Final Report of Mid-Term Evaluation of USAID/Egypt Small and Emerging Business Program

(Draft Final Report)

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List of Abbreviations and Acronyms

ABA	Alexandria Business Association
AsBA	Assuit Businessmen's Association
BAs	Business Associations
BdC	Banque du Caire
BDS	Business Development Services
CBE	Central Bank of Egypt
CGAP	Consultant Group to Assist the Poorest
CGC	Credit Guarantee Company
CRS	Catholic Relief Services
CIDA	Canadian International Development Agency
DBACD	Dakahleya Businessmen's Association for Community Development
EBI	Egyptian Banking Institute
EC	(Delegation of the) European Commission, Cairo
ECES/ILS	Egyptian Center for Economic Studies
EQI	Environmental Quality International
EU	European Union
GoE	Government of Egypt
INGOs	International Non-Governmental Organizations
KfW	Kreditanstalt für Wiederaufbau
MENA	Middle East and North Africa
MFI	Microfinance Institution
MFP	Microfinance Provider
MIS	Management Information System
MISA	Ministry of Insurance and Social Affairs
MSMEs	Micro-, small and medium-sized enterprises
NBD	National Bank for Development
NBFI	Non-Bank Financial Institution
NCBA	National Cooperative Business Association
NCW/WBDC	National Council for Women /Women's Business Development Council
NGO	Non-Governmental Organization
PBDAC	Principal Bank for Development and Agricultural Credit
PRSP	Poverty Reduction Strategy Paper
SBACD	Sharkeya Businessmen Association for Community Development
SEB	Small and Emerging Businesses Project
SEC	Small Enterprise Credit Project
SFD	Social Fund for Development
SMED	Small and Micro Enterprise Development Project
SMEpol	Small and Micro Enterprise Policy reform
TA	Technical Assistance
UNDP	United Nation Development Program
USAID	United States Agency for International Development

1.0 Executive Summary

This report is the result of a five-week assessment of USAID/Egypt's Small and Emerging Business Project (SEB). The assessment comprised of two different components: an evaluation of the SEB Project itself including implementing partners, approaches, objectives and outcomes; and an assessment of the microfinance industry in Egypt. Recommendations to USAID/Egypt on future support to the microfinance sector are based on the findings of these two assessment components.

1.1 Evaluation of the SEB Project

The SEB project evaluation consisted of a detailed review of six implementing partners including ABA, AsBA, BdC, DBACD, EQI and CGC. In addition, the evaluation included a review of the microfinance project objectives, approaches and outcomes of USAID/Egypt. USAID/Egypt's support to the microfinance sector started in 1989 and it has allocated a total of $141 million[1] since the beginning. It has worked with a total of nine partner business associations and two banks. Together, these institutions reach over 270,000 active clients as of June 30, 2004.

USAID/Egypt's approach has been to create retail NGO-Business Association partners and replicate the same institutional model across the country. The main lending methodologies used are individual lending and group lending. Since 1993 technical assistance has been provided by NCBA/EQI. The TA support included a package of services consisting of an MIS system, an accounting manual, the two loan products, training for loan officers as well as periodic support to staff on implementing any of these systems. USAID/Egypt has become known as the best practices donor and some of its partners are indeed among the best in Egypt.

USAID's activities over the past 15 years have enabled development of a number of market leaders who have achieved significant scale of outreach as compared to their peers in Egypt. One of USAID's most notable achievements is the introduction of two banks to microfinance, one of which is utilizing its own funds. USAID partner MFIs has been able to attain high portfolio quality through solid lending methodologies and mechanisms. On the other hand, USAID's approach has also created institutions that are heavily reliant on it for vision and growth. The technical assistance and training activities supported by USAID have not lead to independent and innovative MFIs. Rather, USAID's partners have limited products and lack the capacity to innovate and respond to market needs. Many of USAID's partner MFIs have limited institutional visions, lack sound governance, and are highly inefficient.

Some of the strategies used in the past by USAID, which were appropriate to introduce microfinance to the market, are no longer appropriate as the industry is now at a different stage of development. While there are some strong MFPs in the market, there are considerable areas for improvement within these MFPs such as governance, capacity of management, back office systems and market orientation. USAID should broaden its support to address the above weaknesses at the retail level as well as ensure development of suitable support structures that can help all MFPs increase market penetration.

1.2 Assessment of the Small and Microfinance Sector in Egypt

A Financial Systems Approach was used to review the microfinance sector. A key point to note here is that though in Egypt this sector technically (by internationally accepted definition of loan sizes below 250% of GNP per capita) consists of micro-enterprise financing it is referred to as ‘small and

1 See Annex 10.

microfinance' sector. Although the Assessment Team is aware of this misnomer it will use the term Small and Microfinance in this report as recommended by USAID. The Financial Systems Approach includes analysis of the enabling environment, the retail providers of small and microfinance, the capacity building providers and the clients. Overall the small and microfinance industry in Egypt appears to be highly fragmented and this fragmentation has led to limited interaction across groups, limited sharing of information, and little common vision or strategy to address their shared environmental constraints. In general, there is a low level of application of good practices across all levels of stakeholders – policy-makers, donors, TA providers, wholesalers and retail providers of microfinance. A sectoral assessment is made further challenging by the lack of consolidated, accurate and reliable data on the industry. Key findings across each level of analysis are provided below.

At the client level, the Assessment Team observes that there is considerable lack of clarity on the target clientele by all stakeholders. As opposed to international accepted principles the market for microfinance in Egypt is defined by size of the enterprise instead of poor households. Furthermore, there is no agreed definition among the various stakeholders as to what constitutes 'micro' or 'small and medium' enterprise. The size of the market for small and microfinance is estimated to be around 2 million. Access to finance continues to be listed as one of the major constraints to growth of this sector but there is low level of market penetration, currently estimated to be less than 14%.

The retail level is comprised of NGOs, government programs and a small number of banks. The entry of banks in this sector was prompted largely by USAID's initiative. There is significant depth of outreach (loan sizes ranges well below 250% GNP per capita) by Egyptian MFPs but in general few of the providers have achieved scale. The dominant methodologies for credit delivery are individual lending. Group lending is also popular among some MFPs to reach poorer clients. The gender balance has also steadily moved towards poor women. The MFPs continue to be largely donor-dependent and lack institutional identity and vision and are influenced more by the primary funding agency's vision for them than as an independent entity with a specific mission. Capacity of senior and middle management is a common source of weakness in these institutions. There is little exposure to, and incorporation of international good practice microfinance. Although the MFPs demonstrate sound knowledge and practice of their lending methodology, their focus on the donor as opposed to their clients, makes them more 'supply-driven' and not market-oriented towards the financial needs of target clientele. As noted by USAID itself there is little diversity in the range of financial products offered to clients and savings is noticeably absent as are BDS for clients. With regard to back office systems there is also much room for improvement. There are few real commercial linkages between MFPs and formal financial institutions and banks allow overdraft facilities to MFPs on the basis of guarantees which are leveraged often at a rate less than 1:1. None of the banks lend to MFPs on the basis of their primary asset – loan portfolio. In comparing with select other regions, some of the key providers in Egypt match or exceed averages in terms of outreach and profitability but leave room for improvement on efficiency such as caseload per loan officer.

As for support structures, there are few local technical service providers to MFPs. The quality of local technical service provision is low and has not evolved with the needs of the MFPs and neither are some of the major providers aware of and apply established international best practices. Wholesalers of finance to the retail institutions are few and far between and their effectiveness is limited. There are few other support structures such as credit bureaus etc. for the industry.

At the policy, legal and regulatory level, the findings suggest a fragmented set of stakeholders with several parallel and conflicting policies and strategies on (medium) and small enterprise finance, which include microfinance. In the fragmented, crowded and intensely competitive donor 'market', USAID/Egypt has been able to maintain a strong focus on best practices, outreach and financial sustainability. However, there is no Code of Conduct at any level, whether donor, government, or retail. While current legislation does not hinder operation of the small and microfinance sector it is also not enabling the growth of the sector to the next level and eventual integration into the financial sector of Egypt.

1.3 Recommendations for Future Programming in Microfinance

As the microfinance sector has grown and is now in a relatively more developed stage than when USAID commenced its activities in the sector, USAID should now focus on sector-building as opposed to institution-building in which it has played a vital role in the past. Industry-building can be accomplished by adoption of the options below by USAID/Egypt. It is expected that these recommendations will result in significant progress towards creating an integrated financial system providing access to market-responsive and sustainable financial services to the poor and low-income population. It will also secure USAID/Egypt's position as a forward-thinking market leader for microfinance among the donor community and in the financial sector at large.

General good practice principles should guide all investments. Many of the key investment principles are already applied by USAID/Egypt and others need to be incorporated for the future investments in consideration of adopting a sector-development approach as opposed to an institutional-building approach. Key investment principles include *adherence to free market principles, transparent selection process; demand-driven support; fostering local capacity for capacity-building services; cost participation, increasing over time; continued assistance dependent upon performance.*

The Team recommends the use of an umbrella Facility to accomplish USAID objectives, while promoting sound principles. The umbrella facility would be responsible for:

1. ***Issuing sub-contracts for technical assistance and training***. Given that the needs of the MFPs differ by their stage of development and it is unlikely that any one firm can be best equipped to satisfy all of these needs, this Facility could help source multiple providers who are the most qualified in the relevant technical area. In operational terms, the Facility would be tasked with working with MFPs to identify their capacity building needs and then sub-contracting out these task orders/RFPs/TORs to the best qualified local or international TA providers.

2. ***Provide support for operations***. As a general rule, grants for operations or equipment should be allowed only in the early stages of development but should be phased out as an organization matures.

3. ***Provide support for portfolio capitalization.*** Institutions should be supported in accessing grant or concessional loans in the earlier years of development but should progressively source commercial sources of financing as they mature.

4. ***Supporting the Development of a National Microfinance Practitioner's Network.*** AViD recommends that USAID champions the establishment of a national Egyptian network/association of microfinance practitioners to develop a shared vision and strategy to alleviate the constraints facing the sector. In preparation for creating a national network, it is recommended that USAID support a Secretariat vested with the responsibility of industry-building.

5. ***Supporting an Enabling Environment.*** At the policy level it important to begin to engage government agencies which have a distortionary effect on the industry. Donor coordination may be the best approach to achieving impact at this level.

   At the legal and regulatory level, USAID should not seek new legislation for microfinance in the immediate term. Rather than legislation, the easing of the legal and regulatory constraints can begin with a process to build consensus among the various 'sub-groups' of stakeholders such as government agencies, donors, practitioners and service providers. MISA, as the regulatory and supervisory body for NGO/MFIs, does not have the capacity nor the knowledge to properly oversee microfinance institutions and an alternative regulatory institution should be selected.

In the long-run, Egyptian legislation needs to allow for commercially oriented, financial intermediaries serving the poor. This will eventually require modifications in the existing legal and regulatory framework. It is important that USAID promote a participatory and informed process to reaching the final recommendations to government.

2.0 Background

USAID began its support to assist the Government of Egypt (GoE) in revitalizing the MSME sector in 1989 with the Small and Micro Enterprise Development Project (SMED) designed to enhance the capacities of Business Associations to act as viable financial intermediaries. In 1991, the Small Enterprise Credit Project (SEC) helped establish an SME lending unit at the National Bank for Development (NBD) serving Greater Cairo and increased funding support to several other Business Associations around the country. As a continuation of its support to the MSME sector, USAID initiated the Small and Emerging Business (SEB) Project in 1999 under the Intermediate Result 16.3 Enhanced Opportunities for Business Growth of the Economic Growth Strategic Objective SO 16: Strengthened Environment for Trade and Investment.

In preparation for the next phase of its involvement in the microfinance sector, USAID/Egypt contracted Avid Consulting Corporation, a U.S. based 8 (a) small business, in September 2004 to conduct a Mid-term Evaluation of the SEB project. The Scope of Work (see Annex 1) included a review of selected USAID-funded partner institutions; an assessment of the SEB project model; and an overall microfinance sector review as the basis for recommendations to USAID/Egypt for future activities and products for the development of Egypt's microfinance sector.

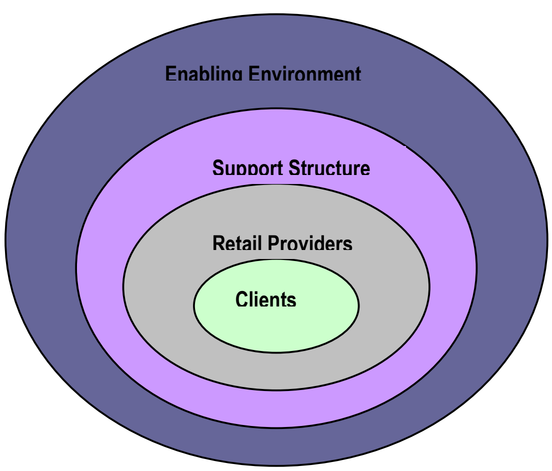
The AViD Team consisted of three international experts in microfinance and two local consultants and the assessment took place between September 20 and October 21, 2004.

This report presents the findings and recommendations of the AViD Team. The views and recommendations expressed in this report are those of the AViD Team, and do not necessarily represent the views of Egyptian microfinance stakeholders, nor of USAID/Egypt.

3.0 AViD Methodology

AViD used a Financial Systems Approach to analyze the microfinance sector. This approach breaks down analysis into four levels: the enabling environment, the supporting infrastructure, the providers and the clients.

Figure 1: Financial Systems Approach



At the level of the SEB project, the evaluation reviewed the six pre-selected institutions listed in the Scope of Work including Alexandria Business Association (ABA), Dakahleya Businessmen's Association for Community Development (DBACD), Assiut Businessmen's Association (AsBA), Banque du Caire (BdC), the Credit Guarantee Company (CGC) and Environment Quality International (EQI). The review also included analysis of the approach, strategy and targets of the SEB program and the resulting impact this approach has had on the overall development of the sector.

The assessment comprised of a review of secondary sources and primary data collection through field visits to the pre-selected institutions and semi-structured interviews with: key persons at the USAID-supported MFPs; TA providers such as EQI and CGC; and, other industry stakeholders including non-USAID supported MFPs, donors and policy-makers. In order to gain an understanding of the philosophy and rationale of the previous and on-going USAID programs in microfinance, members of the AViD team met with USAID personnel including program staff, contracts staff and SEB staff at the Mission and a representative from the EGAT/MED Office in USAID Washington. Additionally, Focus Group Discussions and individual interviews with clients were held wherever possible to glean information on the financial needs and products desired by the target segment. Client information was also obtained from impact research studies conducted by EQI and independent consultants. A list of of persons met is given in Annex 2 and a list of documents reviewed is available in Annex 12.

This report is divided into seven main sections. Sections One through Three present the Summary, Background and Methodology. Section Four presents the political, economic, legislative and regulatory environment and historical developments for MSME finance in Egypt. Section Five presents the historical evolution, achievements and missed opportunities of the USAID funded SEB program Section Six covers the findings of the Assessment Team on clients and the market, the microfinance providers, their support (training, TA and finance) service providers, and their donors. Section Seven offers recommendations to USAID/Egypt for microfinance based on constraints and gaps identified in the market. A series of annexes to this report provide greater detail on all of the organizations evaluated in this mission.

4.0 The Setting for Microfinance in Egypt

4.1 Country Profile of Egypt

Egypt is one of the largest countries in the Middle East and North Africa (MENA) region, both in terms of land mass and population. The majority of Egypt's 68.1 million inhabitants live in approximately 5% of the country's land concentrated in the narrow Nile Valley and Delta. Egypt's GNI per capita is $1,360, placing it as a middle-income country. Starting in 1991, the country has been on a reform path spurred by liberalization of the economy. The liberalization included controlling inflation and dismantling the public sector dominance of the economy. It has also included the elimination of credit controls and liberalization of interest rates and foreign exchange regimes. The fiscal balance, foreign reserves, and external debt have all improved since the late 1980s. Egypt's GDP growth reached a high of 5.6% per annum in the late 1990s but has fallen to only 3.2% per annum since 2002. The service sector is the most dominant in the economy comprising nearly 50% of GDP.

There are 1.7 million people and 25.9 million[2] poor people respectively in Egypt living on or below \$1.08/day PPP_{1993}[3] and \$2.15/day PPP_{1993} respectively. The findings from the Poverty Reduction Strategy (PRSP) suggest that poverty incidence in Egypt fell from 19.4 percent in 1995/96 to 16.7 percent in 1999/2000. The distribution of poverty varies with region, with a higher concentration of the poor in Upper Egypt. Poverty rates in rural areas reach up to 22% of the population and approximately 54% of all poor in Egypt live in the rural areas of Upper Egypt. The lowest concentration of poor is in the Metropolitan regions (Cairo, Alexandria, Port Said, Suez). According to the above-mentioned World Bank study, the determinants of poverty in Egypt reveals that household size, household demographic composition, and the level of education and employment

2 El-Laithy, H., Loshkin, M., and Banerji, A. *Poverty and Economic Growth in Egypt 1995-2000* and Policy Research Working Paper, World Bank 2003.
3 Purchasing Power Parity is the rate of exchange between two countries at which the price of a representative basket of goods is the same.

status of the head of the household are important factors affecting household capacity to escape poverty.

Current official estimates place unemployment at 9%, although it is widely believed to be higher. The labor force in Egypt has been growing at 2.7% per year and half a million job seekers enter the market each year. Official unemployment statistics indicate that female unemployment is almost three times that of male unemployment. Although women's participation in the labor force increased five times faster than men's during 1980-1996, the participation rate in 1996 was 25% for women compared to 73% for men.

4.2 The Financial System and the Banking Sector

The Central Bank of Egypt (CBE) uses money supply targeting as its main policy tool and is responsible for processing of licenses and registration of banks and financial institutions. The CBE has issued a moratorium on new bank licenses since 1983 and is currently in the process of reforming the banking sector, including consolidation and rationalization of the existing 62 banks with over 2,300 branches. The banking sector is not very competitive, consumer-oriented or efficient due to the preponderant influence of public sector banks, which are poorly managed and have low operating standards.

The formal banking sector of Egypt is comprised of commercial banks, business and investment banks, and specialized banks such as industrial banks and agricultural banks. Though the number of private commercial banks far exceeds the number of public sector banks, the latter have a much larger branch network than the private banks, not surprisingly. These public banks (Banque du Caire, Bank Misr, National Bank of Egypt and Bank of Alexandria) account for 50% of the banking system's total assets and 58% of the total deposits.

There is a wide range of financial products offered by the formal financial sector in Egypt. These include retail, corporate and investment banking; consumer credit; real estate financing; industrial and agricultural financing; leasing; fund management; and insurance. The lending products are primarily short-to-mid term and the market interest rate is approximately 14% per annum, with a 2% variance based on the credit risk of the borrower. All commercial banks offer savings products, with public banks offering rates of return that are 1% less than private banks. Term deposits, foreign currency deposits and long-term treasury notes are also offered. Islamic banks do not offer interest earning deposits but instead offer investment deposits with quasi-guaranteed returns.

Confidence in the Egyptian banking sector is fairly high and the CBE is known to have intervened to prevent bank collapses in the past (i.e. Pyramids Bank, Islamic Bank for Investment and Development). There is no deposit insurance fund in the Egyptian banking system but the general perception of the public is that the public banks are more secure than private ones because of the potential for government bail-out if necessary.

In addition to the banks, there are 11 insurance companies in Egypt. Three public companies along with the Egyptian Re-insurance Company account for 90% of the market share. Legally, joint ventures in insurance are allowed as long as they provide only one kind of insurance – life or non-life. The Egyptian Insurance Supervisory Agency (EISA) regulates all insurance companies. All financial institutions such as funds, investment-banking companies and leasing companies as well as the stock exchange and securities market that do not come under the CBE or EISA supervision are regulated by a variety of authorities such as the Capital Market Authority (CMA), Mortgage Finance Authority, Investment Authority, among others.

Semi-formal actors providing financial services in Egypt include Business Associations (BAs), NGOs, and "projects" within multi-sectoral development agencies. As legal regulations prevent most of these actors from offering savings products the focus of activities for these institutions is the provision of credit, both in-kind and cash products. None of these entities are subject to prudential regulation.

In addition to semi-formal financial service providers, there are numerous informal sources of finance in Egypt, the most common being the *Gamiya* or ROSCAs and moneylenders both of which primarily cater to the lower-income market segments. Of course, informal providers operate beyond any regulatory framework.

The sections below discuss more in detail the current state of policy, regulatory and legal regimes that pertain to microfinance and the provision of financial services to the poor.

4.2 The National Policy Dialogue

Currently, there is no national policy framework for microfinance in Egypt. Additionally, policy dialogue has attempted to combine the full gamut of enterprises from micro to medium, despite their very different approaches, methodologies, needs and preferences. The objectives of poverty reduction, employment generation, integration of the financial system and expanded financial service provision have been combined and a strategy that addresses all of these objectives has been sought. The AViD Evaluation Team finds that the lack of segregation of microfinance from SME finance is a major source of confusion for setting policy and is a major reason for the lack of national consensus. Table 1, below, illustrates the inherent differences between Microfinance and SME finance.

Table 1: Key Differences Between Microfinance and SME Finance

Microfinance	SME Finance
Tool for poverty reduction.	Tool for employment generation.
Provided by informal, semi-formal and formal financial institutions.	Usually semi-formal and formal financial institutions.
Loans based on social collateral.	Loans based on cash-flow analysis of enterprise and physical collateral at times.
Household is unit of analysis.	Enterprise is unit of analysis.
Business activity is almost always in the informal sector.	Business activity is often formal and registered with appropriate authorities.

Because the enterprise continues to be the main unit of analysis in Egypt, and not the household, there is continued discussion as to the definitions of micro-, small and medium enterprises. USAID's definition of micro-enterprises, as defined by USAID Washington, is firms with up to 10 employees. The SFD follows a separate definition, as set in the new SME Law, which identifies micro-enterprises as those with fewer than 5 employees and with less than £E 50,000 paid up capital. Small enterprises are defined as those with between 5 to 49 employees. Other ministries, such as the Ministry of Agriculture or the Ministry of Industry, each uses its own separate definition. In Egypt, the abbreviation "SME" is used to refer to Small and Micro Enterprises, rather than the usual Small and Medium enterprise, adding further confusion and once again lumping vastly different categories of firms within one group.

There are numerous players within the government who are engaged in setting policy (see Map of Stakeholders, Annex 3), often in an uncoordinated manner resulting in several parallel and overlapping initiatives. As a general rule, non-governmental stakeholders have been kept out of the process for setting any of the policies that affect them and their reactions to draft initiatives are not incorporated in final documents.

In a national policy paper issued in June 1998, with support from USAID, the then Ministry of Economy, articulated the role of MSMEs in the economy and presented a framework for the government's support. In this document, the government identified the need to minimize subsidies for satisfying the financial needs of MSMEs. It also identified the need for non-financial services such as training, technical support, and marketing. Soon after this effort, the Ministry of International Trade, through its unit focused on policy reform for SMEs (SMEPol)[4], developed a competitiveness strategy document. This paper identified the needs and ways in which the government could improve the competitiveness of SMEs in the Egyptian market, particularly for firms interested in trade.

The only attempt at present to define a national policy and strategy on microfinance as opposed to micro and small enterprises has been recently initiated by the Government of Egypt, along with the three main donors supporting the microfinance sector, USAID, UNDP and KfW. This one-year project is based on a series of roundtables with some of the stakeholders to define a national policy framework on microfinance which includes a shared vision on the promotion of a sustainable microfinance sector; a shared strategy on the necessary policy reforms, legal and regulatory changes relating to the financial infrastructure; and the definition of action plans for the Government of Egypt which different donors can support in coordination with the government. This project, while well intentioned, seems to be premature for the market in Egypt as not all stakeholders are involved nor do the various sub-groups of stakeholders share a vision for their respective constituencies.

4.4 The Legal and Regulatory Framework for Microfinance

The following analysis is based on a cursory look at the legal and regulatory landscape in Egypt and is not considered an exhaustive analysis. This section looks at the legal and regulatory framework for microfinance, and not the laws or regulations affecting MSMEs.

Currently, there is no separate law for microfinance in Egypt which is appropriate given the level of maturity of the industry. However, microfinance providers are affected by several existing laws including the NGO law, the SME law, the Companies Law and the Banking Law. Under the existing laws, the types of institutions which can legally offer some or all microfinance services in Egypt are banks and NGOs. Firms registered under the Companies law are not allowed to engage in insurance, banking, savings or investment of funds and there is no existing law for non-bank financial institutions (NBFIs). While NGOs are not given the full capacity to engage in all financial intermediation, they are not restricted from engaging in credit services. No other legal structure is allowed to engage in credit, deposit-taking, insurance or other form of financial intermediation.

In early 2004, the government issued Law 141, the Small Establishments Development Law, which identified the Social Fund for Development (SFD) as the arm of the government addressing the needs of MSMEs. While the new law does not address microfinance institutions per se, it does empower the SFD with the coordinating role for all financial and non-financial support to MSMEs. In addition to its coordination role, the SFD is to provide financial and non-financial services to MSMEs, serve as the licensing body for these firms, coordinate with all government agencies and other donors and providers, and channel provincial level funds that are to be used for on-lending to MSMEs. This law was itself drafted by the SFD as per the instructions of the Prime Minister, with little or no involvement of other stakeholders. The law seems to have ignored many of the major recommendations set forth in the policy papers of earlier years, which promoted the role of the government as facilitator and not provider and which also promoted a more commercial approach to addressing the financial needs of MSMEs.

4 SMEpol is now housed under the Ministry of Finance.

4.4.1 Banking Legislation and Regulation

Law 88 of 2003, the Central Bank, the Banking Machinery and Exchange Law, presents a high barrier of entry for institutions wishing to transform into banks or for entry of new banks interested in serving the microfinance market segment. As mentioned earlier, the CBE has had a moratorium on any new bank licenses since 1983. The business of banking is defined under this law as accepting deposits, obtaining finance, and investing funds in the form of credit. Any entity engaging in these activities must be registered as a bank. The paid up capital requirement for a bank is £E 1 billion (approximately $161 million) and banks must pay a registration fee for each office set at £E 7,000 for each branch and £E 10,000 for the head office. Banks are allowed to set their own interest rates and to define the parameters of lending, including the guarantees required. With regard to regulation, the CBE does not prioritize microfinance but sees its main focus on the overall banking sector.

While the existing banking law presents an insurmountable barrier of entry for new banks to serve the microfinance market (or for transformation of NGOs into banks), there is no legal restriction on banks downscaling their lending to serve this market segment. Of the 62 banks in Egypt, only 3 have entered the microfinance market. Through the initiative of USAID downscaling has been undertaken by the National Development Bank, Banque du Caire. Most recently Bank Misr has also entered the market of its own volition. Although the existing banking law does not prohibit banks from entering this market, Egyptian banking practices are considered unfavorable for reaching the MSME sector even though the and NBD, BdC and Bank Misr have demonstrated the profitability of serving this market segment. There appears to be a general bias among bankers in other banks (besides the above-mentioned 3) that the transaction costs of serving MSMEs is high and that these enterprises are high risk. To address the high risk factor, banks in turn require high levels of guarantees which are either unattainable or too costly for MSMEs to obtain.

4.4.2 NGO Legislation and Regulation

The existing NGO law applies to associations, NGOs and unions. This law was revised in July 2002 and although somewhat improved, it still poses many restrictions for the development of microfinance. Associations, NGOs and unions are regulated and supervised by the Ministry of Insurance and Social Affairs (MISA). MISA can remove board members or dissolve any of these organization should they engage in political activity, accept funding from foreign sources without approval, violate any laws or not adhere to specific assembly and board requirements as stipulated in the law.

The weaknesses related to the legal structure and regulation of associations and NGOs include:

- MISA's lack of understanding or technical capacity to oversee the work of microfinance institutions.
- The types of reporting required by MISA are appropriate for charities and social service organizations, but not for good practice microfinance institutions.
- There are highly restrictive governance rules in the law, which has created poor governance practices among NGO/MFIs.
- The law requires that the Chairman of the board sign all checks of the NGO. This is an inefficient system for any organization engaged in credit. It also allows the Chairman to be involved at a very operational level of the organization, rather than in his/her natural role as part of the governance structure. However, exemptions from this feature seem to be easily available and do not pose a serious constraint unless the NGO concerned wants to use it for other purposes such as centralizing authority.

4.4.3 Consensus Guidelines for Legislation and Regulation in Microfinance

As per CGAP Microfinance Consensus Guidelines – Guiding Principles on Regulation and Supervision of Microfinance MFPs that mobilize savings must be subject to prudential[5] regulation to both protect depositors and to prevent systemic risk in the banking and financial sector. Appropriate mechanisms for regulating such institutions need to be developed and it is preferred that the regulatory body for such institutions is housed within the central bank of the country which usually has the regulatory authority over all formal savings institutions and banks. However, MFPs which are primarily lending organizations should not be subject to prudential regulation as they do not present threat of systemic risk. Instead their activities and performance needs to be monitored through informal mechanisms such as a Practitioners Code of Conduct based on international best practice ensuring all the while that there are penalties to violations of such Code.

4.4.3 Conclusions

While there have been many attempts at creating a coherent national policy for the broad MSME market segment, the existing policy, legal and regulatory framework is fragmented. One of the main reasons for this fragmentation is the lack of clarity regarding the objectives and the target clients for microfinance versus that for SMEs. The AViD Evaluation Team believes that the policy dialogue would be greatly advanced with a broader understanding of microfinance and a segregation of microfinance from the much broader MSME framework.

Some banks such as BdC, NBD and Bank Misr have been able to downscale to reach a lower income market segment. None of these banks have required guarantees to integrate microfinance within their financial services. Given the limited regulatory constraints for banks to engage in microfinance, a continued focus by USAID on engaging banks to downscale could have significant impact on integration of microfinance within the financial sector.

Microfinance is an important poverty alleviation tool. While the banks engaged in microfinance have been able to downscale, few of them are able to reach as far down as NGOs. NGOs have thus been the primary intermediary for reaching the poor. However, the legal and regulatory focus for addressing the development of the microfinance sector must address the barriers that currently limit NGO's capacity to grow and provide a broader array of financial services to their clients.

NGO/MFIs have trouble accessing commercial loans without guarantees nor can they mobilize savings, thus their future to operate independently of donor support is questionable. Due to these restrictions imposed by their legal status, NGOs are not the best institutional form for a commercially oriented financial intermediary serving low income households. The existing legal framework does not allow for non-bank financial institutions or companies to engage in financial services. Additionally, there is a high barrier of entry and a moratorium on any new banks so the potential for creating greenfield 'microfinance banks' is small. Therefore NGO/MFIs have limited ability to transform into more commercially oriented businesses, whether it is NBFIs, specialized Micro-Deposit Taking Institutions (MDIs) or banks.

There has been a great deal of international experience in recent years on the issue of legislation and regulation for microfinance. In some countries, separate laws addressing microfinance have been

5 Regulation or supervision is prudential when it governs the financial soundness of licensed intermediaries' businesses, in order to prevent financial-system instability and losses to small, unsophisticated depositors, *CGAP Microfinance Consensus Guidelines – Guiding Principles on Regulation and Supervision of Microfinance.*

issued.[6] In other countries revisions of the existing laws allowing for special windows for microfinance, whether under the NGO law or the banking law, have been pursued. Before engaging in major legal and regulatory revisions, it is important for Egypt to assess its existing legislation and regulatory bodies and determine the best approach to be taken. In terms of supervision, the current supervisory authority for most NGOs, MISA, is inadequate and inappropriate for supervising NGOs offering financial services. There is a clear need for a separate authority that is better suited to supervise these institutions qualified to ensure adherence to consumer practices and at the same time allowing the room for innovation in delivering financial services to the poor.

6 This includes BiH, Ethiopia, Uganda, Honduras, Kyrgyz Republic and Pakistan.

5.0 The USAID Small and Emerging Businesses (SEB) Project

5.1 Historic Evolution and Positioning

USAID/Egypt was one of the very first donors to utilize microfinance as a development approach to address unemployment and poverty in the country. USAID began its support under the agricultural Strategic Objective to rural and agricultural credit with a three year project through the PBDAC. This project had mixed results and was discontinued. A US$40 million agreement was signed with the Ministry of International Cooperation for the Small and Micro Enterprise Development Project (SMED) in 1989 with the aim to enhance the capacity of NGOs to act as financial intermediaries. Since the early 1990s, USAID/Egypt has re-engaged with the Government and the banking sector to increase small entrepreneurs' access to credit through the establishment of a Credit Guarantee Company and support to commercial banks. These two delivery mechanisms form the basis of USAID's support to microfinance in Egypt, which has thus been aimed at increasing access to finance (outreach) using sustainable vehicles (banks and viable NGOs).

USAID/Egypt's support since 1989 can be divided into three phases:

1. **1989-1995: Starting up**

   At this point in time the retail market for microfinance was relatively undeveloped with few institutionalized sources of microfinance. Hence under the SMED, four cooperative agreements were signed for support to 3 business associations in Alexandria (ABA), Port Said (SEDAP) and Cairo (ESED). In 1990, USAID/Egypt supported the establishment of the Credit Guarantee Company (CGC) to guarantee bank loans to small businesses backed by a soft loan from the Government. In 1991, the $ 20 million Small Enterprise Credit Project (SEC) was approved, and a cooperative agreement awarded to the National Bank for Development (NDB) to deliver micro credit through 13 branches in Cairo. A planned expansion to Upper Egypt did not materialize, and the cooperation ended in 1996. Three contracts with ACDI/VOCA and the US PVO National Cooperative Business Association (NCBA) were awarded for technical assistance. A total of $42,515,910 was awarded during this phase.

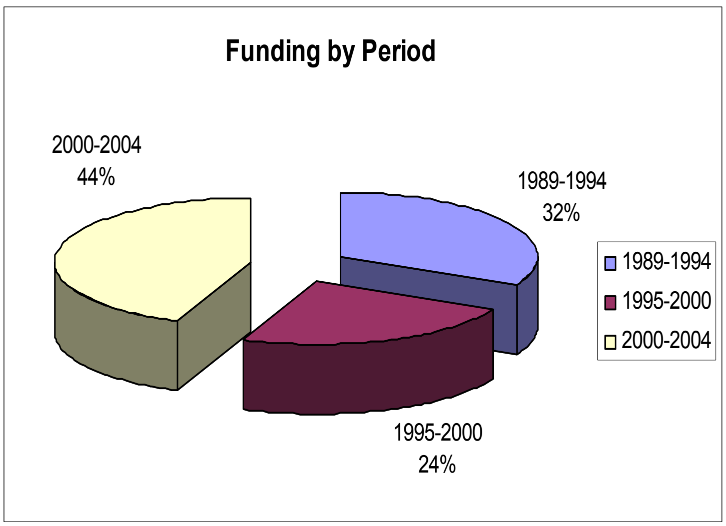
2. **1996-2000: Replication**

   Based on an amendment to the SEC Project document, the two delivery mechanisms were consolidated into the $85 million Small and Emerging Business (SEB) Project approved in 1997. Three new business associations were established in Assiut (AsBA), Sharkeya (SBACD), and Dakahlya (DBACD), enabling growth of outreach numbers and geographic coverage beyond the urban centers. After a prolonged delay, a $9 million financing agreement with CGC was signed in 1999 to augment its guarantee funds, but the intended out-sourcing to CGC of the management of new operational grants and collateral guarantees did not come to fruition. A total of $31,330,407 was awarded during this phase.

3. **2001-2004: Diversification**

   At the level of MFPs a combination of factors spurred growth during this phase – a massive devaluation of the Egyptian pound which effectively doubled the USAID/Egypt funds allocated as US$ bank deposits against which business associations could borrow; and a group loan product was introduced to reach poor women and thus deepened outreach. At the level of the USAID/Egypt SEB program, growth occurred with the signing of 5 cooperative agreements with business associations (LEAD, ABA, AsBA and DBACD), awarding of a new contract to NCBA/EQI for continued TA provision, and signing of a memorandum of understanding with Banque du Caire for technical assistance to their micro credit product. The cooperative agreement with CGC to manage the operational and collateral support of banks and NGOs was finally signed in 2003, and CGC allocated funds to three former CARE-supported MFPs in Sohag, Aswan and Fayoum. Additionally, USAID/Egypt supported two research initiatives on formalization of informal enterprises (with ECES/ILS) and impact of SME development on poverty (with ERF), and supported a network of women's business centers (with NCW/WBDC). As a second engagement in industry building, USAID/Egypt also co-funded a national policy framework for microfinance with UNDP and KfW. A total of $52,854,058 was allocated during this phase, but a significant part of the allocated resources was not disbursed due to the devaluation. Figure 2 provides a snapshot of the different funding allocations by period.

Figure 2: USAID Allocated Funding by Period



Externally, USAID/Egypt has differentiated itself from other donors in the microfinance market with the sheer volume of funds available, and is known as a "good practices" player in the field. USAID is considered the most dominant and influential bilateral donor in the industry in Egypt. Its partners include the largest institutions in Egypt in terms of client outreach.

Internally in USAID/Egypt, the support for microfinance has been a consistent part of the Economic Growth: Strengthened Trade and Investment Environment Strategic Objective since the 1990s. At inception, the SEB Project was placed under the Strategic Objective: "Accelerated Private Sector-led, Export-Oriented Growth" and the related Intermediate Results (IRs): "Improved Capacity to Promote Small and Emerging Business Growth" and "Expanded and Deepened Financial Services." In the Strategic Plan for FY2000-2009 developed in 1999, SEB was placed as a project under the IR 16.3: Enhanced Opportunities for Business Growth. Following a review in 2000-02, the Results Framework was revised in March 2004, and USAID/Egypt's microfinance activities, including the SEB project are now placed more appropriately under IR 16.1: Modernized Financial Sector, where it can benefit from increased synergy with the policy- and macroeconomic support provided, especially under the Egypt Financial Services Project.

The following analysis takes into account USAID/Egypt's overall support to microfinance from 1988 to date, whether funded under SMED, SEC or the SEB Project, as several of the cooperative agreements issued in recent years have used obligated SEC or SMED funds.

5.2 Results Achieved

USAID has provided substantial support to the development of finance for micro- and small businesses in Egypt over the past 15 years and is credited with having funded some 70% of microfinance activity in Egypt. As there is no industry-wide compilation of outreach and performance data, this figure is considered a rough estimate. From a situation 15 years ago, when there were few semi-formal or formal MFPs, USAID/Egypt has successfully engaged two commercial banks and nine NGOs in the provision of financial services to low-income Egyptians.

In the fragmented, crowded and intensely competitive donor 'market', USAID/Egypt has been able to maintain a strong focus on best practices, outreach and financial sustainability. The investment has translated into considerable growth of outreach. USAID/Egypt's past support has created relatively solid 'market leaders' in the industry that have achieved significant scale and in some cases financial sustainability[7]. Combined, the current USAID institutions have reached a total of 265,688 active clients as of June 2004 with an outstanding portfolio of over $50 million.

Table 2: Performance of USAID Partners

Institution	Active Clients As of June 2004	Outstanding Portfolio LE	Outstanding Portfolio USD
1. ABA	39,917	52,497,503	$8,467,339.19
2. AsBA	49,432	48,834,300	$7,876,500.00
3. DBACD	26,752	30,808,235	$4,969,070.16
4. ESED	39,097	52,150,467	$8,411,365.65
5. SEDAP	5,078	6,862,083	$1,106,787.58
6. SBACD	15,585	19,054,168	$3,073,252.90
7. LEAD	3,474	1,820,414	$293,615.16
8. SPDA Fayoum	2,397	2,558,750	$412,701.61
9. SCDA Sohag	1,164	3,755,372	$605,705.16
10. Aswan	366	821,272	$132,463.23
11. Banque du Caire	63,426	118,341,519	$19,087,341.77
12. NBD	19,000	n/a	n/a
Total	**265,688**	**337,504,083**	**$54,436,142.42**

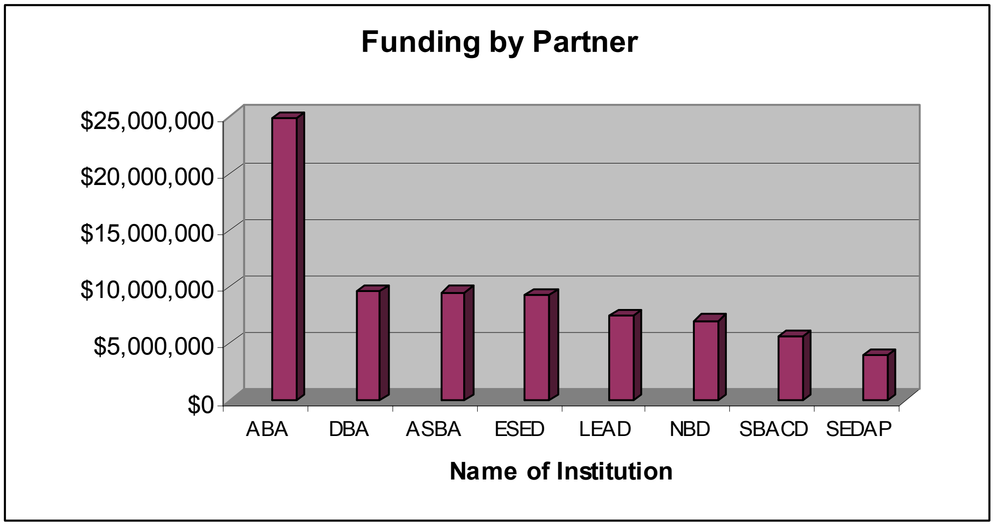
Source: NCBA/EQI Quarterly Report April-June 2004

USAID/Egypt's support has included direct cooperative grants with the MFPs that finance collateral guarantees, start-up costs and in some cases operational costs. Direct cooperative grants have ranged in size from $3.9 million to $9.3 million per institution, depending on the target outreach. Some MFPs have signed multiple cooperative agreements, such as ABA and AsBA, while others have only received one. As institutions have grown, direct operational support has been reduced for older branches, but is maintained for new start-up branches. As Figure 3 illustrates, ABA has been the largest recipient of USAID funding with an allocation above $24 million since 1989. Support to BdC has been in the form of technical assistance only, as defined by a Memorandum of Understanding by USAID and BdC.

7 It is difficult to verify self-reported OSS and FSS data from the MFPs. This evaluation team finds that there are many discrepancies in the data provided by the institutions and is thus unable to report on these figures. Aswan, for example, with only 366 loans outstanding as of June 30, 2004, reports 327.5% OSS. This number is clearly incorrect.

Since 2003, operating grants and collateral guarantees have been channeled through the Credit Guarantee Company. There remain four active direct cooperative agreements with ABA, AsBA, LEAD, and DBACD.

Figure 3: USAID Funding by NGO/MFPs



In addition to direct operational and capital fund guarantees for its partners, USAID/Egypt has issued four contracts for technical assistance. ACDI/VOCA was awarded one contract in 1995 at $1.5 million to support the NBD project. The remaining three contracts for $13,693,367 were awarded to NCBA/EQI for support to the business associations and Banque du Caire. Total funding for technical assistance thus far has been $15.1 million[8]. CGC, which functions as a wholesaling institution, has been allocated over $ 45 million by USAID to date.

5.2.1. Accomplishments and Areas for Improvement

Some of the key achievements of the USAID-retail-MFI partners include:

- Largest client outreach in Egypt
- Considerable depth of outreach with loan sizes averaging well below the cut-off point of 250% below GNP/capita
- Sound methodologies and credit delivery systems
- Low PAR
- Linkages with commercial banks have been established albeit with dollar-based collateral guarantees.

Areas for improvement include:

- Governance structures and mechanisms
- Institutional development as an independent financial services provider with its own vision beyond the vision of the donor
- Reducing the heavy reliance on one donor
- Improving commercial orientation
- Enhancing internal capacity for innovation, market orientation and product development
- Improving productivity.

8 This includes a contract for $1.5 million with ACDI/VOCA as well as three contracts with NCBA/EQI for $13,693,376.

With regard to USAID's technical assistance support structures the key accomplishments have been the following:

- Delivery of a sound credit methodology for microfinance
- Ensuring high outreach and profitability of MFIs
- Development of basic systems for a start-up MFI
- Provision of guarantee mechanism that may be required in the early stages of sector-development

However the support structures have fallen short in the following areas (closely related as one would expect given areas of improvement for MFIs listed above):

- Creating strong institutions that can function beyond the life of donor support
- Building processes of strong governance within MFIs
- Providing TA tailored to the stage of development of the MFI
- Capacity-building of management and staff at all levels
- Being market oriented to the needs of the clients
- Introducing and incorporating international best practice in the development of the sector
- Designing an appropriate guarantee mechanism that is approved and desired by potential retail MFIs

5.3 Approaches and Strategies

USAID/Egypt takes a ‘market leader' approach in microfinance, establishing and developing institutions to lead the industry by example. USAID has supported the founding of two models, the ‘NGO model' and the 'Bank model.' The 'NGO model' has entailed supporting the start-up of new business associations or working with an existing business association to incorporate microfinance as one of its activities. Due to restrictions in the previous NGO law, business associations were restricted to work in their own governorates. To reach broad outreach across the country, USAID expanded this model geographically by helping to create new institutions in many of the governorates in Egypt. Most recently, USAID has worked with three of the BAs to obtain approval from the government to work on a national scale although this support is reportedly dominated by USAID's preferences for expansion of the BA rather than the BA's own.

The ‘Bank model' engaged existing banks, the National Development Bank and Banque du Caire, to incorporate micro and small-scale lending within their existing infrastructure and product line. USAID's support was primarily in the form of technical assistance (BdC), but included co-financing of capital in the case of NDB.

USAID/Egypt supported individual lending exclusively in the start-up phase. Individual lending was considered the more culturally appropriate methodology, given the fact that in Egypt registered enterprises have typically been more male-owned and few institutions had experience with organizing women's groups. In addition, USAID/Egypt believed that it was necessary to build strong institutions that were financially self-sufficient before expanding the product range and outreach to the poorer segments of the market. Internationally, evidence from around the world suggests that sustainable institutions can be created regardless of the product mix or gender targeting. The key to sound microfinance provision is to offer the products most appropriate for the target market. Diversification of products with the introduction of a group loan product in 2000 was done primarily to reach more women. The explosive growth of the group lending product in its first two years demonstrated that there was huge demand in the market for group lending and there was a segment of the market that was clearly not being reached through the individual lending product.

USAID/Egypt has performed a high level of direct, if informal, participation in the operations of the MFPs. This has been the approach taken as there were few individuals in the industry, whether implementing partners, governments or donors, who were knowledgeable about microfinance. USAID was involved in establishing NGOs, selecting board members, approving geographic areas of operation, determining the product mix, selecting software, and so on and so forth. Much of this involvement was necessary in the early phases to ensure the sound institutional development of USAID's partners and proper reporting. As institutions have developed, USAID has appropriately been less active at the operational level. While its monitoring role continues to be important, USAID should utilize a broader set of good-practice indicators that include outreach, institutional and financial performance of its partners.

USAID's technical assistance component of the SEB has focused on reaching high levels of outreach quickly. This has been measured by the number of branches or units to be supported by technical assistance. This approach has resulted in the development and continued usage of a standardized 'toolkit' for start-up branches that has included a set of policies, procedures, manuals, MIS, staff training and incentive schemes one for individual and one for group loan product. This 'toolkit' has been replicated and installed with each branch opening across Egypt.

The tools in this standard package have enabled the MFPs to attain the current outreach, displaying standardized operating systems for the two products. Unfortunately, the limitations in the toolkit are also replicated and most importantly this 'turn-key' system has not lead to capacity building of staff, management and board. Furthermore, the toolkit has remained static over the 15 years of development within and around the institutions, and the tools, as well as the technical assistance coming with it has therefore become increasingly irrelevant and non-responsive to the changing needs of the growing partner MFPs. Unsurprisingly, several of the more developed MFPs have tried to build their own systems and procedures to accommodate the changing environment. However, since the capacities of management have not been developed to conduct proper diagnostics the selection of these new systems and procedures have not always been most suited to their needs.

5.4 *Conclusions*

The achievements of USAID/Egypt in stimulating and fostering the development of microfinance in Egypt is clear from the outreach and level of sustainability of some of its partners (discussed more in detail in the following section). Given the relatively more developed market it is now working in, recommendations for future programming activities and products for this sector are provided in Section 7.

6.0 The Emerging Microfinance Industry

6.1 The Target Market and Clientele

Globally, microfinance is defined as the provision of financial services for the poor. According to the Consultative Group for Assistance to the Poorest (CGAP), microfinance clients comprise of female heads of households, pensioners, displaced persons, retrenched workers, small farmers, and micro-entrepreneurs. All of these persons can be further divided into four poverty levels: destitute, extreme poor, moderate poor, and vulnerable non-poor. An important conceptual change over the last 10 years in terms of defining clients for microfinance has been the shift from using the enterprise to using the household as the unit of analysis – a move initiated by USAID's AIMS project. This change was based on the concept that micro enterprises (on- and off-farm) are embedded in a dynamic household economy where resources are allocated in response to internal and external forces and fungibility within household and enterprises are vital to their economic dynamics. Regarding products, microfinance is not limited to enterprise lending, but covers all financial services offered to these clients such as savings, insurance, consumption loans, housing loans, and other types of financial products and services.

6.1.1 Market Size

A cursory analysis suggests that Egypt possesses the main conditions necessary for a fertile microfinance industry: large population of 68.1 million, high population density and a high percentage of people living in poverty (defined as less than \$2.15/day PPP_{1993}) [9].

In absolute numbers the market for microfinance is significant. Nearly 30% of the total population or 19.84 million individuals live in poverty[10]. Assuming average household size of seven persons, this number would translate into 2.8 million households that could be potential clients for microfinance services. As not all poor households have the ability to service debt, the market size should be narrowed to the percentage of the poor households who have 'debt capacity'. Regardless, there is a huge potential demand for microfinance services.

Loan size per GNI per capita is often used as a proxy to determine the upper limit of microfinance where loan amounts under 250% of the GNI per capita are considered microfinance. In Egypt, where the GNI per capita is \$1,360 per annum, the maximum loan size for microfinance loans would be \$3,400 (£E 21,080 at the exchange rate of 1US\$=LE 6.2). As discussed later, by and large, MFPs in Egypt are well below this cut-off point.

6.1.2 Market Characteristics

Whether registered in the formal private sector, or operating in the larger informal sector, the vast majority of micro- and small enterprises are characterized by low capitalization, low productivity levels and poor quality products, serving small and local markets. Despite its numerical weight and importance, the contribution of this sector to local private investment remains relatively small, and small enterprises operate under legal, institutional and policy constraints which reduce their competitive potential. The most pressing constraints of micro- and small enterprises were compiled and ranked in a study in 2003[11] and include:

- Inadequate access to financial services
- Insufficient supply of skilled labor, especially in modern management, accounting and technical skills
- Limited access to markets and market information
- Limited access to modern technology
- An over-regulated business environment with arbitrary taxation practices, bureaucratic market entry procedures and abundant employer regulations as particular constraints.

Micro-, small and medium sized enterprises (MSMEs) need access both to short-term working capital as well as medium-term investment capital. Small businesses in general are more highly geared financially (ratio of borrowings to equity) and more reliant on short-term borrowings than larger companies. Many MSMEs face difficulties accessing formal credit due to a variety of reasons:

<u>Perceived High Risk</u>: Most commercial banks favor larger scale urban trade and commerce investments which are considered less risky and yield quick returns. In Egypt, where the banking

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[9] Purchasing Power Parity is the rate of exchange between two countries at which the price of a representative basket of goods is the same.
10 El-Laithy et al.
[11] Summarized in Government of Arab Republic of Egypt, UNDP, USAID and KfW: " Microfinance Sector Development Approach", March/April 2003.

sector displays a growing reluctance to extend credit in general, the perceived high-risk of MSMEs makes this market segment even less interesting. Lending is often based on a historical relationship or personal connection with the management/key personnel of the bank.

Guarantees and track records: Banks require asset collateral (e.g. registered/valued land/property) which most MSMEs do not possess or cannot collateralize due to complicated bureaucracy and unclear legislation. Banks also require a well documented credit history which is unavailable for new enterprises. Businesses also need well-prepared business plans, audit reports and other documentation which is costly to produce.

Capacity: Many banks are not set up to cope with the preparatory work needed to package and ensure due diligence of an MSME project, nor do they have access to appraisal and monitoring tools specifically geared towards this customer segment.

Micro enterprises typically operating in the informal sector face the same constraints as formal MSMEs, but even more acutely. While formal MSMEs might be denied credit because of non-fulfillment of eligibility requirements (license, registration, social security subscriptions, tax cards etc), informal micro enterprises would be rejected because of their lack of registration. With no defined legal status, an informal micro enterprise cannot contract a bank loan, and any loan to a micro enterprise would therefore depend on the personal collateral and third party guarantees of the owner.

6.1.3 Market penetration

Estimates suggest that current coverage of small and microfinance services (as per available numbers), there are about 270,000[12] people reached in Egypt indicating a market penetration by the main microfinance providers (MFPs) at less than 14% (assuming a market size of approximately 2 million). Clearly, the unmet demand for financial services remains high.

The sources of finance available to MSMEs are limited to expensive supplier creditors and money lenders, the few commercial banks such as Banque du Caire and Misr Bank who are willing to lend to MSMEs, and donor-dependent NGOs which are discussed in greater detail in the following section.

6.2 The Microfinance Providers in Egypt

Microfinance in Egypt is provided by a mix of public and private sector actors, each with unique comparative advantages and roles in the sector. These include:

Commercial Banks
A few commercial banks have entered the microfinance market including two public banks (Banque du Caire, Banque Misr), a private bank (National Bank for Development) and a specialized bank (Principal Bank for Development and Agricultural Credit). These banks have had considerable outreach to the moderate poor. Their core comparative advantage is their extensive network of branches across the country which allows them the opportunity to scale up rapidly. This is true in particular for PBDAC with its enviable network of over 600 branches. In addition, some of these banks have superior back office systems such as accounting, MIS, and loan tracking as compared to NGOs. In terms of products, banks currently offer a very limited range of credit for the microfinance

12 There is no outreach data available for the entire industry. This number is an estimate based on institutions with published information on their outreach figures. This number does not include outreach of SFD or the multitude of CDAs and small multi-sectoral NGOs engaged in microfinance.

market. Their comparative advantage of being able to offer a wider range of financial products such as micro-savings, insurance, and consumer loans has not yet been exploited.

Non-Governmental Organizations

There have been a variety of NGOs active in microfinance including international NGOs such as CARE, and CRS, Egyptian NGOs, and community development associations (CDAs). The international NGOs have taken the role of capacity building, while the Egyptian NGOs have been direct providers. Business Associations, while registered as NGOs, are required to have a larger board structure than a regular NGO and many have received government permission to operate beyond their immediate governorate. Reportedly there are thousands of NGOs registered in the country and while many do not engage exclusively in microfinance, they do incorporate credit as part of their overall integrated community development programs. Generally, NGO-MFPs are more successful at reaching further down the economic scale through their targeted products such as the Poverty Lending project of the USAID/Egypt-funded BAs. CDAs, which are primarily village-focused, are likely to have the greatest depth of outreach. None of the NGOs currently have infrastructure that can match the branch network of public sector banks, and for the most part, NGOs rarely extend their services beyond the home governorate which, together with the legal restrictions on their product range, is often a constraining factor for their growth.

Government programs (e.g. Social Fund for Development)

The main government agency directly involved in microfinance is the Social Fund for Development (SFD). SFD acts as a depository and intermediary for development funds from multiple donors to Egypt, is a wholesaler and retailer of microfinance and has recently also become a policy-maker for the sector having been vested with a new role as coordinator for Micro- and Small Enterprise finance in the recently adopted SME Law. It wholesales loans for capitalization of CDAs, NGOs and banks (such as PBDAC). It also on-lends funds to the government program Productive Families Associations. Much of its lending is subsidized, with little focus on ensuring financial discipline among its clients. SFD is estimated to be reaching 125,000 people through banks and NGOs and has invested £E 172 million in microfinance.

The Post Office

The Post Office offers savings opportunities for all segments of society through its extensive network of outlets across the country but there have been some reports of post offices refusing to deal with the poor who often deposit very small amounts. The Post Office does not currently offer credit products, but there is some discussion of it starting to offer loans in the near future, possibly in collaboration with SFD.

6.2.1 Outreach of Microfinance Providers

The following analysis on the performance and market responsiveness of microfinance providers (MFPs) in Egypt is based primarily on an in-depth review of four key players (ABA, AsBA, DBACD, and BdC) all of which are partners of USAID/Egypt. Interviews with other key industry actors such as non-USAID/Egypt funded NGO-MFPs and donors were used to glean additional information on the industry and triangulate findings from the primary institutional assessments. *Table 3*, below, illustrates the recent figures of ABA, AsBA, DBACD and others by PlaNET Finance as well as figures from NCBA/EQI quarterly reports.

Table 3: Outreach of Key MFPs*

Institution	Active Clients As of June 30, 2004
1. ABA	39,917
2. AsBA	49,432
3. DBACD	26,752
4. ESED	39,097

5. SEDAP	5,078
6. SBACD	15,585
7. LEAD	3,474
8. SPDA Fayoum	2,397
9. SCDA Sohag	1,164
10. Aswan	366
11. Banque du Caire	63,426
12. NBD	19,000
13. Misr Bank	N/A
14. PBDAC	5,261
Total	**270,949**

**Figures reported here on USAID/Egypt partners are from EQI's June 2004 report except for MFPs visited by the AViD Evaluation Team.*

Although quantifying the precise depth of outreach of MFPs was outside the scope of this assignment, using loan size as a proxy it can be claimed that Egypt's MFPs have attained significant depth of outreach. The average size of loan given out by MFPs ranges from £E 500-7,000 and is well below the internationally accepted standard for microfinance (below 250% of the GNP per capita). Even BdC is working within this range with an average loan size of £E 3,035. The market leaders among the NGOs, such as ABA, AsBA and DBACD, have reached out to the moderate poor as previously their focus was more on the vulnerable non-poor. It is possible that some of the smaller NGOs may be reaching the extreme poor.

The dominant suppliers of microfinance services continue to be NGOs, collectively serving more than 180,000 active clients. However, some commercial banks, such as BdC, have demonstrated strong interest in serving this market. Given their recent entry, they are not yet utilizing their full capacity for microfinance and their commitment to this segment in the longer term is yet to be proven.

The gender balance at the client level has steadily moved in favor of women. In 2000, the USAID/Egypt-supported MFPs introduced a Poverty Lending product targeting women exclusively. This had a major impact on outreach. AsBA and LEAD reportedly have higher percentages of female clients compared to other USAID-funded MFPs. It is important to note here that it is industry practice to analyze two different indicators for gender outreach. These are: percentage of active clients who are women and percentage of the outstanding portfolio lent to women. Data available from the MFPs and EQI suggests that neither tracks these indicators. Instead the reports provide information on cumulative data and new monthly disbursements to women, neither of which are sufficient to track overall institutional trends over time.

6.2.2 Institutional Characteristics, Capacity and Constraints

The dominant microfinance delivery methodology used in Egypt is individual lending. Group lending has become popular among some of the larger MFPs to reach poorer clients, primarily women and has been used traditionally by CDAs of their microfinance activities.

All semi-formal MFPs in Egypt are restricted in their potential for growth by their legal status as NGOs (including Business Associations), which prohibits these organizations from mobilizing savings and offering financial products other than credit[13]. They cannot accept hard currency funding (including loans from international financiers) without government approval and have difficulties in borrowing funds from local commercial banks without a collateral guarantee.

13 Given the level of institutional development of the majority of NGO-MFPs in Egypt the Assessment Team would not recommend that NGOs be allowed to mobilize savings. Similar sentiment has been expressed by the KfW study as well.

MFPs in Egypt display a lack of institutional identity and vision. Regardless of their age, MFPs are heavily influenced by their primary funding agency's vision for them rather than their own unique vision as an independent entity with a specific mission. This can be attributed in part to the fact that many of these institutions, and especially the USAID/Egypt funded business associations, were not born organically but were created by their donor in collaboration with the Governorate because at the time there were few MFIs operating and the retail market was quite small. On the other hand, most banks in Egypt are limited by vision and commitment to microfinance and therefore require donor-guarantees and subsidized TA to enter the market. With the exception of BdC and NBD (both of which are USAID-assisted), it is questionable whether many commercial banks would be willing to risk their own balance sheets for investment in this market segment without collateral guarantees. The introduction of BdC and NBD to the microfinance market is clearly one of the most significant achievements of USAID/Egypt.

Despite many years of technical assistance, none of the business associations reviewed had a strategic business plan to guide operations. Two of the largest business associations have formulated financial projections, but characteristically, one was developed externally by an auditor. Following the Planet ratings earlier in 2004, several business associations are however planning to embark on a strategic business planning process for 2005.

In terms of governance and leadership, in some cases, there is significant centralization of knowledge, information and power with the Chairman of the Board. This severely hampers the development of institutional identity with little sense of ownership of the organization by other staff or management.

It would be fair to say that majority of the MFPs in Egypt have weak capacity in there senior and middle management. A strong CEO or Chairman symbolizes most organizations and with few exceptions such as ABA, there is rarely a strong management team and little succession planning for transition from the founder Chairman/CEOs.

In terms of lending methodologies and credit delivery systems MFPs in Egypt, particularly the USAID-supported MFPs, demonstrate sound knowledge and practice. As illustrated through the low Portfolio-at-Risk (PaR) their client selection processes are good. The credit delivery processes such as processing time for loans is fair, averaging between 10 days to 1 month. With the entry of BdC (another USAID partner) into this market however, these MFPs will need to become more efficient to match BdC's turnaround time of less than five days for first loan and less than one hour for repeat loans.

With regard to the back office systems that support a financial institution, there is much room for improvement. A key issue here is the absence of an integrated MIS system (which refers to linking of loan tracking system with the accounting system). Consequently, key indicators which are needed by managers to monitor the health of the institution are not easily available and therefore not used. Furthermore, to operationalize zero tolerance for fraud there needs to be ongoing improvements for more sophisticated systems for internal control.

Financing in the microfinance industry remains strongly donor-dependent with little movement towards direct (non-guaranteed) commercial linkages between formal financial institutions and MFPs. Egypt's geo-strategic importance translates into considerable interest by donor agencies. The large amounts of donor funds available (further increased due to the devaluation) do not give MFPs incentives to seek commercial sources of funds, and banks in Egypt demand guarantees or cash collateral in order to lend to NGO-MFPs, even when these can demonstrate sound asset (portfolio) quality and a good credit history. USAID/Egypt should be commended for channeling funds for capital through commercial banks, and establishing a non-cash guarantee mechanism in the CGC although it was not used by BdC or NBD, the two bank-partners of USAID who have entered the market. The leverage ratio of guaranteed NGO-MFPs does, however, remain low as leveraging beyond a 1:1 ratio has only been accomplished by one MFP (ABA). Often the leverage is less than 1:1 even with a hard currency collateral guarantee. Donors should continue to engage commercial banks in a dialogue to increase the risk share of banks and base lending decisions on the quality of portfolio of MFPs rather than a guarantee.

The microfinance sector in Egypt is characterized by a narrow range of financial products with few innovations for addressing the diverse financial needs of the poor. Some systematized primarily quantitative market research takes place prior to the opening of new distribution points or branches but MFPs there is little market research to determine the financial needs of the target clientele. The transition from a product-oriented approach to a market-oriented operational approach[14] has not yet happened among Egyptian MFPs. The lack of a more diverse line of financial products responding to client demand is clearly a factor limiting growth to substantive scale.

The legal restrictions, barring NGOs from mobilizing savings are recognized, but MFPs could explore alternatives a little more creatively, for example by offering linkage services as agents of a local bank so that clients could access some form of savings services. With the exception of NBD, few of the banks actively target the lower-income segment with deposit products. As a result, few among the poor have access to safe savings services and often end up saving in-kind – gold, livestock or cash.

As no industry-wide information is available on the financial performance of MFPs in terms of profitability, efficiency and productivity, the comparison of performance against regional and international benchmarks below includes only the MFPs reviewed by the AViD Evaluation Team and the USAID/Egypt funded MFPs for which data was availed from EQI. *Table 4*, below, illustrates this comparison.

Table 4: Comparative Performance of Select Egyptian MFPs with Select Other Regions*

Category	ABA	DBA	AsBA	MENA	Africa Med.	S.Asia Med.	LatAm large
Average age (years)	14	6	7.5	5	7	11	12
Outreach							
Active clients	43256	19606	40220	9821	9800	37490	37759
Vol. of Port. Outstanding	8.28m	3.82m	8.13m	3.39m	1.72m	3.47m	50.71m
Profitability							
OSS	128%	111%	132%	91%	91%	129%	109%
FSS	117%	107%	125%	83%	83%	94%	102%
Productivity							
Caseload (6/30/04)	116	150	116	153	408	471	451

**As of December 31, 2003*

Combined, the institutions currently supported by USAID/Egypt have reached a total of 255,164[15] active clients as of June 2004. Compared to MFIs reporting to the MIX of comparable age, the outreach of BdC and the largest business organizations far exceeds the average for the Middle East and North Africa (MENA) region, and is at the level of Latin American MFIs. The average volume of loans outstanding for most of the business associations is comparable to the average reported to the MIX from the South Asia (medium) and Latin America (large) region MFIs. Impressive to note here

[14] For more elaboration of this approach see Woller, G. (2002) *Market Orientation as the Key to Deep Outreach* MicroSave-Africa Briefing Note # 19 at www.microsave.org.
15 This figure does not include NBD which is not currently a USAID partner.

is that some of USAID's partners such as ABA and ASBA exceed even this benchmark. Self-reported operational and financial self-sufficiency for the largest business associations is slightly higher than the average for the MENA region reported to the MIX. Even with an adjustment for the inaccuracies in the data compilation and calculations of ratios, and given the lack of semi-formal microfinance provision in 1989, the achievements in terms of outreach and financial performance are impressive. (See Annex 4-7 for a more detailed review of each of the four pre-selected partners of USAID/Egypt.). The productivity ratios are considerably lower among the USAID/Egypt funded institutions as shown in *Table 4*.

6.3 Support Structures for Microfinance

6.3.1 Technical Assistance Providers

This section will focus on Technical Service Providers for MFPs, and will not include Business Development Service (BDS) providers who serve the micro enterprises themselves. In Egypt, service provision at these two different levels are often confused and interchanged.

In general, there is a very limited number of technical assistance and training providers in Egypt for microfinance institutions. *Table 5* below summarizes some of the activities of the existing TA providers in Egypt.

Table 5: TA Providers for MFPs in Egypt

TA Provider	Currently Operating?	Clients	Activities
NCBA/EQI	Yes	• All USAID-BA partners • Banque du Caire • Misr Bank • Other NGOs	• Help in start-up of branches • Installing systems • Monitoring performance and reporting to USAID • Impact and market research
CRS	Yes	• 6 BAs and NGOs in Upper Egypt	• Help in start-up of MFIs • Training on best-practice microfinance • Support in accessing grants for operations • Support in accessing concessional and commercial financing • Monitoring performance
Sanabel	Yes	• Members and non-members throughout Arab region	• TOT for CGAP training modules • MIX reporting • Translation of Microfinance Gateway • Annual conference
EBI	Yes	• Banks	• Facilitates national strategy roundtables.
CGC Consult	Yes	• Business Associations	• Monitor CGC partners

The main technical service provider for USAID/Egypt partners, whether business associations or banks, has been the consortium of NCBA and Environmental Quality International (EQI)[16]. There are numerous other providers that have operated on a much more micro-level with a select group of partners. These include ACDI/VOCA, CARE, CRS, and CGC Consult. Note that ACDI/VOCA and CARE are no longer active TA providers. In addition to these providers, the Microfinance Network of Arab States, Sanabel, has begun providing training and technical assistance to its members and non-members throughout the Arab region.

NCBA/EQI

The consortium made up of NCBA and EQI, herein referred to as the Contractor, have been the main contractor for technical assistance for USAID/Egypt. It has won three open bids for TA provision since 1993. The Contractor's role has been to provide support for start-up branches, monitoring the performance of USAID partners, reporting to USAID on a quarterly basis and conducting relevant research on behalf of USAID partners.

The contract for TA provision issued by USAID has targeted a number of "units" or branches to be established and supported. The Contractor has often exceeded targets set in its contract and amendments to the contract to increase targets have been common. This approach of linking TA to branches was utilized in order to achieve large geographic outreach quickly. The Contractor was responsible for training new loan officers at the branches, installing accounting and loan tracking systems, training relevant personnel on the use of these systems, installing operational manuals and training relevant staff on the overall operations. A core component of the TA is the use of Al Muhasil, a loan tracking system developed by EQI.

While the approach utilized by USAID was effective in creating a large branch network among its partners, the technical assistance received by the MFIs has not been appropriate to foster strong institutional development of its partners. This style of TA provision is better suited for start-up branches than for growing or established institutions. The USAID approach has not allowed for training nor provided guidance to any partners on strategic planning, business planning, financial projections, market research, impact research, or other areas which would build the capacity of the MFP to manage its growth and become market-oriented in its delivery. Despite the weak governance issues inherent in the business association model and reinforced by the NGO law, this approach has not allowed for capacity building at the board level of any of the USAID partner institutions. Thus members of the board of the BAs do not have a good understanding of microfinance, their role as board members or what they should be monitoring in guiding the growth of these institutions.

As per its contract with USAID, the Contractor has focused its monitoring and reporting on a select set of indicators which provide insight on the outreach and operational sustainability of the USAID partners. USAID/Egypt's indicators are considered insufficient by industry standards and do not provide a comprehensive picture of the health of the MFP. Rather, a combination of qualitative (such as quality of governance, management, staff, and market-orientation) and quantitative indicators gives a more accurate picture of an institution's level of performance and development. The current indicators also do not integrate microfinance industry ratio or trend analysis in its training, monitoring or reporting. A sample of some of the key quantitative indicators commonly used in microfinance and a comparison with the quantitative monitoring conducted of USAID's partners is provided in Annex 11. In addition, there are numerous inaccuracies in the reporting provided to USAID. The cause of these inaccuracies is unclear and may reflect a combination of factors such as poor understanding by the MFPs, human error in data collection and reporting, or weaknesses in the software generating the reports.

Other TA Providers

16 A more detailed analysis of EQI is presented in Annex 9.

A cursory analysis of some of the smaller TA providers such as Save the Children and CRS suggests that the quality of TA support provided by these institutions to many BAs, NGOs and Community Development Associations (CDAs) may be more closely aligned with international good practices. For example, Al Tadamun, an offshoot from Save the Children, tracks all of common microfinance industry indicators through its MIS and its management is highly skilled and knowledgeable about best practices. Smaller institutions supported by CRS demonstrate a deeper understanding at all levels of staff on best practices. Additionally, monitoring and reporting are in line with industry standards.

Among other support institutions for the microfinance sector in Egypt, the Egyptian Banking Institute (EBI) and Sanabel are notable new entrants to the market. The comparative advantage of the former lies in its ability to provide quality training of bank staff on SME finance and its role in microfinance is limited to facilitate the development of the National Microfinance Strategy Project funded by UNDP, USAID and KfW. Sanabel, on the other hand, serves the entire Arab region and has brought in CGAP courses and is involved in training local trainers. More sectoral support is planned through translation of the Microfinance Gateway into Arabic.

6.3.2 Financial Support Structures for Microfinance

With few financial intermediaries and narrow range of instruments available for financial institutions, the Credit Guarantee Company (CGC) is one of the few financial support structures available for microfinance institutions in Egypt. CGC acts as a private sector intermediary of donor funds, which are leveraged at a modest level as non-cash guarantees to banks and recently also NGOs lending to micro-, small and medium-sized enterprises and health care providers. A fee of 1% of the value of the guarantees is charged, payable by the banks. The CGC Guarantee Certificates issued are recognized by the Central Bank as valid collateral. USAID has provided most of the capital for CGC as trust funds for investment. Against these funds, the CGC provides three guarantee products:

- 50% guarantees to banks providing loans to small scale enterprises (SSEs) in all sectors except trade of £E 20,000-1.4 million over 6-60 months.
- 65-80% guarantees to banks lending to health care providers, primarily pharmacies.
- 50-100% guarantees to banks providing overdraft facilities to selected “service units” (banks, NGO or CDA branches) lending to micro enterprises, as well as training, TA and performance monitoring in cooperation with NCBA/EQI, channeling of start-up and operational grants from USAID for NGOs, and planned transfer of loan capital as equity to NGOs breaking even operationally within 2 years. This product is managed by a specialized microfinance unit within CGC and supported by its consulting arm CGC Consult, which shares staff with the private consultancy company FiNBI.

A detailed description and analysis of CGC is presented in Annex 8.

Conceptually the idea of CGC is commendable and the direct guarantees issued for SSEs and health care providers have performed relatively well. There is demand in the market place, and default has been kept below 5%. However, the outsourcing by USAID/Egypt of responsibility for implementing the SEB project to CGC has been less of a success. Some of the key impeding factors for this:

- The delay by three years in signing the financing agreement for CGC due to disputes with the Government over tax exemptions for the for-profit structure and internal governance and management issues, giving CGC a legitimacy problem in the market;
- The complicated funding arrangements involving an unclear division of labor and authority between USAID, NCBA/EQI and CGC;
- The replication of the static SEB model focusing again on “units” and operational break-even rather than financial self-sufficiency;
- A focus on meeting targets set by its donor agencies, and USAID in particular, rather than developing customer relationships with the MFPs and banks it should serve;

- Despite its well-qualified, commercially oriented staff CGC remains unexposed to international good microfinance practices and has not received the quality of TA needed.

6.4 Donors

A wide range of donors are involved in microfinance in Egypt. They range from multilateral donors such as the UNDP, World Bank, IFC, EU to bilateral agencies such as USAID, GTZ, KfW, Egyptian Swiss Development Fund, and CIDA among others. Funds to Egypt are all channeled through the Ministry of International Cooperation (MoIC).

An interesting feature of the donor community for microfinance is that many of them channel their funds through the Social Fund for Development (SFD), which is widely known for its subsidized and high tolerance for non-repayment microfinance practices. The point to note here is that some donors to SFD such as the Arab Fund and Kuwait Fund insist that SFD use subsidized interest rates for on-lending to NGOs and MFPs. Others such as KfW, UNDP and the EU have channeled their funds with an agreement to have SFD adhere to good practice microfinance that does not prescribe interest rate caps and ensures financial discipline at all levels.

Without a doubt, SFD has an impressive budget for microfinance and can easily distort the market through its subsidized lending practices, creating unfortunate outcomes for best practice MFPs. In engaging the SFD to adhere to good practices these donors have adopted a strategy to influence SFD from within and move it towards good practice through positive incentives of support such as upgrading of their MIS systems.

Table 6: Key Donors and Their Activities in Microfinance in Egypt
NON-SFD donors: **USAID** is the largest bilateral donor by far and is unofficially estimated to have financed 70% (US$ 77 million) of all activities in the sector since 1989. USAID has made substantial contribution to microfinance development in Egypt through development of a number of retail MFPs. It provides both financial and technical assistance support to its retail partners. **The Egyptian Swiss Development Fund (ESDF)** was capitalized by a debt to grant swap of SFR 90 million (US$ 90 million) in 1995. Only 40% of this amount is directed at income generating activities implemented by NGOs and CDAs and they cover 20 governorates. Some NGOs complain about the lengthy approval and disbursement process. **SFD donors:** The following donor agencies have channeled their resources through the Social Fund for Development (SFD) to a large extent. **KfW** has been supporting SME finance through credit lines to the SFD (SEDO), and is currently entering the microfinance arena with support to the SFD Microfinance Unit in coordination with EC and UNDP. **World Bank, UNDP, the European Commission** and several bilateral donors including KfW and JICA contribute to the Social Fund for Development managed by the Government of Egypt, which lends to NGOs and banks through the Small Enterprise Development Organization (SEDO) for SME finance and the Microfinance Unit for microfinance. **The European Commission** has allocated a total of Euro 317 million (US$ 380.4 million) through three grants to SFD since 1991, supporting investments in public works, SME finance through SEDO including the upgrading and extension to all departments of SEDO's MIS; and microfinance loans through the MFU. The newest program provides 11 million to the SEDO and Euro 4 million to the MFU for credit lines to MFIs, technical assistance and non-financial services. In addition to their contributions to the SFD, EU supports agricultural MSME credit through the Euro 18 million FISC program with the Ministry of Agriculture, which is implemented through the Cairo International Bank as an agent bank. **CIDA** funds basic education and SME development through non-financial services in Egypt, linking SMEs to finance via the Social Fund for Development (SFD). In Upper Egypt, business start-ups have been supported, while competitiveness has been the focus in the Delta. A new $Can 20 million project will provide capacity building to BDS providers and support brokerage between SMEs and multi-national companies. In addition, applied SME research will be funded, along with the continued support to SME policy development through SMEpol. The SMEpol supports an enabling SME environment through policy change, institutional capacity-building within the key

economic ministries of government, and public awareness through information dissemination and stakeholder meetings.

UNDP piloted a 3-year MicroStart program in 2000 with technical backstopping from UNCDF and in cooperation with SFD, including grants for capital and technical assistance to three start-up MFIs provided by ACDI/VOCA. The three MFIs have performed well, one has accessed commercial capital with a guarantee from the Credit Guarantee Company, and all are committed to microfinance good practices. UNDP linked the MicroStart project to its support to reform in the SFD, and is planning to coordinate capacity building support by KfW, GtZ, UNDP and EC to microfinance through SFD, bringing in international technical assistance to help. In addition, the UNDP/SFD BEST project provided business development services to MSMEs through 3 vocational training centers to promote competitiveness.

Other than the few best practice donors such as USAID, KfW, and UNDP, many donors demonstrate a lack of understanding of the performance standards that need to be monitored for microfinance investments.

The "Building a National Strategy for Microfinance in Egypt: A Sector Development Approach" project launched in 2003 by UNDP/UNCDF, USAID and KfW is the only example of a more coherent and coordinated approach by donors that the AViD Evaluation Team could find in Egypt. Based on a sector analysis and a promising design document, the project aims to develop a shared vision on microfinance, a national policy, strategy and action plan for support to the industry by Government and donors alike.

6.5 Conclusion

There is an enormous market for microfinance, between two and three million potential clients, and the current market penetration is low – less than 15%. As such there is huge unmet demand for financial services and few providers have been able to reach scale in numbers of clients. While the provision of financial services for the poor continues to be dominated by NGOs, it is encouraging to note that some banks are demonstrating interest in serving this market segment and BdC's commitment to this sector is truly impressive. The Assessment Team is in agreement with USAID/Egypt that the range of products offered is limited with an all but complete absence of savings services for the poor. The expansion of MFPs to rural areas has been slow.

At the institutional level, the quality of MFPs is varied. The age and impressive level of outreach of the largest institutions is not matched by the level of institutional development (understood to include a clear institutional identity and business plan, back office systems and processes), a factor that impedes growth and expansion. The quality of governance and leadership is variable and structurally there are numerous impediments to NGOs being able to serve as one-stop shop for financial services for the poor. The quality of USAID-supported MFPs is variable and in some aspects they are stronger than non-USAID-supported MFPs and in other cases, there is room for improvement.

On the support structures for MFPs the number of technical assistance providers is small. The quality of TA provided is insufficient for the market needs. Some of the smaller providers and some new entrants offer higher quality TA but serve fewer institutions.

The financial support intermediaries for microfinance are even fewer than the TA providers with CGC and SFD as the only players in this market. SFD does not adhere to internationally recognized best practice microfinance, and is also distortionary in its practices. CGC has been vested with multiple responsibilities as a quasi-administrative arm of USAID. In doing so, its core competency of being a guarantor has been compromised. In terms of suppliers of finance, there are few commercial banks lending to MFPs, and the main financiers continue to be donor agencies. Un-coordinated efforts and lack of good funding practices has resulted in donors further fragmenting the microfinance industry.

Clearly there is much room for improvement at all levels and many opportunities for guiding the retail providers to the next level of maturity and for building the sector as a whole. Specific recommendations for future investment are provided in Section 7.

7.0 Opportunities for Future Programming

7.1 Principles for Investment

This section presents a series of recommended options for USAID/Egypt to consider in the programming of the funds available in the coming years. Although USAID/Egypt applies many of the principles listed below the Assessment Team wishes to re-iterate these general principles to guide future investment in the small and microfinance sector.

1. ***Adherence to free market principles.*** Market forces, rather than subsidies, should be relied upon to encourage financial intermediaries to improve performance. Funders should provide support to MFPs according to their stage of development. MFPs should access capital for their loan portfolio from commercial sources. Grant subsidies, when used, should be temporary, transparent and linked to institution building and product development rather than to cover recurrent operating costs. Market distortions created by support to one MFP but not another with similar needs and justification should be avoided.

2. ***Transparent selection process.*** Criteria for investments at all levels, including the selection of recipient MFPs and TA providers should be clearly stated and available to anyone meeting the minimum requirements and serious about achieving sustainable operations. The selection process should be based on objectively verifiable indicators and evaluation criteria.

3. ***Demand-driven support.*** Any assistance to the sector should be demand driven, based on the applicants' analysis of their needs. Funders should avoid imposing solutions on recipients. For meaningful change to occur and endure, capacity building assistance must be desired and valued by the client.

4. ***Fostering local capacity for capacity-building services.*** The market for capacity building for MFPs is not sufficiently developed at this time, and therefore building local capacity to deliver the services MFPs will need on an on-going basis must be part of the overall program.

5. ***Cost participation, increasing over time.*** Requiring MFPs to participate in the investment cost helps to ensure that assistance is demand-driven and that the recipient takes ownership and responsibility for achieving results. Cost sharing from MFPs should be on an increasing basis as sustainability is improved.

6. ***Continued assistance dependent upon performance.*** Continued investment in an MFP should be contingent on their full commitment to institutional development and to achieving maximum returns on investment. Supported MFPs or service providers should submit a business plan or budget showing all funding sources (use of e.g. the CGAP guidelines on disclosure should be encouraged), and performance should be measured against the plan targets set.

7.2 Structure

Support to MFPs should be based on their performance and existing stage of development, whether start-up, mid-tier, or mature institution and in adherence to the principles of funding outlined above. The AViD Evaluation Team is in agreement with USAID/Egypt that no new direct cooperative agreements should be issued with any partner MFPs.

Adhering to free market principles, the structure of any future TA contract should be based on a model that allows for the support of multiple TA providers and should not limit TA provision to only one provider. A subcontracting mechanism that competes specific task orders with multiple providers for TA delivery would enable this to occur.

An umbrella Facility is one of the mechanisms that can be used to accomplish USAID objectives, while promoting sound principles. The umbrella facility would be responsible for:

1. ***Issuing sub-contracts for technical assistance and training***. The Facility would be tasked with working with MFPs to identify their capacity building needs and sourcing, in a competitive bidding process, local or international TA providers to support these needs. The type of technical assistance and training needed will vary by institution (NGOs, banks or any other type of provider), depending on its stage of development. See Table 7 for a sample of the types of TA and training that might be needed for MFPs at different levels of maturity.

Some of the training or TA needs could be tailored to specific institutions and others can be provided to a group of MFPs in the same stage of development. The Facility would then review bids received and issue a sub-contract to the TA provider which best meets the requirements of the Task Order.

2. ***Provide support for operations***. As a general rule, grants for operations or equipment should be allowed only in the early stages of development but should be discontinued as an organization matures. In exceptional circumstances (force majeure), bridge funds for operations can be made available at concessional rates.

3. Provide support for portfolio capitalization. Institutions should be supported in accessing grant or concessional loans in the earlier years of development but should progressively source commercial sources of financing. Grants or loans with restrictions pertaining to methodology, interest rates or other specifications should be discouraged for all MFPs, such as funding from SFD which has capped interest rates.

Table 7: Recommended Support Based on Stage of Development of MFPs			
Stage of Development	**Technical Assistance and Training**	**Operational Support**	**Capital Support**
Start-Up Institutions (0-2 years)	• Market research • Product development • Strategic planning and business planning • Financial projections • Board development • Lending methodologies • TOT for credit officer training • Delinquency management	• Consider some grants for basic start up - equipment and operational support. • Support in sourcing operational financing (grant or concessional loans).	• Support in accessing grant funding for capitalization. • Support in accessing unrestricted concessional funding for on-lending. • Support in accessing credit guarantees for commercial borrowing.
Mid-Tier Institutions (2-4 years)	• Strategic planning and business planning • Board development • Impact research • Liquidity management • Risk management • Internal controls • Financial analysis	• Operational and equipment grants should be phased out. • Bridget funds can be made available at concessional rates under exceptional circumstances (force majeure). • Support in accessing commercial or concessional borrowing for financing of operational costs not covered by income.	• Support in accessing credit commercial borrowing with and without guarantees.
Mature Institutions (more than 4 years)	• Governance • Liquidity management • Risk management • Transformation in NBFI, Deposit Taking MFI or other type of organization as allowed by law.	• No operational or equipment grants.	• Support in accessing commercial financing without guarantees. • Support in accessing equity investments. • Support in savings mobilization.

3. Supporting the Development of a National Microfinance Practitioner's Network

It is recommended that USAID champions the establishment of a national Egyptian network/association of microfinance practitioners to develop a shared vision and strategy to alleviate the constraints facing the sector. In preparation for creating a national network, it is recommended that USAID support a Secretariat vested with the responsibility of industry-building. It is important to ensure that this Secretariat is not any member of the industry with vested interests in the direction of development of this industry. The non-partisan entity could be based in the umbrella Facility mentioned above, or could be housed elsewhere, provided that it is an objective facilitator to the process.

4. Supporting an Enabling Environment

Given the existing environment for microfinance in Egypt, the results achieved to date by USAID is impressive. However, to allow for continued growth of the sector, it is necessary for USAID and other donors to address the current policy, legal and regulatory constraints faced by the industry as a whole.

At the policy level it important to begin to engage government agencies which have a distortionary effect on the industry. Donor coordination may be the best approach to achieving impact at this level. Donors need to build a consensus on principles for funding and should limit funding that places restrictions such as interest rate or other caps on lending of their monies.

At the legal and regulatory level, USAID should not seek new legislation for microfinance in the immediate term. Current understanding among policy makers on microfinance is still relatively shallow and there is a high risk that such legislation would be more detrimental than enabling to the development of the sector. Rather than legislation, the easing of the legal and regulatory constraints can begin with a process to build consensus among the various 'sub-groups' of stakeholders such as government agencies, donors, practitioners and service providers. Once sub-groups have a shared vision and approach for addressing constraints faced in the sector, facilitating contact between the various sub-groups to engage in a participatory dialogue would follow.

In the long-run, Egyptian legislation needs to allow for commercially oriented, financial intermediaries serving the poor. This will eventually require modifications in the existing legal and regulatory framework. It is important that USAID promote a participatory and informed process to reaching the final recommendations to government. This process can be achieved in part through USAID's existing support of the National Microfinance Strategy project supported with UNDP and KfW. It can also be supported through the work of the umbrella Facility by:

- Bringing together the more homogenous ‘sub-groups’ of stakeholders (e.g. government, donors, practitioners, service providers) to build internal consensus on their roles, constraints and joint agendas in workshops, training or other events.
- Facilitating contact between the practitioner's network and the policy level dialogues to ensure that the voice of practitioners is heard.
- Promoting a Code of Conduct for microfinance standards.

8.0 Conclusion

USAID/Egypt has played a vital role in developing retail providers of microfinance. Given the stage of development of the industry, it should now focus on industry building. Adoption of the above options by USAID/Egypt will result in significant progress towards creating an integrated financial system providing access to market-responsive and sustainable financial services to the poor and low-income population. It will also secure USAID/Egypt’s position as a forward-thinking market leader for microfinance among the donor community and in the financial sector at large.