activities and serve as a work site for loan officers. These offices receive very frequent visits from Regional Managers. The loan approval process is held in the local offices for group loans and at HQ for individual loans. All operations involving cash handling (disbursements, repayments) are made through local partner bank teller windows. Information processing is also mostly centralized in HQ: client data are entered directly by loan officers at the local office, the disbursement and repayment data are entered at HQ and updated databases are sent back each week to local offices via e-mail or diskette.

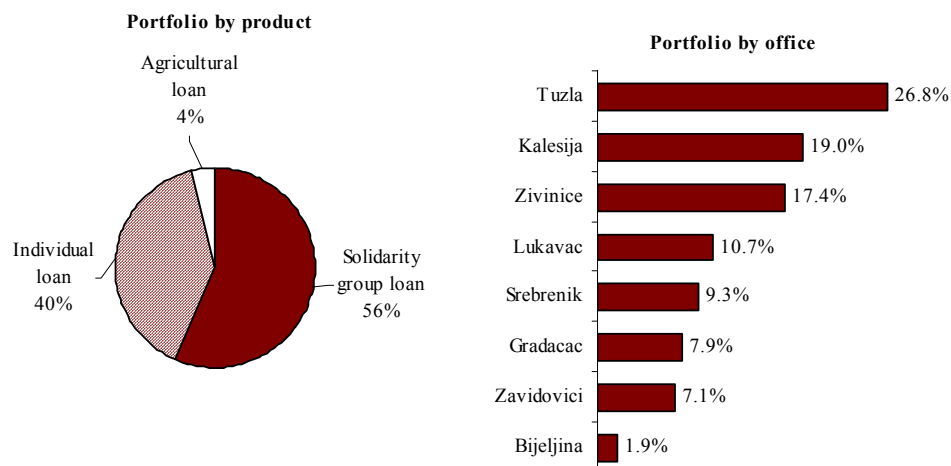


Human resources	2001	2002	2003
Number of employees ⁽¹⁾	28	37	39
% Loan officers	46%	65%	56%
Turnover (exits/ period average staff)	16%	9%	5%

⁽¹⁾Head count includes temporary staff.

Loan Products *Detailed description of products is provided in appendix.*

Solidarity group loans, using a methodology inspired from models in Latin America and adapted to the Bosnian context, were for several years the only product offered by MI-BOSPO. The product offering was expanded in 2001 with the introduction of an individual loan product for loans up to 30,000 BAM, considerably higher than the group loan maximum now capped at 3,000 BAM. An interest rate pricing policy that favors repeat clients was adopted in 2001 for both products. An agricultural loan product launched in 2002, with a notably lower interest rate, is still being tested in limited areas.



External audits and reporting From 2000 to 2002, the accounts of MI-BOSPO were audited by Revik d.o.o. Sarajevo, a local partner of PriceWaterhouseCoopers Netherlands. This firm has audited 8 other Bosnian MFIs in the past and has been in communications with World Bank actors on microfinance issues. Deloitte and Touche was hired for the 2003 audit. The auditors have always certified the accounts without reserve.

Governance and Decision Making

Decision making

Decision-making process

New Board learning to adopt role of strategy setter

The decision-making process relies substantially on the work of the management team, especially with recent Board changes (refer to Institutional Presentation). Given the Executive Director's determinant role in the development of MI-BOSPO, Board members have considerable confidence in her abilities and may benefit from being more critical on principle. The Board approves all procedure manuals, and tackles any other matter that has an important impact on profitability. Through a series of board management workshops and discussions, as well as the staff and board retreat that took place in October 2003, MI-BOSPO is making it a priority to strengthen its governance structure and expand the board's role in strategy-setting.

The Board has met more frequently than required over the last several months given the turnover and year-end approvals but is only required to meet four times a year. MI-BOSPO therefore has no structural impediments to timely decision-making as the Board may be convened when needed.

Skills and engagement of governance bodies

Significant Board turnover in 2003 but newly constituted Board eager to learn

The new Board appears highly motivated and is striving now to develop as a group. The Chairwoman has been active with MI-BOSPO since its genesis within the NGO BOSPO where she was a client. She provides a strong sense of moral purpose to the group. Members of the Board are coming from the fields of finance, economics and banking and MI-BOSPO will further educate them on microfinance-specific topics including indicator definition, etc.

Board committees not yet operational

The Board has developed a series of committees (strategic planning, financial control, recruitment, compensations and business communication) with mixed Board and management membership in 2003. These committees are not yet operational, although the financial committee did get involved in reviewing and producing the 2003 reports. As they develop, they would be able to address certain issues and free up time during the full Board meeting, which can cover issues in some cases in too great a detail.

Management information

Quality management information, especially market/competitor analysis

MI-BOSPO management and Board have quality management information regarding financial and portfolio performance. MI-BOSPO is noteworthy for its careful analysis of competitors, market size, market share, etc. Given its recent renewal, the Board may need more information at first to bring itself "up-to-speed." The Board has also requested to receive the Internal Controller reports for information, as for now they were only sent to management.

Communication of strategic decisions

Clear communication of strategic decisions

MI-BOSPO has a practice of open communication with regards to performance and strategy. All staff receives via email the monthly financial report, and regional credit meetings discuss the major initiatives of MI-BOSPO in addition to the performance of each loan officer.

Planning

<i>Team keenly aware of risks</i>	Risk identification MI-BOSPO is keenly aware of internal and external risks related to their operations. The entire leadership team works on risk identification in their daily work. To address competitive risks, MI-BOSPO has chosen to expand, differentiate, and more tailor its products to women entrepreneurs with improved marketing. The Executive Director is also very active in the microfinance sector to keep informed and, when possible, play a role in issues concerning MI-BOSPO's operating environment.
<i>Risks and priorities for mergers need to be more carefully analyzed</i>	The most important risk for MI-BOSPO, can it survive in the long term without merging, needs to be more carefully analyzed. The entire sector is considering mergers and MI-BOSPO, along with others, have remained open to potential mergers or other forms of collaboration. MI-BOSPO therefore needs to clarify its goals with respect to a possible merger, whether it be merging, taking over, or being taken over.
<i>Annual budgets and projections developed in Microfin and monitored</i>	Budgeting and projections The process of overall business planning and projections is centralized at headquarters and led by the Finance Director and Credit Manager, who both use the Excel-based business planning software Microfin. Each year, projections on the volume of loan disbursements and loan officers recruitments are issued by the Credit Manager and handed over to the Finance Manager for evaluation of costs, cash flow projections and analysis of the projected financial performances. The combined inputs from the respective departments are discussed among the leadership team before being finalized. Operational targets are compared with actual results on a monthly basis with credit staff.
<i>Very modest expansion in 2004 and beyond</i>	Feasibility of current strategy The current strategy of modest expansion is easy to implement in the short-term but may not be aggressive enough over the long-term. The goal for 2004 is to increase the portfolio and client base by 17-18% through existing capacity and the opening of one new office in Srebrenica. This modest pace of growth in 2004 is continued through 2008 in current projections, with a constant portfolio yield, an assumption difficult to maintain in a highly competitive environment. This would result in five years with an increase by 75% from today of the number of clients and 113% of the portfolio size.

The 5-year business plan for 2001-2005 issued in 2001 had more ambitious targets in terms of portfolio growth (almost 600% in 5 years) that were only achieved by 78% in 2001, and 71% in 2002: the targets in terms of average loan size were indeed not met due to a slower than planned start of the individual loan, which also had a negative impact on the profitability indicators. The next 5-year plan issued in 2003 (2003-2007) set more modest targets (growth of 179% in 5 years) that were almost achieved in 2003; 94%, as again individual loan achievements were only 78% of targets.

Key Aspect	Expected Changes
Services offered and geographic coverage	<ul style="list-style-type: none"> <input type="checkbox"/> Introduce modified credit products Jan 1, 2004 (same basic products, minor modifications to loan terms) <input type="checkbox"/> Decrease effective interest rate from 32% to 28% beginning of 2004 <input type="checkbox"/> Increase portfolio allocation in services and production sectors <input type="checkbox"/> Open Srebrenica office in 2004 <input type="checkbox"/> Hire 3 additional loan officers in 2004 <input type="checkbox"/> Move into new headquarters building
Operational methods	<ul style="list-style-type: none"> <input type="checkbox"/> Greater emphasis on marketing and communication; increase market share from 17% to 20% <input type="checkbox"/> No major changes expected.
Structure and statutes	<ul style="list-style-type: none"> <input type="checkbox"/> No changes to structure or statute expected in 2004 <input type="checkbox"/> Possible transformation upon passage of anticipated new microcredit law to financial company in future <input type="checkbox"/> Remain open to merger opportunities
Supervision	<ul style="list-style-type: none"> <input type="checkbox"/> There is no supervision current or planned for microfinance entities in Bosnia unless they register as banks
Financing	<ul style="list-style-type: none"> <input type="checkbox"/> An increase by 18% of the portfolio in 2004 or 1 million EUR, 75% by 2008 or 6.4 million EUR <input type="checkbox"/> If transformed to financial company beyond 2004, equity participations would be possible

Source: Business Plan 2004

Management Team

Highly motivated team The management team is a highly motivated and strong-willed group of individuals. They have adopted international standards for their work culture and performance. Consistent with that theme, the team refers to itself as the “leadership team” and includes the Executive Director, the Finance Director, the Credit Manager, the Internal Controller, the Human Resource Manager, and the MIS Specialist. Although the different managers are fully responsible for the operations of their departments, the preponderant role of the Executive Director in MI-BOSPO's development does make her vital to the institution. She has already begun delegating further to staff so as to try to minimize the key-person risk associated with her position.

MI-BOSPO seeking to improve its sophistication with regards to marketing, product development, internal control, and financial analysis The management team has been working together for several years, with the exception of the more recently appointed Finance Director, having grown into their respective positions via internal promotion. Therefore, several members do not have the educational or professional background anticipated in the job descriptions. To complement the on-the-job training, MI-BOSPO is seeking to increase its level of sophistication, notably marketing, product development, and internal control/audit. As the Finance Director is new to her position, her training and conference participation is a priority for the team in 2004.

Executive Director: Nejjira Nalić

Ms. Nalić has led MI-BOSPO since its genesis as a program within the NGO BOSPO. She has built the organization from scratch locally with the technical assistance of the World Bank and Women’s World Banking. Her microfinance knowledge is drawn from on-the-job experience and complemented by several international microfinance trainings led by WWB, MFC, and LID. Her secondary school focus was interpretation and her prior work experience in administration, interpretation, and NGO management.

Definition of roles and separation of tasks

Clear separation of tasks

The roles of each manager appear to be clearly defined and without overlap. In several instances managers are called to work on issues not ordinarily under their charge in “cross-functional” teams or based on individual competencies. For example, the HR manager is working actively on marketing issues and the MIS specialist on the move to new headquarters.

Communication within management team

Constant communication within leadership team; possibility for efficiency gains

The leadership team meets almost daily to discuss major issues of the day, on a weekly basis as an “internal Board” to discuss policy matters, and on a monthly basis or so with formal minutes. There is a goal to raise an issue no more than twice at a formal meeting. The team works towards consensus decision-making to avoid calling issues to a type of “vote.” Given the frequency of communication and the liveliness of debates, the leadership team may benefit from more formal rules with regards to communication and meeting processes to increase efficiency.

Human Resource Management

Skills management: recruitment, training, and internal promotion

Policies and strong work culture promote quality staff performance

MI-BOSPO has built its motivated team through clear recruitment procedures, internal promotion of staff in key management roles, and on-going training. The strong work culture for high quality performance is a notable characteristic at MI-BOSPO.

- ❑ Recruitment is transparent and conducted through radio ads and other public means with clear policies and procedures.²
- ❑ The salary structure was renegotiated in 2003 after a year-long process involving a “cross-functional” team of staff from different departments. Similar to industry salary agreements, the MI-BOSPO structure includes a base salary and then a range of coefficients for each position that are a function of the base salary. Staff is very satisfied with the pay scale. MI-BOSPO plans to participate in a “pay club” with several other MFIs to evaluate salary levels in comparison to other industry actors.
- ❑ Other staff benefits included in the work contract go above and beyond legal requirements.
- ❑ Training for new loan officers includes 7 days of theoretical training and 3 to 4 weeks of on-the-job training before issuing loans.
- ❑ MI-BOSPO offers 6 to 9 workshops per year for on-going training based on requests covering various topics such as client communication, delinquency management, and computer applications. Internal education and training has been budgeted at 20,000 BAM in 2003 and 2004.
- ❑ To continue motivating staff, MI-BOSPO has instituted several initiatives including special service awards, anti-stress weekends, an internal “job shadowing” program to allow employees an opportunity to learn about the positions of other colleagues, and education scholarships.
- ❑ The turnover rate in staff has been improving over time, down from 16%³ in 2001 to 5% in 2003.

² Employment of two individuals for the same family is not normally permitted and if occurs is purely exceptional with Board of Director approval.

³ In 2001, 6 new loan officers were hired to develop the individual loan product and 3 of them had left within a few months of hire.

All-staff performance evaluations to be implemented in 04, will complement loan officer incentive policy

Performance evaluation

Despite a long-time stated goal of innovative human resource management, MI-BOSPO is just now developing an overall staff evaluation system. The loan officer incentive system has nevertheless served as a mean of performance evaluation linked to financial reward. Other staff have received raises for strong performance, but this was based on the Executive Director's appreciation. The new evaluation system, already tested on a few employees, includes both a self-evaluation and an evaluation by other peers, subordinates, and supervisors.

HR manager has prominent role in management team

Skills of Human Resource Manager

MI-BOSPO invested very early in a Human Resource Manager, creating the position in 2000 when there were only 20 employees. The Human Resource Manager does not have prior HR experience but has a prominent role in the leadership team. Her time is split between human resource needs, leadership team needs, and other administrative issues, as she is also responsible for procurement/administration and supervising four other employees in her department. She is often called upon for other tasks given her strong English language skills.

Information Management and Systems

Management Information System (MIS) and Equipment

Fully computerized information system; internally developed system facilitate an efficient loan processing and provides all needed information

Description

The fully computerized information system and fluid information flow facilitate an efficient loan processing process, and provide all needed information to monitor the activities. The internally developed loan tracking system handles all steps of the loan processing

(loan evaluation and approval process, contracting, collateral registration, disbursements, repayments), and produces all documents and reports that loan officers and credit managers use in their day-to-day work. The Bosnian accounting software is basic but sufficient given that the internal MIS manager has added a report generation module for financial statements production.

Computing Resources

Access to Internet: Dial-up connection: at least one access in each office (two connections in HO)

Network: Local Area Network in head office

Software used: Loan tracking: internally developed software (Visual Fox Pro based)

Accounting: Bosnian software

Windows and Microsoft Office suite

Information flow that ensures a good level of control

The information flow is designed to ensure a strong level of control with an effective separation of duties and several check points: loan officers enter data needed for the loan evaluation; all credit approval documents are checked during the Credit Committee or Solidarity Group approval, disbursement documents are issued by the MIS Operator; repayment information transmitted by banks are entered by the MIS operator; consistency of bank and MIS information is checked daily by the accountant before entering data in the accounting system, etc.

Main risks mitigated

Security

The risk of data loss is effectively mitigated by extensive back-up and storage procedures: daily back-ups of data on the server hard disks and on the MIS manager laptop, weekly back-ups stored in the bank safe. An electronic version of the MIS source code is also stored in the bank safe.

Furthermore all important paper documents are either stored in locked rooms or in safes. Even though the system has never been “fraud tested”, the risk of data manipulation is reasonably low as individual passwords determine several access levels (read-only for accounting staff, possibility to add information but not to modify or erase data for loan officers, etc.). An audit trail has also been implemented to better control potential data manipulation determine. There is frequent reconciliation between the two systems (accounting and loan tracking) to rapidly detect errors. The fact that passwords may be one-digit long nevertheless weakens this protection.

Overall information system easy to use

Ease of system use

The management information system overall is easy to use: the data entry process is streamlined, information is readily available for all staff, and standard reports and documents are clear and well-conceived. All staff are sufficiently trained to the use of the software.

Databases in headquarters and field offices not yet linked

The current system does not yet allow direct access to up-to-date information for loan officers outside Tuzla: the loan tracking software is indeed available in all MI-BOSPO offices, but the master database containing the latest information about repayments is housed at headquarters in Tuzla. Other databases are updated on a weekly basis. Loan officers thus have to call

headquarters on repayment days to check if any of their clients is late. This is not a major problem for now, since late clients are very few at MI-BOSPO.

MIS plan and future improvements

*On-going
improvement process*

The system is continuously being improved. Modifications required by a change in the procedures/products or possible improvements identified by staff members can easily be implemented by the internal MIS manager since he is the one who created the software.

*Upgrade to more
robust technologies
ahead*

Future plans include: upgrades to more robust technologies for hardware (server) and software (from Visual Fox Pro database to SQL server) as soon as the headquarters moves to its new premises; development of a new module to help accountants with cash flow projections; and development of a new module for analytical accounting by office. An integrated software combining both accounting and loan tracking is being discussed, but there has been no formal decision as yet given various opinions of international experts on this “philosophical” choice.

*Important key person
risk*

Skills of MIS Manager

The MIS manager has all the necessary skills to manage the information system. The key person risk for this position remains very high despite MI-BOSPO’s efforts to reduce it. The specifications of the software have been put on paper, but a new MIS manager would still need several months to get up-to-speed.

Information on Activities

Information quality

*Accurate, up-to-date
and rich information
by product, by loan
officer or
consolidated*

The portfolio information is accurate and up-to-date. Numerous reports or indicator calculations are preset in the system or could easily be added if deemed necessary. Key data on outstanding and disbursed loans as well as portfolio quality are readily available, by product, by loan officer, by office or consolidated. Data on client businesses is also entered into the system. Data about guarantors is tracked, therefore it is easy to know how many loans have been supported by a given guarantor.

The very rich information about clients is stored in a database (business evaluations, credit history, etc.) and has been used in the past for product development. MI-BOSPO could nevertheless be further exploited notably to build standards for loan officers on client activity performance or other for other uses.

Information dissemination

*Information widely
disseminated both
internally and
externally*

The information is widely disseminated, both internally (all staff has at least read-only access to the system, receives a monthly report in their e-mailbox and discusses performances during their monthly meetings with their regional manager) and externally (donor reports, annual report on the web site).

Financial and Accounting Information

Accurate, up-to-date information ; financial statements available each month

Quality of information

Financial information is timely and of high quality. The external auditor always certified the accounts without reserve and never mentioned any major problems regarding the accounting information. All accounting documents are centralized and recorded at headquarters. Reconciliation with bank and portfolio information is performed immediately after input and at the end of each month.

Monthly statements available with quarterly analysis; Activity Based Costing planned

MI-BOSPO produces monthly financial statements with calculations of reserves, loan write-offs and amortization expenses. The internal financial statements conform to microfinance best practices and facilitate performance ratio calculations and analysis. As imposed by LIP II funds conditions, analytical information by municipality, status of client, purpose of loan, created and existing jobs, should be available before the end of the first semester of 2004. MI-BOSPO will also produce information by office and loan officer to get a better sense of the profitability by area and product (each loan officer being dedicated to a specific loan product).

MI-BOSPO achieves this level of quality despite a number of administrative burdens that complicate the accounting process. MI-BOSPO must report to both entities, the Brčko District, several cantons and municipalities for tax purposes. Given donor requirements and the need to work with banks closest to the branch offices, MI-BOSPO must manage 14 bank accounts for loan transactions and 2 accounts for expenses. Even if the MIS handles projections of loan repayments for each individual account, the institution is currently thinking about reducing the number of accounts since some donor have given up the separate bank account requirement.

Financial management and skills of finance department

Financial performance closely monitored

Financial performance is closely monitored by the finance team and commented during management team meetings. This includes calculation of key ratios and monthly comparisons of actual performance vs. targets. The profitability by loan officer and office will soon complement this already very rich set of ratios. The newly appointed Finance Manager who was previously Financial Coordinator is rapidly upgrading her knowledge of international standards in financial analysis with external trainings and participation in external conferences and meetings.

Risk Management

Procedures and Internal Controls

Inventory of procedures in 2003

Quality of procedures to limit risks

MI-BOSPO has developed its work procedures over several years that have effectively controlled most risks. In 2003, the MFI took an inventory of all policies and procedures to ensure that they were duly recorded, reviewed by the leadership team, and approved by the Board. This initiative was coupled with the creation of an Internal Controller position. The procedures are now enumerated under Credit Acts, Financial Acts, Personnel Administrative Acts, Informational Acts, and Internal Audit Acts. There are also Founding Acts and General Acts although most of these are simply key documents required by law. The structure of these acts results in some duplication between documents, but the Board members at the time approving the documents, coming from the banking sector, required MI-BOSPO do it as such. Now that MI-BOSPO has recorded all of these steps, they will be analyzing their efficiency during a process mapping exercise with WWB and then reviewing the internal control aspect of any procedure updates.

Cash handling and credit risk well-managed

MI-BOSPO has been controlling fraud and credit risk similar to many other Bosnian MFIs in part by using banks to handle all disbursements and repayments, thereby separating cash handling from other credit functions. All loans are approved by a second party, in the case of a group loan via a “check” with the group from a second loan officer or in the case of individual loans through credit committees. The transactions are recorded in the MIS by an MIS operator upon documentation from the credit and finance departments. Loan officers therefore have minimal opportunities to fraud the system.

As in any MFI, minor improvements could be made to increase the rigor with which group loan clients are tested to minimize loan sharing and other problems that could have a negative impact on portfolio quality. Additionally, there are purchasing procedures, such as requiring three bids, that are used to minimize administrative risks.

Opportunity to formalize more regular controls by staff

MI-BOSPO has an opportunity to further develop internal control by making more active use of staff for verification. There are controls being performed by the Internal Controller that could be performed by other staff on a more regular basis, and the Internal Controller could simply check that these controls have been performed. It is expected that the Regional Managers will be spending more time in the field monitoring loan officers, therefore they could institute more regular controls on compliance with credit procedures in this context.

Systematic controls

Transparency enables MI-BOSPO to identify areas of poor performance

Although there are no stated systematic controls for poor performance, the policies, procedures, and transparency with regard to financial and portfolio performance ensure that poor performance is recognized quickly. Actual performance on financial and portfolio indicators are regularly compared to targets to quickly identify any potential deviations.

Internal Audit

Internal audit procedures

Internal Controller position created in 2003

In 2003, MI-BOSPO created a position of Internal Controller to review MI-BOSPO's procedures, however the position does not report formally to the Board. To comply with LIP guidelines, MI-BOSPO will phase out the Internal Controller position in favor of an Internal Auditor position reporting to the Board. In many ways, the Internal Controller already functions as an Internal Auditor, although he is not reporting directly to the Board and plays a more active role in policy review and management decisions.

Internal audit procedures not yet formalized; internal controller senior MI-BOSPO staff member

Formal internal audit procedures are in their beginning stages. Two policy documents on internal audit were written in 2003 as part of the policy documentation initiative, however each is only a few of pages in length and remains very theoretical. The Internal Controller, a long-time senior MI-BOSPO employee familiar with all aspects of operations, has been working to learn as much as possible about proper procedures through both existing public documents and LIP-sponsored trainings.

Quality of internal audit

Audit covers several "big picture" topics; More routine audits to be scheduled

Although in its initial stages, MI-BOSPO's approach to audit has covered key areas that many internal auditors miss: compliance with Board decisions and business strategy. The audit reports cover problem definition, goal of the audit, the audit method, the sample, and any other areas. In addition to the "big picture" topics covered, the auditor has begun sampling loan files and visited a random sample of 88 clients in 2003. As MI-BOSPO gains more audit experience, the auditor/controller could track improvements as a result of recommendations from prior audit visits, overall trends and issues for MI-BOSPO, etc. The most significant findings for the controller have been related to a lack of compliance by loan officers with certain credit procedures in limited cases.

To ensure the quality of audit and to strive for a positive reception by staff, the Internal Controller spent time "selling" the idea of audit. As a result, the Internal Controller feels he is well received and will get requests for consultations by staff on internal control issues.

Approach to risk management and internal controls

Individual departments asked to further analyze their respective risks

MI-BOSPO is very conscious of external risks and has been working to further formalize the approach to internal risks. The departments have been asked to reflect more individually on the respective risks that they should be controlling so as to make risk management an even greater part of a department manager's role. The Finance Department is the first to have undergone this exercise and written down these risks.

Activities: Products and Services

Portfolio Management

Market, competition, and competitive advantages

Highly competitive market requires vigilance to attract and maintain clients

The Bosnian microfinance environment is highly competitive, notably in urban areas where MFIs have been operating for years and banks are offering consumer loans. Microfinance clients will “shop around” to find the products most suited to their needs or, in many cases, take loans from more than one source at a time. Bosnian MFIs therefore must have increasingly strong competitive advantages to maintain their position.

MI-BOSPO seeking to compete as niche player who provides easy and fast service; Competition on price over long-term unlikely

MI-BOSPO is a very strong medium sized regional player in the Bosnian market with a clear target market of women, even if many of the business funded are headed by men in the household. Being present in the Tuzla region in one form or another for 8 years, MI-BOSPO has been able to develop a loyal clientele and recognition. While other MFIs have or are phasing out a group loan product given client preferences for individual loans, MI-BOSPO continues to be the largest provider of group loans in its market, and therefore always available to those with no other recourse. Without the economies of scale of a large MFI as well as a higher average cost of funds, it is unlikely that MI-BOSPO will be able to compete on price over the long-term, despite a reduction in interest rates in January 2004.

Strong market share and client retention, but need for more aggressive marketing

Marketing is a focal point in 2004 and the focus of a cross-functional team including the Credit Manager and HR Manager. Other actors in the market have grown increasingly aggressive with their marketing efforts. Whether through marketing, first-mover advantage or other means, MI-BOSPO has achieved depth in its target market, with 17% market share. The high client retention rate for the area contributes to this strong performance. Although MI-BOSPO has developed and refined loan products, it has not been actively marketing these changes (agriculture, service and production business loans) and has focused more generally on changing the image of being not just a group loan provider. Given the competitive microfinance market, delays in marketing leave more opportunities for the competition.

Client selection, portfolio monitoring and delinquency management

Portfolio management contributes to strong portfolio quality

MI-BOSPO’s strong portfolio quality is attributable mainly to a careful client selection and a well-established credit methodology.

- ❑ Individual loan clients undergo a retrospective cash flow analysis based on the IPC methodological approach. Group loan clients now also undergo a similar analysis.
- ❑ Given the pre-selection by loan officers, the credit committee or approving loan officer does not typically reject candidates but may reduce the loan size from the request.
- ❑ Loan officers are expected to visit clients for monitoring.
- ❑ Loan officers know of client delinquency within 24 hours from headquarters where all repayments are recorded from bank statements. Pre-printed repayment slips increase the accuracy of repayment data. There are clear procedures outlining measures to be taken for delinquent clients.
- ❑ Loan officers receive incentive pay for performance based on client caseload, portfolio quality, and other factors. The policy has recently changed from being loan officer focused to office focused so as to avoid any problems with client referrals between group loan and individual loan officers.

- ❑ Late penalties of 0.2% per day are a strong incentive to pay on time, although they are not applied if clients have a “good” reason for being late (sickness, family problems)..
- ❑ MI-BOSPO seeks to preserve a strong image with regards to delinquency and will therefore refer to court all cases, even if the net value to be recovered is insignificant. There are currently 53 court cases pending.

Loan officer skills

Strategy of segregating LOs by product to ensure appropriate skills

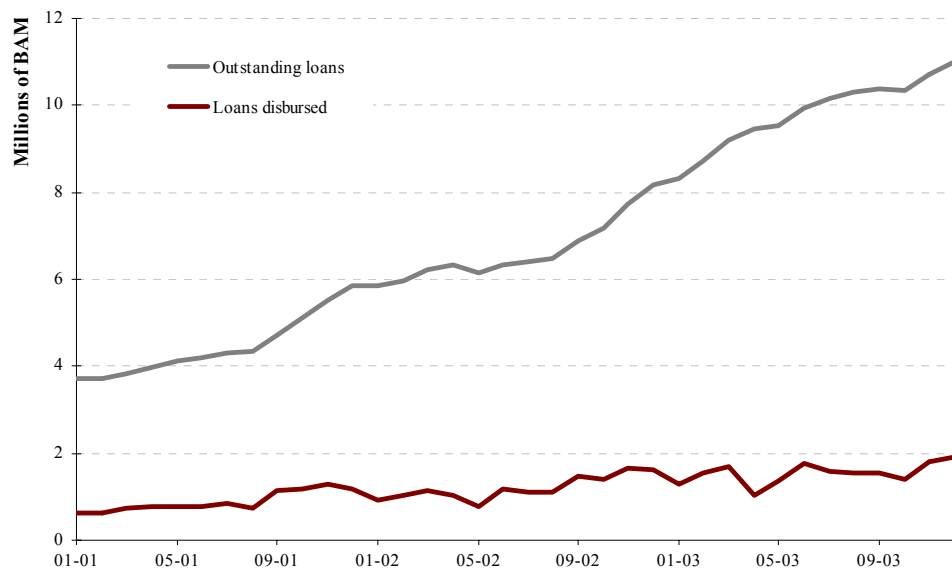
Loan officers focus exclusively on either group or individual loans, therefore loan officer recruitment and training are oriented to ensure the appropriate skills for the type of position. MI-BOSPO is able to find university educated economists in the market to serve as individual loan officers, although this requirement is less critical for group loan officers. The on-the-job training is perhaps the most important element of MI-BOSPO’s success in building a quality pool of loan officers.

Portfolio diversification policies

There are no formal diversification policies, however the Credit Manager seeks to minimize risk in agriculture (maximum portfolio of 500,000 BAM in 2004) and to increase marginally the percent in service and production sectors. There is a preference to maximize the portfolio outside of the city of Tuzla, where client cross-indebtedness and urban issues make it a riskier market. Additionally, MI-BOSPO must monitor portfolio distribution by product and by cycle as the blended portfolio yield should not be lower than 28% to meet profitability goals, although different products and cycles have varied effective interest rates.

Portfolio at risk Write-off ratio

Evolution of loan portfolio



In EUR, unless otherwise stated	Dec. 2001	Dec. 2002	Dec. 2003
Loan portfolio	2,994,659	4,185,324	5,636,174
Loan portfolio (BAM)	5,857,044	8,185,782	11,023,398
Evolution	52.6%	39.8%	34.7%
Average outstanding loan	2,253,225	3,364,976	4,966,556
Number of active borrowers	4,460	5,499	7,162
Evolution	?	23.3%	30.2%
Average outstanding loan per client	671	761	787
% of GDP per capita	45.5%	51.6%	53.3%
Average amount disbursed	1,002	1,135	1,178
% of GDP per capita	67.9%	77.0%	79.8%
PAR 31-365	0.3%	0.2%	0.2%
PAR > 365	0.0%	0.0%	0.0%
Write-off ratio	1.0%	0.8%	0.8%

Strong development of individual loan product resulting in an increase of average loan size; position regarding agriculture loan not clearly defined

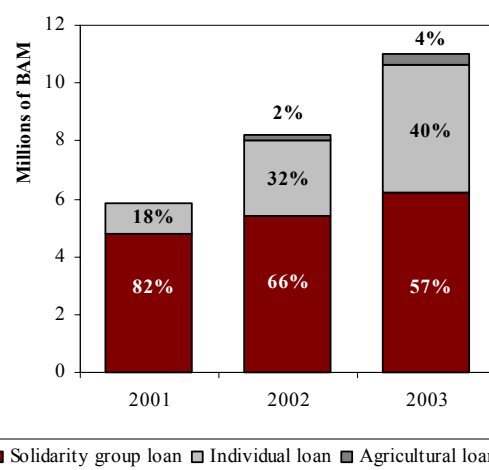
The constant growth of the loan portfolio over the past three years, is mainly driven by the development of the individual loan. This growth also explains the increase of average loan size, as average loans are above 4,000 BAM (approx. 2,000 EUR) for individual loans and less than 1,800 BAM (approx. 900 EUR) for solidarity group loan. The agriculture loan that was launched in 2002 will not be a focus for MI-BOSPO and is so far only available in 2 offices, explaining its slow growth.

Outstanding portfolio quality, typical of most Bosnian MFIs

The PAR31 remains exceptionally low over the period and no discrepancies among products can be noted. Even though MI-BOSPO policies regarding late clients account in part for this very good portfolio quality, these results are typical for Bosnia. MI-BOSPO very rarely reschedules loans, only when the economic situation of the client activity make it impossible to repay the installments. The outstanding amount of these loans is included in the regular portfolio figures, but can be easily identified (1,457 BAM total in 2003).

Although MI-BOSPO does have a conservative write-off policy and each month writes off all loans over 90 days in arrears, the write-off ratio remains minimal at approximately 0.8% annually. Since MI-BOSPO began operations, it has recovered approximately half of all amounts written off.

Portfolio per product



Credit risk coverage

Coverage by provisions

	2001	2002	2003
Risk coverage ratio	433.2%	571.8%	638.2%
PAR 31 net of loan loss provision / Equity	PAR31 fully covered by provisions		

High risk coverage ratio by provision

MI-BOSPO has a very conservative provision policy, as required of LIP program participants, that includes a provision on healthy portfolio (see table). This, and the very good quality of the portfolio, result in a high risk coverage ratio of more than 600% in 2003.

Provisions	
Healthy portfolio	1%
PAR 1 – 30	20%
PAR 31 – 60	60%
PAR 61 – 90	80%
PAR >91	100% and written off

Coverage by guarantees

Guarantees taken, serve more often as a dissuasion than actual guarantee

Guarantees are requested of loan clients as an additional measure of risk coverage, although their realization is not easy and guarantors are used more to pressure clients than as an actual source of payment. MI-BOSPO uses solidarity groups, personal guarantees, salary withholdings, bills of exchange and movable property as collateral for the loans. The group loan contracts are signed by all group members making them jointly and severally liable for the loan.

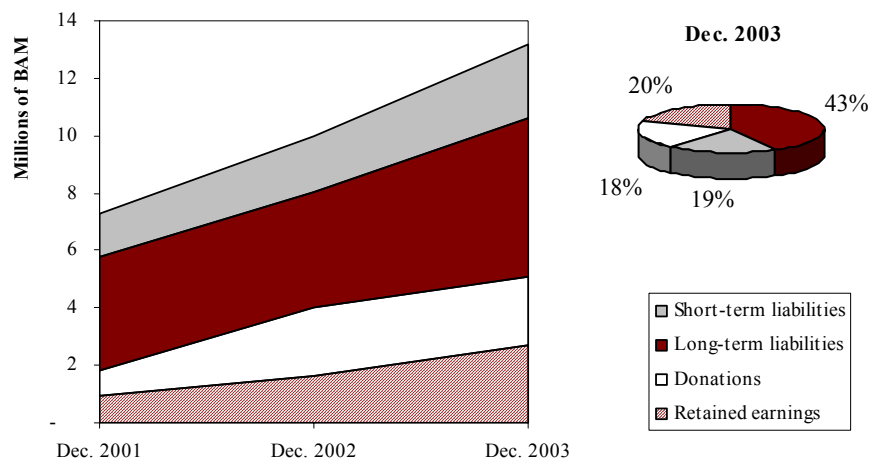
- ❑ For individual loans, a required guarantor is a spouse if he exists.
- ❑ Salary withholdings must be approved by the employer, who is financially liable for paying the amount if the employer over issued such guarantees, a violation of the law.
- ❑ When executing a bill of exchange, MI-BOSPO may take the bill to a bank, but if the funds are not available then the bill is simply returned within 24 hours unpaid.
- ❑ Moveable property may also be pledged but is a challenge to execute since MFIs do not like to force property sales and culturally it is not well accepted to purchase such items. An expected law on a movable property register, expected in the near future, will provide additional opportunities to simplify procedures and help strengthen guarantee coverage.
- ❑ Mortgages are far too costly to use as collateral and administrative costs motivate many homeowners to not register their deed after purchase.

Funding and Liquidity

Asset Liability Management and Financing Strategy

Description of capital structure

Details on funding sources in appendix



MI-BOSPO has a long-term funding base of 20% retained earnings, 18% donated equity and 43% long-term liabilities. MI-BOSPO's portfolio growth was mostly financed by loans, notably LIP loans⁴, as there was no major international partner providing significant equity contributions. LIP has had a predominant place in MI-BOSPO's capital structure since 2000, typically representing more than 30% of total assets and more than 50% of liabilities over the past 3 years. Another important source of funds is a commercial revolving loan fund from Raiffeisen (14%). With its current funding structure, MI-BOSPO does not fully comply with the LIP II loan requirements: a leverage of 300% and 25% of the portfolio financed by commercial loans. Currently, leverage is 160%, and 22% of the portfolio is financed by commercial loans. MI-BOSPO's expected portfolio growth through commercial funding should rectify this.

Asset/liability management procedures

Maturity, and exchange rate risks very limited MI-BOSPO does not face any major risk related to its asset/liability structure. Long term⁵ liabilities and equity represent 81% of total assets while at least 76% of assets are short term. The Bosnian Convertible Marka (BAM) has a fixed parity to the Euro thus preventing major exchange variations since most liabilities are either labeled in Euros or in BAM. Furthermore, MI-BOSPO denominates its loans in Euros, a technique widely applied by MFIs and banks in Bosnia although not legally enforceable.

Financing strategy

Very active fundraising; less opportunities for cheap sources of funding than competitors Given that MI-BOSPO could not rely on a major international founder that would finance its first years of existence, the Executive Director had to seek other funding sources from the beginning and has been successful in doing so. WWB network membership helped a lot in this process, with increased exposure to international commercial and semi-commercial funding sources and the allocation of a capitalization fund of 500,000 USD that increased leverage for banking relationship such as Raiffeisen. Thanks to these efforts MI-BOSPO's growth was

⁴ See "Microfinance Environment"

⁵ All loans issued with a term over 12 months were considered long term.

never limited by the lack of funds. The institution was even among the first MFIs in Bosnia to access commercial funding.

MI-BOSPO is entering a new phase of its financing strategy since the institution will likely not be eligible for the next round of LIP loans, unless it merges with one of the major Bosnian MFIs. This excludes MI-BOSPO from the most accessible and cheapest source of funds in Bosnia. Fruitful contacts have already been established with potential funders in Bosnia and abroad, and the 2 million BAM needed to finance 2004 growth have already been secured. Nevertheless MI-BOSPO financing costs are likely to remain higher than that of its major competitors, its average funding cost is already 5% per year, which is a handicap in the competitive Bosnian market.

Liquidity Management

Physical security of liquidity

No cash handling risk MI-BOSPO faces no cash handling risk since all cash operations are held in local partner banks, with extremely rare exceptions. The institution does not anticipate any changes in this operating procedure as geographic coverage of bank branches meets MI-BOSPO's needs and there is no fear of competition from local banks.

Cash flow projections

Good weekly cash flow projections; liquidity management made more complex by existence of numerous bank accounts MI-BOSPO efficiently manages to plan its funding needs. Annual cash flow projections based on the hypothesis of growth in portfolio underlying the business plan are generated with Microfin and are used to define the schedule of negotiations with potential financiers. These funding plans have so far been realized and MI-BOSPO always managed to cover its needs: the institution even had a reserve of funds of 1,100,000 BAM at the end of 2003 since the total amount of the revolving loan negotiated with Raiffeisen is not yet used.

All tools are in place to ensure an efficient day-to-day cash management:

- disbursements plans are sent by loan officers one week in advance,
- forecasts of daily repayments are calculated for each bank account by the MIS, and
- budgets include monthly plans of operating expenses.

This exercise is made more complex by the fact that funds are split among 12 different bank accounts. MI-BOSPO is considering merging some of its bank accounts (see "Accounting information") in order to make liquidity management more efficient.

Prudential norms and security margins

Security margins set to limit risk of illiquidity In order to guarantee its liquidity, MI-BOSPO always keeps at least 5% of the total portfolio plus 50% of monthly operating expenses in cash in the bank accounts. The level of this reserve is calculated every week, before each disbursement, and compared with the actual level of cash on hand in the banks. No shortage of funds ever resulted in the need for MI-BOSPO to go under the level of this reserve.

Efficiency and Profitability

Ratio	Dec. 2001	Dec. 2002	Dec. 2003	Formula
Productivity				
Staff productivity	159	149	184	Active borrowers / Number of personnel (end of period)
Loan officer productivity	343	229	326	Active borrowers / Number of loan officers (end of period)
Profitability				
ROA	10.0%	7.8%	9.2%	Net operating income before donations / Average assets
Adjusted	2.9%	2.9%	5.8%	ROA after adjustments to net income
ROE	45.0%	23.1%	23.4%	Net operating income before donations / Average equity
Adjusted	13.0%	8.6%	14.8%	ROE after adjustments to net income
Liabilities/Equity	295.1%	148.2%	158.9%	Total liabilities (savings + borrowings) / equity (end of period)
Portfolio Yield	35.9%	34.8%	32.6%	Portfolio revenue / 13-month average gross outstanding portfolio
Operating expenses	18.3%	18.7%	16.5%	Operating expense / 13-month average gross outstanding portfolio
Funding expense ratio	3.5%	5.6%	4.8%	Interest and fees paid on funding liabilities / 13-month average gross outstanding portfolio
Loan Loss Provision expense ratio	1.2%	1.0%	1.2%	Net loan loss expense / 13-month average gross outstanding portfolio
Adjustment expense ratio	9.2%	6.5%	4.0%	Total adjustments / 13-month average gross outstanding portfolio
Outstanding Loan Portfolio / Assets	79.4%	81.2%	82.6%	Net portfolio / Total assets
Operational self-sufficiency	156.5%	140.6%	148.8%	Revenue from operations / (Financial expense + Loan loss expense + Operating expense).
Financial self-sufficiency	111.7%	112.0%	126.1%	Operating self-sufficiency after adjustments to expenses

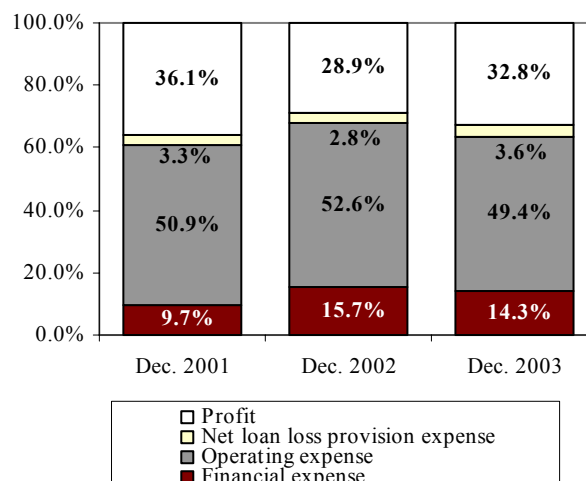
MI-BOSPO's performance will be compared with that of the group ECA Medium (Eastern Europe and Central Asia Medium) of the MBB n°9 (July 2003) that also includes: Constanta (Georgia), FINCA-KGZ (Kyrgyzstan), KEP (Kosovo), NOA (Croatia), Prizma (Bosnia), PSHM (Albania), Sunrise (Bosnia), XAC (Mongolia).

Operational self-sufficiency

The institution is highly profitable before and after adjustments, with an operational self-sufficiency of 149%, which is above that of its MBB peer group at 121%. Although there has been improvement in the operating expense ratio, operational self-sufficiency has been trending downward over the past several years given the combined impact of a declining portfolio yield and an increasing cost of funds.

High profitability with downward trend due to declining portfolio yield and rising financial costs

Expenses and Profit as a % Financial income



Transformation of several quasi-loans into equity explains the decrease of leverage and ROE

Return on assets (ROA) and Return on equity (ROE)

The ROA follows the same pattern as the operational self-sufficiency. The transformation of several quasi-loans (CWS, part of LIP loans) in 2002, and the addition of retained earnings over the years explain the decrease of the leverage ratio and consequently the sharp decrease of the ROE (decreasing from almost 45% in 2001 to 23% in 2003).

Downward pressure on interest rates due to competition and importance of social mission

Portfolio yield and effective interest rate

The portfolio yield follows a downward trend over the period (from 35.9% in 2001 to 32.6% in 2003) due to several interest rate cuts decided by the management to make MI-BOSPO's products more competitive. At the end of 2001, MI-BOSPO introduced a declining interest scale as clients go from cycle to cycle. In 2002, the average interest rate was lowered from 36% to 33%. The management team also strongly believes that it is part of MI-BOSPO's social mission to keep the interest rates as low as possible, without putting sustainability at risk.

Loan officers productivity lowered by introduction of individual loan

Personnel productivity

The launch in 2001 of the individual loan product has lowered the average productivity of loan officers. However, the overall productivity of the personnel has improved over the period, from 159 in 2001 to 184 in 2003, as the percent of loan officers of all staff has increased. The "ideal" caseload for an individual loan officer is 200 compared to 450 for group loan officers. The recruitment of 6 loan officers in October 2002, whose caseloads at the end of 2002 were minimal, explains the dip in both indicators in 2002. MI-BOSPO's performance nevertheless remains above the average of its MBB peer group, 100 for staff productivity and 198 for loan officer productivity.

Operating expense ratio lowered thanks to economies of scale

Operating expense ratio

The operating expense ratio is on a downward trend, thanks to economies of scale, with a temporary increase in 2002 (18.3% in 2001, 18.7% in 2002, 16.5% in 2003). The 2002 "peak" is due to an investment in staff, notably the development of the individual loan product, that resulted in an increase of 62% of the staff costs, which is to be compared to a portfolio growth of only 40%. The level of operating costs is lower than that of its MBB peers at 34.2%.

Very low loan loss provision expense consistent with good portfolio quality

Loan loss provision expense ratio (cost of risk)

The level of the loan loss provision expense ratio remains very low over the period (less than 1.2%), which is consistent with the overall exceptional quality of the portfolio. The provision of 1% of the healthy portfolio represents more than 75% of the total amount of the loan loss reserve.

Financially self-sufficient after adjustments (mainly cost of funds)

Adjustment expense ratio and financial self-sufficiency

According to Planet Rating's adjustment methodology, MI-BOSPO has achieved financial self-sufficiency. The adjustment expense ratio of 4.7% in 2003 is attributable to the standard adjustments of the cost of funds, inflation, loan loss provisions, and in-kind donations. The cost of funds adjustment accounts for 98% of these adjustment expenses, since the adjustment for the other items is minimal. Please note that the shadow cost of funds was lowered from 12% in 2001 and 2002 to 10% in 2003 to take into account the fact that MI-BOSPO was able to access funds at 8.5% and 9.5%. The other years were not changed to allow comparability with our previous reports about Bosnia. Please refer to the annex for further details on these adjustments.

Management of non-portfolio productive assets

Short-term investment opportunities not readily available in Bosnia; significant cost of liquidity margin (financed on revolving commercial loan)

The level of non-portfolio productive assets is low (4% of assets, all in cash deposits). 84% of the assets are invested in the portfolio and the rest is either in fixed assets (for a reasonable 4%), or restricted deposits (8% – these are funds that guarantee Raiffeisen loans and may not be used for on-lending purposes. They are originated from a Deutsche Bank loan and the WWB capitalization fund). Short-term investment opportunities are not readily available in Bosnia at attractive rates. At present, the current level of liquidity corresponds roughly to the internal liquidity margin set by MI-BOSPO. However, there is a cost to this strategy as MI-BOSPO pays interest on its credit line with Raiffeisen, which could be used only in the case of serious need.

Profitability outlook

High competitive pressure on interest rates and increase in cost of funds and staff cost will contribute a decrease in profitability

The downward trend in profitability that has been observed over the past several years is likely to continue given the following factors:

- ❑ Downward pressure on interest rates due to competition, social mission, and product pricing, including advantages for repeat clients. Nevertheless, MI-BOSPO plans on a stable portfolio yield at 28.3%;
- ❑ An expected increase in the cost of funds given that MI-BOSPO will not be eligible for future LIP funds and subsequently will need more commercial rate funds. The business plan projects an increase from 4.1% in 2003 to 5.3% in 2008;
- ❑ An overall salary increase set in January 2004 that, with the 8% increase in staff, will result in an overall staff cost increase of 27% in 2004 as compared with 2003.

Higher productivity could mitigate this downward trend

In the medium term, improved productivity and greater economies of scale might compensate for these negative trends on profitability if MI-BOSPO achieves a sufficient portfolio growth (either internally or via merger). This is indeed the only potential cost reduction factor since staff expenses contribute for 70% of operating expenses. So far, MI-BOSPO management has planned a stable portfolio per loan officer, approximately 500,000 BAM per loan officer in 2003 through 2007 with a declining number of clients per loan officer with the development of the individual loan product. This constant level will not allow for the easiest economies of scale, higher portfolio size per loan officer. An upcoming process mapping workshop will help the management team define more precisely the goals for each type of personnel.

Appendices

Product Descriptions

Product Features	Solidarity group Loan	Individual Loan	Agricultural Loan
Date created	September 1996	July 1st 2001	September 1st 2002
Target clientele	Low income women entrepreneurs involved in income generation activities (urban and rural)	Women entrepreneurs who developed micro or small businesses or who are active in family profit accumulating business (urban and rural)	Women entrepreneurs actively participating in family agriculture activities of larger scale (rural)
Purpose	Trade, services, agriculture and production, for working and fixed assets	Trade, services, agriculture and production for working and fixed assets (loan terms slightly vary according to the financed activity)	Agriculture; working and fixed assets
Minimum / Maximum loan amount	500 BAM – 3,000 BAM	500 BAM – 30,000 BAM	500 BAM – 30,000 BAM
Average loan at disbursement	1,800	4,000	4,500
Annual nominal interest rate	26% - 33%	26% - 34%	20% - 28%
Flat or declining?	declining	declining	declining
Fees	--	--	--
Savings	--	--	--
Repayment frequency	monthly	monthly	monthly
Term (without grace period)	3 to 15 months	3 to 30 months	3 to 30 months
Average loan term	12 months	13 months	18 months
Guarantees	Group solidarity	Salaried guarantors, warrantors, bills of exchange	Salaried guarantors, warrantors, bills of exchange
Effective annual interest rate	26% - 33%	26% - 34%	20% - 28%
Main changes	Reduction of maximum loan amount from 5,000 to 3,000 BAM when the individual loan was introduced	--	--

Descriptions of funding sources

Main loans

Loan Providers	Initial Amount	Capital outstanding on 31/12/2003	Interest rate	Maturity date	Restrictions and Comments
Local Initiative Project I (LIP I) ⁽¹⁾	1,316,352 EUR	1,316,352 EUR	5%	2017	484,378 EUR of the initial 1,800,000 EUR loan granted in 2000 was forgiven in 2002
Local Initiative Project II (LIP II) ⁽¹⁾	1,000,000 EUR	1,000,000 EUR	5%	2017	
UNHCR	244,927 EUR	244,927 EUR	0%	-	This loan shall be transformed into a grant after Dec. 2004
Deutsche Bank	125,000 USD	125,000 USD	2%	June 2006	This loan is only used as a guarantee for the loans received from Raiffeisen. The amount of the loan is kept in restricted accounts.
KfW ⁽²⁾	200,000 EUR	177,800 EUR	EURIBOR	Sept. 2007	To be used for loans disbursements in rural areas only
KfW II ⁽²⁾	150,000 EUR	Loan was not yet disbursed	EURIBOR	March 2009	To be used for loans disbursements in rural areas only
UMCOR ⁽³⁾	50,000 USD	50,000 USD	0%	-	To be used for at least 50 loans. Loans shall only be granted to women in Zavidovici geographic area. Should be transformed into a grant before the end of 2004
Raiffeisen Bank	1,533,876 EUR	975,033 EUR	8.5%	Oct. 2005	Revolving loan fund for up to 3 millions BAM.
TRIODOS	200,000 EUR	200,000 EUR	9.5%		One year contract, renewable twice.

- (1) Obligations related to the two LIP loans include: keeping the maximum loan amount under 30,000 KM; keeping a ratio of "equity / total assets" of at least 15%; maintaining a positive adjusted ROA; keeping the PAR30 under 5% and the write-off ratio under 3%. For the duration of the contract, MI-BOSPO shall receive LIP consent regarding the following acts: investments (except for the permitted investments that include : microcredits, fixed assets, state bonds with maturity dates not exceeding 30 days, deposits for less than 30 days); issuing of mortgage, pledge and other collateral; changes in statutes; essential changes in the legal structure; changes in the policy regarding conflicts of interest.
- (2) This loan shall only be used for loan disbursements. The loans issued on KfW funds shall comply with the following conditions : loans shall not exceed 50,000 KM and maximum maturity is 24 months; grace period shall not exceed 9 months for agriculture loans and 6 months for other loans; beneficiaries have to be located in rural areas of the North and North East regions of Bosnia and Herzegovina; beneficiaries should be involved in agriculture or agro-processing businesses; loans beneficiaries shall not have any other financial obligations; MI-BOSPO related parties shall not receive loans for more than 5% of the KfW loan; loan approval procedures shall comply with international best practices and take into account the applicant's overall economic situation; credit committees have to meet at least once a week; the loan tracking system has to be computer based
- (3) For the duration of the loan, MI-BOSPO shall obtain consent of UMCOR before: entering into any merger or consolidation; creating any pledge or mortgage; amending the credit manual. 20% of the loans issued on UMCOR funds shall be disbursed to minority returnees. The total amount of the loan will be immediately due if MI-BOSPO does not comply with all the terms of the contract described above; or falls into bankruptcy; or is not permitted to perform microcredit activities anymore; or sells a substantial part of its assets without UMCOR consent; or conducts lending activities that do not comply with microcredit definitions.

Principal Grants

Grants	Amount Granted	Amount received 31/12/2003	Restrictions and Comments
Women's World Banking (WWB)	500,000 USD	450,000 USD	Donation for capitalization, to be used only for loan disbursements. WWB can ask for the reimbursement of this grant if MI-BOSPO does not comply with the pre-set performance targets.
Women's World Banking (WWB)	31,686 EUR	31,686 EUR	Amounts granted to cover operating expenses related to seminars and trainings
Local Initiative Project (LIP)	484,378 EUR	484,378 EUR	Part of the loan "LID I" that was converted into a grant in 2002
Local Initiative Project (LIP)	120,159 EUR	120,159 EUR	Amounts granted in 1999 and 2000 to cover operating expenses
Catholic World Services (CWS)	74,444 EUR	74,444 EUR	Part of the CWS loan that was converted into a grant in 2002. For loan disbursements only.
Clotilde Luce	1,647 EUR	1,647 EUR	For loan disbursements only
Danish Refugee Council (DRC)	13,023 EUR	13,023 EUR	Amounts granted to cover operating expenses related to seminars and study tours to Belgrade and Poland.

Financial Statements and Notes

General notes to financial statements per 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. MI-BOSPO is not considered as a multi-service institution.
4. Portfolio reporting
 - (1) The loan loss reserve is shown as a negative asset in the balance sheet. It is calculated monthly and additional amounts added to the reserve are expensed in the income statement through a separate account. The schedule of provisions by age category is presented in the section Credit Risk Coverage.
 - (2) Loans are written off as a matter of accounting practice monthly when a loan is late by 90 days.
 - (3) MI-BOSPO suspends interest accruals when loans become doubtful of collection (when overdue by more than 90 days or when the borrower defaults).
5. Portfolio quality
 - (1) Portfolio quality and the calculations of such are displayed in the tables in Section A and the calculations are based on standard portfolio at risk calculation of: (outstanding loan principal for loans in arrears over X days)/(total portfolio outstanding).
 - (2) MI-BOSPO has rescheduled loans on a limited basis. They are tracked in the MIS, but are not automatically included in the PAR. In December 2003, the amount of rescheduled loans was less than 1,500 BAM (750 EUR). MI-BOSPO does not refinance loans.
 - (3) MI-BOSPO employees are not eligible for any loan from the institution.
6. Donations
 - (1) Revenue from donations is shown separately in the income statement.
 - (2) Please refer to Appendix “Description of funding sources” for a table of donations received to date.
 - (3) All grant revenue is passed through the income statement.
 - (4) Please refer to the appendix on Adjustments for details on in-kind donations.
 - (5) These financial statements segregate the equity received from donations from the equity earned from profits since 1999.
7. Details of liabilities
 - (1) Details on funding liabilities are provided in Appendix “Description of funding sources”
 - (2) MI-BOSPO has no savings collection.
8. Other significant Accounting Policies
 - (1) MI-BOSPO’s accounting is performed on an accrual basis.
 - (2) The depreciation of fixed assets on a flat basis using the following schedule:

Asset Class	%
Furniture and equipment	11 – 13
Vehicles	16
Computer equipment	25
 - (3) Exchange gains and losses on accounts denominated in foreign currencies are recorded in the income statement.

Specific notes to the financial statements

These financial statements have been certified without reserve by REVIK d.o.o Sarajevo.

Balance Sheet

1. **Short Term Gross Loan Portfolio:** Includes only the parts of the loans that are due within one year.
2. **Loan loss reserve:**

Loan loss reserve constitution	Provision	Dec. 2001	Dec. 2002	Dec. 2003
Healthy portfolio	1.0%	57,911	81,507	109,515
PAR < 30 days	20%	5,778	3,617	11,061
PAR 31-60 days	60%	4,099	4,987	5,471
PAR 61-90 days	80%	8,994	6,927	5,943
PAR > 90 days	100%	-	-	6,516
Theoretical reserve		76,782	97,038	138,506
Reserve on balance sheet		78,293	97,038	147,180

3. **Accounts receivable and other assets:** Accounts receivable on employees, prepaid consulting fees, other current assets
4. **Long Term Net Investments:** Restricted deposits secured until Nov. 2005, guaranteeing the 3,000,000 BAM revolving loan from Raiffeisen. These deposits are remunerated 1,75% of their annual level.
5. **Long Term Gross Portfolio:** MI-BOSPO began issuing long term loans (with initial maturity of more than one year) in June 2002. The maximum maturities are 15 months for group loans and 30 months for individual and agricultural loans. This category only includes the installments whose maturity is over one year.
6. **Net Fixed Assets:** In 2003, the fixed assets were 61% vehicles, 22% computer equipments, 14% furniture and equipment and 3% construction in progress.
7. **Short term borrowings:** Details on funding sources can be found in appendix. In 2003, loans from Raiffeisen, UMCOR and Triodos were due within one year.
8. **Accounts Payable and Other Short Term Liabilities:** Salaries payable, audit fee payable, accrued interest, bank fee payable, other liabilities.
9. **Long term borrowing:** Details on funding sources can be found in appendix. In 2003, loans from LID, UNHCR, Deutsche Bank, KfW had maturity date over one year.
10. **Donated equity:** Includes all donations received since 1999 (donations for operating expenses and donations for on-lending).
11. **Retained earnings without donations:** Accumulated retained earning of which all donations have been subtracted.

Income Statement

12. **Fees and commissions on loans:** The institution stopped charging commissions on loans in April 1st, 2001, to avoid the tax burden it incurred.
13. **Financial Revenue from Investment:** Interest on deposits in bank
14. **Other Operating Revenue:** Gain on exchange rate
15. **Other Financial Expenses:** Exchange loss
16. **Personnel expenses:** Wages and salaries, taxes and contribution, hot meals for employees, wages of temporary workers.
17. **Consulting fees:** External audit, lawyer, accounting service.
18. **Others:** The most important costs in this category are (in declining order of importance) vehicles and fuel (17%), marketing (17%), communication (16%), stationery and office supplies (13%), staff retreat (12%), fees to board of directors (9%), education of employees (8%), utilities (6%)

MI-BOSPO Balance sheet	BAM				EUR			Evolution		
	Notes	Dec. 2000	Dec. 2001	Dec. 2002	Dec. 2003	Dec. 2001	Dec. 2002	Dec. 2003	2002/2001	2003/2002
ASSETS		4,117,007	7,281,743	9,960,732	13,166,845	3,723,096	5,092,841	6,732,101	36.8%	32.2%
Short Term Assets			6,300,298	8,356,728	11,124,195	3,221,291	4,272,727	5,687,711	32.6%	33.1%
Cash and Due from Banks			432,706	436,206	578,047	221,239	223,029	295,551	0.8%	32.5%
Short Term Investments									-	-
Short Term Net Loan Portfolio			5,778,751	7,797,470	10,398,400	2,954,628	3,986,783	5,316,617	34.9%	33.4%
Short Term Gross Loan Portfolio	1	3,837,943	5,857,044	7,894,508	10,545,580	2,994,659	4,036,398	5,391,869	34.8%	33.6%
(Loan Loss Reserve)	2	69,335	78,293	97,038	147,180	40,031	49,615	75,252	23.9%	51.7%
Interest Receivable			86,695	121,559	147,328	44,326	62,152	75,328	40.2%	21.2%
On loan portfolio			86,695	121,559	147,328	44,326	62,152	75,328	40.2%	21.2%
On investments									-	-
Accounts receivable and other assets	3		2,146	1,493	420	1,097	763	215	(30.4%)	(71.9%)
Long term assets			981,445	1,604,004	2,042,650	501,805	820,114	1,044,390	63.4%	27.3%
Long Term Net Investments	4		832,933	1,104,363	1,042,650	425,872	564,652	533,098	32.6%	(5.6%)
Long Term Gross Loan Portfolio	5	0	0	291,274	477,818	0	148,926	244,304	-	64.0%
Net Fixed Assets	6	119,321	148,512	208,367	522,182	75,933	106,536	266,987	40.3%	150.6%
Other Long Term Assets									-	-
LIABILITIES AND EQUITY			7,281,743	9,960,732	13,166,845	3,723,096	5,092,841	6,732,101	36.8%	32.2%
Liabilities			5,438,521	5,948,158	8,082,115	2,780,672	3,041,245	4,132,320	9.4%	35.9%
Short term liabilities			1,501,671	1,913,896	2,529,296	767,792	978,559	1,293,209	27.5%	32.2%
Short Term Borrowings	7	146,300	1,462,000	1,783,500	2,376,424	747,509	911,889	1,215,046	22.0%	33.2%
Interest payable										
Accounts Payable and Other Short Term Liabilities	8		39,671	130,396	152,872	20,283	66,670	78,162	228.7%	17.2%
Long term liabilities			3,936,850	4,034,262	5,552,819	2,012,879	2,062,685	2,839,111	2.5%	37.6%
Long Term Time Deposits									-	-
Long Term Borrowings		3,236,000	3,936,850	4,034,262	5,552,819	2,012,879	2,062,685	2,839,111	2.5%	37.6%
Other Long Term Liabilities	9								-	-
Equity		692,861	1,843,222	4,012,574	5,084,730	942,424	2,051,597	2,599,781	117.7%	26.7%
Paid-In Capital									-	-
Donated equity	10	311,246	890,983	2,384,275	2,391,796	455,552	1,219,060	1,222,906	167.6%	0.3%
Retained earnings without donations and reserves	11		952,239	1,628,299	2,692,934	486,872	832,536	1,376,875	71.0%	65.4%
Current year			570,624	676,060	1,064,635	291,755	345,664	544,339	18.5%	57.5%
Other equity accounts									-	-

MI-BOSPO Income Statement	Notes	BAM			EUR			Evolution	
		Dec. 2001	Dec. 2002	Dec. 2003	Dec. 2001	Dec. 2002	Dec. 2003	2002/2001	2003/2002
Financial Revenue (a)		1,581,060	2,339,658	3,248,227	808,383	1,196,248	1,660,792	48%	38.8%
Financial Revenue from Loan Portfolio		1,581,060	2,291,268	3,168,999	808,383	1,171,507	1,620,283	44.9%	38.3%
Interest on Loan Portfolio		1,512,638	2,281,430	3,150,017	773,400	1,166,477	1,610,578	50.8%	38.1%
Fees and Commissions on Loan Portfolio	12	53,215	0	0	27,208	0	0	(100.0%)	-
Penalty Revenue on Loan Portfolio		15,207	9,838	18,982	7,775	5,030	9,705	(35.3%)	92.9%
Financial Revenue from Investments	13	0	0	20,938	0	0	10,705	-	-
Other Operating Revenue	14	0	48,390	58,290	0	24,741	29,803	-	20.5%
Financial Expense (b)		153,288	366,351	463,283	78,375	187,312	236,873	139.0%	26.5%
Interest paid on borrowings		131,984	256,954	401,877	67,482	131,378	205,476	94.7%	56.4%
Net Inflation Adjustment Expense									
Other Financial Expenses	15	21,304	109,397	61,406	10,893	55,934	31,396	413.5%	(43.9%)
Financial income [c=a-b]		1,427,772	1,973,307	2,784,944	730,008	1,008,936	1,423,919	38.2%	41.1%
Net Loan Loss provision expense (d)		51,609	66,658	117,161	26,387	34,082	59,903	29.2%	75.8%
Loan loss provision expense and write off		53,755	74,469	124,201	27,484	38,075	63,503	38.5%	66.8%
Recovery from Loans written off		2,146	7,811	7,040	1,097	3,994	3,599	264.0%	(9.9%)
Operating expense (e)		805,539	1,230,589	1,603,148	411,866	629,190	819,676	52.8%	30.3%
Personnel Expense (includes fringe)	16	484,672	785,430	1,091,315	247,809	401,584	557,980	62.1%	38.9%
Administrative Expense (non-staff operating expenses)		320,867	445,159	511,833	164,057	227,606	261,696	38.7%	15.0%
Depreciation and amortization		28,260	38,612	56,667	14,449	19,742	28,973	36.6%	46.8%
Consulting fees	17	68,157	90,674	45,302	34,848	46,361	23,163	33.0%	(50.0%)
Rental costs		49,718	56,665	67,828	25,420	28,972	34,680	14.0%	19.7%
Travel costs		17,737	28,750	14,496					
Bank fee		40,248	42,170	55,658					
Others	18	116,747	188,288	271,882	59,692	96,270	139,011	61.3%	44.4%
Net Operating Income Before Taxes and Donations [f=c-d-e]		570,624	676,060	1,064,635	291,755	345,664	544,339	18.5%	57.5%
Income Taxes (g)								-	-
Net Operating Income Before Donations [h=f-g]		570,624	676,060	1,064,635	291,755	345,664	544,339	18.5%	57.5%
Non Operating Revenue (i)								-	-
Non Operating Expense (including related taxes) (j)								-	-
Net Income Before Donations [k=h+i-j]		570,624	676,060	1,064,635	291,755	345,664	544,339	18.5%	57.5%
Donations (l)		579,737	1,493,292	7,521	296,415	763,508	3,846	157.6%	(99.5%)
Net Income (after Taxes and Donations) [m=k+l]		1,150,361	2,169,352	1,072,157	588,170	1,109,172	548,185	88.6%	(50.6%)

Adjustments

MI-BOSPO (BAM)	Dec-01	Dec-02	Dec-03
Adjustment for the cost of funds = A * F - G	328,820	401,197	385,844
A. Funding needs = (b - c)	3,840,037	5,484,591	7,877,214
b. Avg monthly difference between portfolio and savings	4,406,925	6,581,320	9,713,738
c. Equity that used to finance the portfolio= d * e	566,888	1,096,729	1,836,524
d. Avg equity, net of donations	666,927	1,290,269	2,160,617
e. % of equity that may be on lent	85.0%	85.0%	85.0%
F. Shadow price of borrowings	12.0%	12.0%	10.0%
G. Interest expense on borrowings	131,984	256,954	401,877
Adjustment for inflation = (H + I -A - M) * N	0	0	0
H. Avg. equity net of donations	666,927	1,290,269	2,160,617
I. Average donated equity	601,115	1,637,629	2,388,036
M. Average fixed assets	133,917	178,440	365,275
N. Inflation rate	0.9%	0.3%	0.9%
Adjustment for in-kind donations	76,650	23,700	7,080
a. Staff and technical assistance	76,650	23,700	7,080
b. Other	0	0	0
Adjustments for provisions	0	0	0
Loan losses	0	0	0
Other risks	0	0	0
Other adjustments	0	0	0
Total adjustments	405,470	424,897	392,924
Net income before donations	570,624	676,060	1,064,635
Adjusted net income before donations	165,154	251,163	671,711
Adjusted net income before donations (EUR)	84,442	128,418	343,440

Planet Rating performs the following adjustments for the calculation of financial self-sufficiency:

- Inflation adjustment: to account for the net effect of inflation on equity and fixed assets;
- Cost of funds adjustment: to estimate the cost that the institution would have paid if it financed itself at market rates. This adjustment accounts for the cost savings received from donated funds or concessional loans;
- In-kind donations: to account for the hidden cost of resources received that do not appear on financial statements, such as free consulting services, trainings, or use of property; and
- Loan loss provision adjustment: to standardize loan loss provision adjustments to the international standards similar to those used in the MicroBanking Bulletin.