

# EKI

## Bosnia and Herzegovina

### September 2004

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

#### Global Rating

**Rating: A-**  
**Trend: Uncertain**

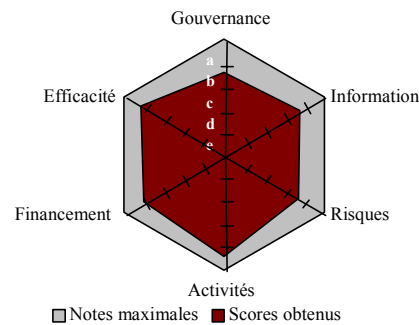
EKI began operations as a project of World Vision International (WVI) in February 1996, in Zenica (Sarajevo was still under blockade). It registered as a local microcredit organization in March 2001. Through its network of nine branches, EKI serves clients in the Federation of BiH and in the Republika Srpska, both in urban and rural areas. With loans from 300 to 30,000 BAM, it serves a clientele comprised of SMEs and microenterprises. As of August 2004, EKI had an outstanding portfolio of over 17.5 million EUR, serving over 17,000 clients of all ethnic origins.

#### Rating Plus Summary

Environment	Favorable
Maturity	Mature: 8.5 years of operations
Scale	Large: Portfolio of 22 million USD
Target market	Broad: Avg. out. loan 1,250 USD (60% of the GDP/Capita)

#### Area Scores

<b>G</b> overnance	<b>b</b>
<b>I</b> nformation	<b>b</b>
<b>R</b> isk Management	<b>b</b>
<b>A</b> ctivities	<b>a</b>
<b>F</b> inancing and liquidity	<b>a</b>
<b>E</b> fficiency and profitability	<b>a</b>



	Dec. 01 <sup>(1)</sup>	Dec. 02	Dec. 03	Aug. 04 <sup>(1)</sup>
Total nb of staff	68	84	102	111
Total assets (kEUR)	7,604	12,239	16,945	19,603
(kBAM)	14,871	23,938	33,141	38,340
Loan portfolio (kEUR)	7,376	11,284	15,238	17,617
Deposits	0	0	0	0
Nb active borrowers	6,367	8,999	13,323	17,493
Number of savers	0	0	0	0
APR <sup>(2)</sup>	See notes			
PAR 31-365	0.6%	0.2%	0.3%	0.3%
PAR > 365	0.0%	0.0%	0.0%	0.0%
Write-off ratio	0.0%	0.5%	0.3%	0.3%
Risk coverage ratio	400.2%	891.7%	719.2%	639.2%
<b>Exchange rate</b>	<b>1.96</b>	<b>1.96</b>	<b>1.96</b>	<b>1.96</b>
<b>1 EUR= xx BAM</b>				

	Dec. 01 <sup>(1)</sup>	Dec. 02	Dec. 03	Aug. 04 <sup>(1)</sup>
<b>PERFORMANCE</b>				
ROE	NA	53.2%	35.8%	32.0%
Liabilities / Equity	NA	586.0%	373.6%	322.1%
ROA	10.1%	7.1%	6.6%	7.2%
Operational self-sufficiency	155.5%	145.5%	145.6%	152.6%
Financial self-sufficiency	101.1%	90.5%	97.5%	93.9%
Portfolio Yield	28.3%	26.1%	23.1%	23.0%
Operating expense ratio	17.5%	16.3%	14.3%	13.0%
Staff productivity	94	107	131	158
Funding expense ratio	0.5%	1.0%	1.2%	1.6%
<b>GROWTH</b>				
Loan portfolio growth	-	53.0%	35.0%	15.6%
Savings portfolio growth	-	-	-	-

(1) Profitability ratios were annualized for 2001 data (May to December) and 2004 data (January to August) by a simple factor of 12/8 to facilitate ease of comparison.

(2) EKI offers three basic products based on business type. The SME loans have the highest average effective interest rate, ranging between 28% and 32%, except for "big loans" to repeat clients (around 23%). Microloans have an average effective rate at 28%, and the agriculture loans have an average effective interest rate of 24%, the lowest among the three products (some loans at 15% when subsidized by donors).

## Rating Scale

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

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

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

## Ratio Formulas

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

# Executive summary

The microfinance sector in BiH, launched after the war with strong support from the World Bank, is highly professional with most institutions adopting best practices since inception. The bulk of funds to the sector has been channeled through the World Bank financed Local Initiatives Project (LIP). In addition to numerous national development agencies, actors such as KfW and USAID have funded MFIs. Subsequent rounds of LIP financing targeting fewer and fewer MFIs have spurred consolidation within the sector through takeovers and mergers, a trend that will likely continue according to many local actors. Although there are over 40 registered microcredit organizations in BiH, most of the portfolio is concentrated among the largest 10 MFIs, a group that includes EKI.

By the end of 2003, these 10 leading MFIs were serving almost 82,000 clients, mainly in urban areas, with a total portfolio of approximately 81 million EUR. Although portfolio quality remains strong, the entire sector is concerned about the potentially high level of client cross-indebtedness. Clients “shop around” to find the products best-suited to their needs or, in many cases, take loans from more than one source at a time. Bosnian MFIs therefore must have increasingly strong competitive advantages to maintain their market position.

EKI began operations as a project of World Vision International (WVI) in February 1996 in Zenica (Sarajevo was still under blockade). It registered as a local microcredit organization in March 2001, serving mostly SMEs. In 2002, EKI created a microcredit product that proved very efficient and led to the redesign of its loan products. Through its network of nine branches, EKI serves clients in the Federation of BiH and in the Republika Srpska, both in urban and rural areas. With loans from 300 to 30,000 BAM, it serves a clientele comprised of SMEs and microenterprises. As of August 2004, EKI had an outstanding portfolio of over 17.5 million EUR, serving over 17,000 clients of all ethnic origins.

**EKI received a final rating of A-.** In the past two years, EKI transformed itself from a SME lending institution to a microlending institution, with new internal systems (MIS, procedures, etc.). This change in loan products implied shifts in the target clientele (types and level of collateral, average amount disbursed) and in the cost and revenue profile. Although it was not entirely anticipated, EKI succeeded in creating a strong microcredit organization. Its main strengths are an impressive portfolio quality (PAR30 <0.5%, with write off <0.5%), leading position in the BiH microcredit market (especially in rural areas), strong MIS, solid financial performance and a solid capital base<sup>1</sup>. Areas for potential improvements include the planning process, treatment of collateral, and the financial analysis per product, essential for an institution offering a variety of products in very diversified markets.

**The trend is uncertain.** EKI has proven its ability to react to changing market conditions. However, the very strong competition that it is facing both from MFIs and from banks make it essential to clarify its present strategy. There is a potential for a very positive trend, as the planned shift to products targeting rural areas may allow EKI to grow quickly, but detailed cost/revenue projections and the evolution of operations are needed to confirm this trend. The concentration of the portfolio in agriculture should be closely monitored. It is also important to bear in mind two factors that could modify this trend: potential impact on institutions of new legislation, potential transformation of EKI, and the availability of World Vision funds.

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<sup>1</sup> If the WV loan may be considered as quasi equity (please refer to the F area for more information).

### **Governance and decision making received a score of “b”:**

- ❑ EKI is currently registered as a not-for-profit MicroCredit Organisation, and plans to transform its legal status as soon as the new proposed legislation takes effect (anticipated to occur in 2005). EKI has begun exploring different options, and is waiting for the new law to be released.
- ❑ The decision-making process is efficient and democratic, although the strategic vision needs to be clarified. WV has a powerful position given their de facto veto right on major issues and their funding contract, but never imposed any decision and prefers to maintain a democratic decision making process. If EKI were to have any conflict with WV, there would be no strong negative effects on operations or planning, as EKI is now technically an independent organization. However, the issues of ownership of funds and the eMerge database are potential areas of contention (refer to the F and I sections). Decisions are made based on regular financial and operational reports, but should be supplemented by market information on clients and competitors to assist Board members and Management Team in developing their vision for the organization.
- ❑ The 2004/2006 objectives include training the branch managers, expanding to rural areas, institutional transformation pending new legislation, and redesigning the SME loan currently losing market share.
- ❑ This strategy is relevant compared to market needs and EKI’s competitive assets, but the plan lacks details on the operating methodology and fails to underline the importance of such changes. The move from 50% of the portfolio invested short term with micro entrepreneurs to 60% invested long term in agriculture represents an important change in the institution’s risk profile. EKI should clarify its strategic vision and planning, vitally important given the competitive market in BiH. It is important to note that EKI has already been very successful in reacting to and managing change. In 2002, EKI successfully shifted from a SME portfolio to a microenterprise portfolio with no negative impact either on its financial performance or on its portfolio quality.
- ❑ Objectives are closely monitored, the budgeting process (completed at the branch level) is precise, and monitoring procedures are efficient. Real achievements in line with or exceed projected performance.
- ❑ The Management Team is entirely local, highly skilled, and motivated. All directors have at least six years of experience in microfinance, and all have the necessary skills to manage their tasks. This team no longer relies upon WV technical support.
- ❑ EKI is currently building a human resource department to manage its team of over 100 employees. Despite the lack of such a department, EKI has succeeded in creating a strong internal culture based on performance, and does not face specific HR challenges. EKI has very low staff turnover, clear recruitment procedures, internal promotion of staff, defined incentives, and on-going training. Improvements may still be made, mainly regarding the training of newly recruited staff and on-going training for operational staff. As EKI grows, decentralizes, develops new products and changes its target clientele, the need for a HR department will increase.

### **Information management and systems received a score of “b”:**

- ❑ Main risks linked to information security are mitigated. The risk of data loss is effectively controlled by extensive back-up and storage procedures. The information flow is straightforward and the system is user friendly. It allows immediate access to information at the branch level, daily consolidation at the HQ level, and constant communication. Data is well shared among the institution. The MIS plan is simple but appropriate. It includes upgrading the database used by eMerge, adding a multi-currency device, as well as purchasing a new server to replace the currently overwhelmed unit.

- ❑ A wider risk exists for the portfolio data ownership, as eMerge is not fully owned by EKI but rather by WV. In the event of the termination of WV's involvement, for reasons of conflict or a natural end of the collaboration, it is not clear what will happen with the database.
- ❑ The MIS team, composed of three staff, has all the necessary skills to manage the information systems. However, EKI is very dependent on eMerge consultants to upgrade the system. The training of an assistant to the MIS Director is currently underway to lower the key person risk for the MIS Director, the only one fully capable of managing eMerge.
- ❑ The portfolio information is accurate, up-to-date, and very detailed. It is available by branch, product and LO. Reports are well presented, all key indicators are monitored, and information is well disseminated and analyzed. There is still room for improvement but it is not a significant issue when compared to overall information quality.
- ❑ Accounting information is timely and of high quality. The external auditor has never had problems and provides clear opinions. Financial statements are generated monthly for each branch approximately a week after the end of the month, are consolidated and include provisions, depreciation, and write off.
- ❑ The Finance Director performs regular financial analysis, including conservative adjustments. Branches are considered as profit centers and HQ expenses are allocated according to the size of the branch portfolio. However, as EKI offers very different products, it is absolutely necessary that the financial analysis is done at the product level (ABC approach).
- ❑ The Finance Director has all the necessary skills to manage and improve the Finance department. EKI is aware of that her department is understaffed and cannot meet all its obligations, and consequently is working on developing the Finance Department's capacity.

**Risk management received a score of “b”:**

- ❑ The Management Team clearly identified operational risks. At the Board level, the standing Audit Committee is responsible for reviewing the Internal Controller's reports and for approving her action plan.
- ❑ The control system successfully minimizes most internal risks: operations manuals formalize all relevant procedures, imply clear segregation of duties, include limits for both lending and purchasing decisions, establish frequent systematic controls, and portfolio quality checks are performed daily. All disbursements and repayments are made through banks, thereby ensuring the physical security of funds, apart from minor amounts of petty cash on hand.
- ❑ Room for improvement remains. All procedures are not yet strictly defined/followed, clients visits controls are too infrequent and not entirely formalized, guarantors are not well monitored, and MIS security could be improved.
- ❑ EKI created the Internal Controller position in October 2003, and this individual reports directly to the Board. The Internal Controller performs thorough audits of the branches, provides recommendations, monitors branches adequately, and compares achievements with objectives. However, she lacks time to visit as many clients and to review as many files as needed. Hiring a second auditor (recruitment under way) and procedure review to increase efficiency would have a positive impact on audit quality.

**Activities and services received a score of “a”:**

- ❑ In terms of outstanding portfolio, EKI is the largest MFI in BiH. Its market position has evolved from serving primarily SMEs, to serving both SMEs and microenterprises since 2002, and it is now expanding services to rural areas. EKI needs to review its strategic marketing strategy in order to maintain its superior position. Consistent with most MFIs in BiH, it lacks a clear commercial strategy and clear product definitions. EKI is aware of

these challenges, and an impressive survey, started beginning of 2004, aims address this through the redesign of the SME loan.

- The lending methodology has proven efficient. The methodology relies on the mobilization of strong collateral (100% for registered businesses, 75% of unregistered business), frequent monitoring thanks to decentralized “satellite offices”, and effective delinquency management. This methodology should be expanded further and formalized to reflect EKI’s development: Collateral levels should be more strictly specified, information managed better, and judicial cases should be centralized.
- LOs are skilled and experienced. They are often highly educated and most of those working in rural areas have a previous experience with rural activities.
- EKI remains quite concentrated in the agriculture business (63% of the outstanding portfolio), and this concentration will increase as the institution’s main strategic goal for the next three years is to expand operations in rural areas. EKI established a simple global diversification rule, which insufficient to supervise EKI’s diverse portfolio because it faces a two-fold risk linked to loan maturity (up to 36 months) and microentrepreneur activities (trade, agriculture, services). Nevertheless, the Management Team is aware of such concentration risks, and monitors the portfolio composition daily.
- EKI’s portfolio experienced rapid growth in 2002 due to new funds obtained by WV. It subsequently grew at a regular pace of 30% annually, reaching over 17 million EUR in August 2004. EKI underwent a complete change in its target clientele within only 2.5 years, from SME to micro lending.
- Portfolio quality is very high, with a PAR30 under 0.3%, no rescheduled loans, and a write-off ratio under 0.5%, despite a highly conservative write-off policy. There is no major difference regarding the portfolio quality within products or branches.
- Credit risk is covered by a very conservative provision policy (PAR30 covered at more than 600% by the loan loss reserve) and strong guarantees.

**Financing and liquidity received a score of “a”:**

- EKI has a long-term funding base consisting of 24% donated equity, 69% long-term liabilities and 7% short-term liabilities. EKI’s portfolio growth was financed primarily by donations and concessional loans provided by WV and other international agencies. Additional important funding sources include World Bank LIP, KfW, and (more recently) Raiffeisen BiH and Blue Orchard.
- WV is EKI’s main donor, and this loan represented 40% of EKI’s total assets as of August 2004. EKI and WV have developed a sound relationship, based on mutual confidence, that guarantees that WV will not withdraw this loan if it could endanger the institutional health of EKI. However, given the strict conditions, this loan has been classified as a liability rather than quasi-equity. If EKI were to begin to borrow money in international capital markets, it would then be appropriate to revise this loan statute, primarily whether it could be classified as equity, to strengthen EKI’s capital base.
- EKI does not presently face any major risks related to its asset/liability structure, but may face increasing issues in the future. The team will need to formalize its ALM strategy and quickly create an ALM committee. Current funding maturity levels are adequate, but the portfolio distribution is increasingly long term (40% above 12 months in Dec. 2002; 60% in August 2004); Currency risk is controlled in the short term because the local currency has a fixed parity to the Euro, and EKI denominates its loans contracts with borrowers in Euros. However, it is not clear that this technique is legally enforceable, or that clients will be subject to the cost of devaluation. Interest rate fluctuation is not yet a major issue, as only a very small percentage of EKI’s liabilities employ a variable interest rate.
- EKI’s financing strategy is clear and the team sufficiently anticipates future needs. EKI projects a demand of 17 Mo EUR for the next three years, of which 6 Mo EUR is already

committed or in negotiation. It is also expected that donors, such as USAID's LAMP program and IFAD, will increase microfinance sector financing for agricultural loans.

- ❑ EKI has never faced a significant liquidity crisis, thanks to conservative liquidity planning, but liquidity management is not currently optimized.

**Efficiency and profitability received a score of “a”:**

- ❑ EKI is a profitable institution; it covers all its operational and financial costs with self-generated revenues. The institution generated a net income of close to 1 Mo EUR in 2003, a ROA above 6.5 % since FY 2001, and in August 2004 the ROA reached 7.2% (before adjustments). Given the high amount of leverage, although decreasing from 766% in 2001 to 322% in 2004, ROE is still quite high (above 30%). However, this high leverage does not reflect a real commercially funded institution, as EKI's liabilities mainly come from the concessional WorldVision's loan, which carries a 0% interest rate.
- ❑ The financial performance structure changed between 2001 and 2002, reflecting EKI's market shift from SMEs to microentreprises. This resulted in a decrease in overall profitability, evidenced by the ROA falling from 10% to 7% in only a year.
- ❑ This performance is explained by the following factors: average portfolio yield is around 25% but on a downward trend (from 28.3% in 2001 to 23.0% in 2004), the operating expense ratio has continually declined over time (17.5% in FY 2001 to 14.3% in FY 2003), and this ratio has fallen to 13.0% in FY 2004 (estimated). EKI has succeeded in maintaining a high level of efficiency while downscaling, but the funding expense ratio has been on an upward trend since 2001 (from 0.5% in 2001 to 1.6% in 2004). Commercial local loans accounted for less than 8% of the total assets in August 2004. The cost of liabilities has remained stable at around 4% for the last 3 years, while loan loss provision expense ratio remained very low over the period (less than 0.7%), consistent with the overall exceptional quality of the portfolio.
- ❑ After adjustments, EKI experienced losses until 2003 (except in 2001, when EKI was working on the SME market), but breaks even after that time with a financial self-sufficiency of 104% in August 2004. These losses after adjustments are mainly due to the application of a commercial interest rate to the WV loan. If WV were to transform this loan into equity, the annualized AROA would increase from (-0.5%) to approximately 3.5% for 2003.
- ❑ EKI should closely monitor its profitability structure in the coming years, as many operational factors continue to evolve and create different results. Gains in economies of scale should continue, as some branches still operate with excess capacity. Plans to expand into rural areas will create downward pressure on the portfolio yield, unless EKI reviews its interest rates. Conversely, this expansion may create upward pressure on costs. The interest rate for microloans may also be subject to downward pressure due to competition and an increased number of repeat clients. Funding costs will surely increase as EKI shifts from concessional to commercial financing sources. New regulations and the institutional transformation may also have an impact on costs.

**Financing needs:**

- ❑ EKI anticipates significant financing needs of 17 Mo EUR for the next three years, of which 6 Mo EUR are already committed or in negotiation.
- ❑ Planet Rating believes that EKI is a solid institution, that has already proven its technical skills to manage lending activities resulting in solid financial performance. Acquisition of a commercial loan is feasible upon review of updated cash flows, primarily regarding the planned expansion into rural areas, to determine the amount of funds needed, and the concentration of the portfolio in agricultural activities.

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

# Rating Plus

The GIRAFE rating evaluates the financial sustainability of an institution regardless of its operating context (economic and political environment, infrastructure) or its development as (maturity, scale, and target clientele). Rating Plus serves to highlight those potential internal and external difficulties.

## Operating Context

### Economic and Political Environment: Favourable

Nine years after the Dayton Agreement ended civil conflict, Bosnia and Herzegovina (BiH) still relies on foreign aid. BiH is still undergoing the transition from a centrally planned system to a free market economy. Much needs to be done to improve the legislative environment or eliminate administrative barriers to investment.

	Dec. 2001	Dec. 2002	Dec. 2003
Exchange rate: 1 EUR = X BAM	1.96	1.96	1.96
GDP/ capita (EUR)	1,476	1,556	1,611
Inflation	0.9%	0.3%	0.9% <sup>(1)</sup>
BiH rating: Moody's			B3+
:COFACE			D

Source: Central Bank of Bosnia and Herzegovina

- ❑ Post-war per capita incomes have recovered, but are still only over half of 1991 levels. Since 2000 economic growth has slowed considerably.
- ❑ The country ranked 60 (out of 175 countries) in the UNDP 2003 Human Development Report, with 20% of the population estimated to be below the national poverty line. 27% of adults can be considered “education poor”, health-related poverty affects 16% of the population, and 29% can be considered “rights-poor” (belonging to households without formally-established property rights).

### Infrastructure: Favourable

Since the war, critical infrastructure has been rebuilt. EKI communicates very efficiently with its branches via email and telephone, but some roads are closed during winter due to snow.

## Institutional Development (MBB Indicators)

### Maturity: Mature ; Scale: Large

- ❑ 8.5 years of operations (including years as a project)
- ❑ Loan portfolio of 22 million USD
- ❑ Grants: 1.5 million EUR since start up.

### Target clientele: Broad; Other Activities: No.

- ❑ Average loan at disbursement is between 90% and 100% of GDP per capita (Dec. 2003 and August 2004) and the average outstanding loan is between 70% and 60%, placing it in the Broad category as defined by the MBB.
- ❑ EKI targets the upper-end of the market: when EKI was launched, products were designed for SMEs, in order to create more jobs (EKI monitors the number of jobs created by funded SMEs). In 2003, EKI decided to downscale by creating a product for unregistered business. It is now also expanding to rural areas. 60% of the outstanding portfolio finances agriculture businesses. Collateral is requested for all loan products, including microloans (approximately 75% of the loan). Although the requirement is flexible, according to the loan amount and level of risk, it makes EKI's product less attractive for the lower end of the market. EKI serves both men and women.

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# Acronyms

ABC	Activity Based Costing
ALM	Asset/Liability Management
BAM	Bosnian Mark (Local Currency)
BiH	Bosnia and Herzegovina
BoD	Board of Directors
CEO	Chief Executive Officer
EIR	Effective interest rate
EUR	Euro
EURIBOR	Euro Interbank Offered Rate
FY	Fiscal Year (October 1 <sup>st</sup> to September 30 <sup>th</sup> )
HO	Head Office
HQ	Headquarters
HR	Human Resources
GNP	Gross National Product
GDP	Gross Domestic Product
GM	General Manager
IAS	International Accounting Standards
LO	Loan officer
MBB	MicroBanking Bulletin
MCO	MicroCredit Organization
MIS	Management Information System
MFI	Microfinance institution
MFC	Microfinance Center for Central and Eastern Europe and the Newly Independent States
NA	Not Applicable
NBFI	Non Banking Financial Institution
NGO	Non Governmental Organization
PAR	Portfolio at risk
ROA	Return on assets
ROE	Return on equity
SME	Small and medium sized enterprise
USAID	United States Agency for International Development
UNDP	United Nations Development Program
UNHCR	United Nations High Commissioner for Refugees
USD	United States Dollar
USDA	United States Department of Agriculture
WV	World Vision
WVI	World Vision International

# Institutional Presentation

**Environment** In December 1995, the Dayton Agreement defined BiH's boundaries and created a joint multi-ethnic government. BiH is composed of two entities, the Bosniak/Croat Federation (FBH) and the Bosnian Serb-led Republika Srpska (RS) - each presiding over roughly one-half of the territory. There is a significant imbalance between the two entities, as GDP per capita in RS is estimated to be only 75% of the countrywide average.

Reforms in the banking sector have been more pronounced than reforms in other sectors of the economy. Competition in the sector has increased, including that of foreign banks, resulting in an overall decline in interest rates and consolidation within the sector, evidence by a decrease from 76 registered banks in 1997 to 38 in 2003. At the end of 2003, the banking system had over 7 billion BAM in assets. MFIs have had difficulty convincing local banks to lend to them, but one exception is Raiffeisen Bank, which has been the most active to lending to MFIs.

The microfinance sector emerged after the war with strong support from the World Bank, is highly professional, and most institutions adopted international best practices since inception. Three rounds of World Bank financing targeting fewer and fewer MFIs have spurred consolidation within the sector through takeovers and mergers.

**Mission** EKI's vision is "to reduce the economic causes of poverty in BiH", "by providing financial services and technical support to those who cannot access credit from the bank, and to businesses that can create or sustain jobs". Therefore, EKI's target clientele includes not only microentrepreneurs but also registered SMEs able to create jobs for unemployed people.

**Legal form and supervision** EKI is a not-for-profit institution, operating under BiH's microcredit law. The law is simple and provides for registration of specialized credit-only, non-government, non-profit institutions with minimal regulation and no formal government supervision. An effort is underway to change the legal framework for MFIs, expand legal options, and review the range of products that may be offered. The regulatory environment differs from the Federation to the RS, thereby requiring MFIs that operate in both entities, like EKI, to register twice and comply with different reporting and supervision rules.

**Ownership and External Support** EKI's General Assembly and Board of Directors are composed of seven members. These individuals, from different backgrounds, were invited by World Vision and the Management Team to join the Board in 2001 when the institution localized. The current Board of Directors, with a mandate of four years, is presided by M. Sead MUCIC. (*A detailed list of Board Members is provided in the appendix.*)

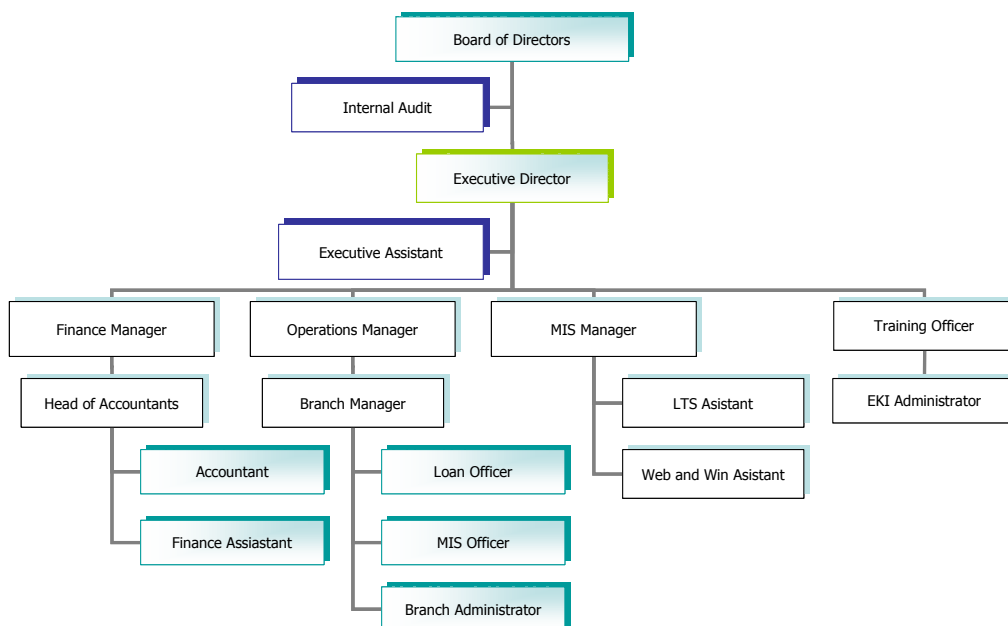
World Vision (WV) is the institution's founder, and although it is not EKI's owner (it only has two seats on the Board) it remains very powerful: WV benefits from a de facto veto right on major issues, as they have two representatives on the Board. Their loan contract outlines very strict rules on operations, among which is a stipulation for maximum PAR and write-off ratio levels. WV controls 40% of EKI's total funding and owns the eMerge database. EKI benefits from WV's network through trainings, visits to other MFIs, and technical assistance through WV's participation in the Board.

*Services* EKI offers three loan products for registered businesses (working capital, fixed assets, and a “big loan” product for repeat clients), two for agriculture (one being subsidized), and one for unregistered microentrepreneurs (“microloans” that may also finance agriculture). One branch also offers group loans, but these loans account for a tiny part of the portfolio (0.4% of the outstanding balance) and EKI has no plan to develop them in the future. All disbursements and repayments are made through banks; EKI does not handle any cash.

Loan Product Features	Registered Businesses	Agriculture	Microloans
Minimum / Maximum loan amount	3,000 BAM to 30,000 BAM	3,000 BAM to 25,000 BAM	300 BAM to 3,000 BAM
% of total outstanding portfolio as of August 2004	21%	33%	46%
Nominal interest rate	12% to 15.60% flat	12% to 15% declining or flat depending on the source of funds	13.20% flat
Fees	Up to 3% of the disbursed amount, depending on the cycle and the product		
Repayment frequency	Monthly		
Term (without grace period)	3 to 18 months	3 to 36 months	3 to 12 months (and 18 months for agriculture)
Grace period	Up to 6 months only for repeat clients	Up to 9 months	Up to 6 months, but only for agriculture
Guarantees	Check, bill of exchange, blank payment order, salary – for 100% of the loan amount	Check, bill of exchange, blank payment order, salary – for 100% of the loan amount	Salary, bill of exchange – for maximum 75% of the loan amount
Effective interest rate	28% to 32%	15% to 24%	Avg. 28%

*Human resources and branches*

EKI has established a network of eight main branches, one very small branch piloting since 2004 a new housing product, and 22 satellites offices, covering a large portion of BiH’s territory. The Management Team is not located in formal headquarters; the Executive Director is in Tuzla along with the MIS Director, the Operations Director is in Doboj, and the Finance Director is in Sarajevo. Operations are very decentralized, as most of credit decisions and basic liquidity management are the responsibility of individual branches.



Human resources	Dec. 01	Dec. 02	Dec. 03	August 04
Number of branches		8	8	9
Number of personnel	68	84	102	111
% Loan officers	50.0%	52.4%	52.0%	53.2%
Turnover (exits/ period average number of personnel)	5.2%	6.6%	5.4%	4.7%

*External audits* PriceWaterhouseCoopers was the external auditor for FY 2000 (end of FY was September 30<sup>th</sup>), after which INACO (International Auditors Cooperation) assumed auditing responsibilities. They have both approved without reserve these financial statements, acknowledging that they give a fair picture in all material respects of the financial position of the institution, and that they are in accordance with international accounting standards.

# Governance and Decision Making

EKI is currently registered as a not-for-profit “MCO” (MicroCredit Organisation), but plans to transform to a more formal institution as soon as new legislation takes effect (planned for 2005). This will to quickly transform its status is admirable as it underlines EKI’s dynamism, and its understanding of the limits of the NGO statute for its operations within context. EKI has already begun exploring different registration options, and is waiting for the new law to be released before they can finalize these plans. It is already clear that WVI will have a key role in the new institutional structure. This new regulation will also impact other aspects of EKI’s operations and therefore its global risk profile, notably in three ways: collateral requirements, Euro denominated borrowings, and new taxes.

## Decision-making

### Decision-making process

The decision-making process is efficient and democratic, although the strategic vision needs to be clarified. The Board of Directors is the final decision maker and reviews all strategic decisions prepared by the Management Team. Although EKI faces the typical challenges that all NGOs face with volunteer Board members, it has succeeded in creating a strong Board. Members come from different backgrounds (bank, government, academia, NGOs), they are prestigious and representative of BiH’s diverse communities, they understand the institution’s operations and challenges, WV’s representative possesses good knowledge of microfinance, meetings take place quarterly and are well prepared by the Management Team/Chairman of the Board. However, institutional governance could benefit from more strategic input in product design (cf. section “A”), and from a revitalization of existing Board sub committees.

Although they are not EKI’s owner, WV has a powerful position in the decision making process, as described above (“Presentation of the Institution”). However, WV never imposed any decision to the Board and prefers to maintain a democratic decision making process. The sound relationship based on confidence that EKI and WV developed prevents conflict and enables EKI to benefit from the expertise and network of WV. If EKI were to conflict with WV, it would not have any strong negative consequences on operations and planning, as EKI is now technically independent, but the ownership of funds and of eMerge database would need to be clarified (refer to the F and I sections).

### Management information

Decisions are made based on regular financial and operational reports. They should be supplemented by market information on clients and competitors, in order to assist governance actors in developing their vision. Reports sent to the BoD should be more concise as the BoD becomes better trained.

## Planning

### **Relevance of the current strategy**

The planning process launched in 2004 was efficient as it involved the whole institution, followed a strict agenda and was approved by the BoD. The results are a three-year business plan (2004/2006), a global action plan for 2004, and monthly action plans for each branch. These plans provide clear activity objectives. The achievements are strictly monitored by the Financial Director and the Operations Director on a monthly basis (approximately), and by the internal controller. All product development is based on thorough market analysis, such as the one currently being conducted to redesign the SME product.

However, the global vision underlining these choices is yet to be refined, as it varies within the Management Team and the Board. It is also necessary to clarify the potential market, by having an approximate number of clients per zone and per product. The target number of clients (20,000 in 2006) has been set up based on the institution's capacity and not on a market estimate.

The 2004/2006 strategy is organized around two main objectives: training the branch managers in order to speed up and increase decentralization, and expanding to rural areas (this will be accomplished by opening new branches and satellite offices and by increasing agriculture loans to 60% of the total portfolio by 2006). The institutional transformation will also be a major objective as soon as the law is reviewed. Although it is not clearly stated in the business plan, one of the major goals is also to redesign the current SME loan that is quickly losing market share (from 45% of the outstanding portfolio in Dec. 2002 to 20% in August 2004).

This strategy is relevant compared to market needs and EKI's competitive assets: EKI already knows the markets into which it is expanding/consolidating, funds will be available to support these news services, and this strategy enables EKI to diversify its risks.

However, the plan lacks details on the operating methodology to implement these strategic choices, and fails underlining the importance of such changes. The move from 50% of the portfolio being invested short term with micro entrepreneurs to 60% being invested medium to long term in agriculture represents an important change in the target clientele, and thus in the risk profile of the institution. These choices will also have important consequences for operations because more decentralization means requires more internal controls, agricultural loans are not managed as microloans, and LO will need more training. The costs and revenues structure will also be affected because agricultural, SME, and micro loans all have very different cost structures, and transport costs may increase with the development of operations in rural areas.

EKI would benefit from clarifying its strategic vision and planning, especially given the strong market competition in BiH. However, it is important to note that EKI has already been very successful in reacting to and managing change. In 2002 it successfully completed the shift from an SME portfolio to a microenterprise portfolio, with no negative impact either on financial performance or portfolio quality.

### **Budgeting Process**

The budgeting process is precise (conducted at the branch level) and subsequent monitoring is efficient. The process starts in October and involves the whole branch staff. Achievements are close to or better than performance targets. However, an ABC approach is increasingly necessary to be more precise when setting the prices for different loan products (refer to the "I" section). EKI has recognized this need and is planning to implement an ABC Tool.

## Management Team

### Skills and experience of management team

The Management Team is entirely local, highly skilled, and motivated. All directors have at least six years of experience in microfinance, and all have the necessary skills to manage their tasks. They frequently attend conferences and training seminars, and receive support from external consultants when needed (launching the first market survey). Composed of the Executive Director and three Directors for Finance, Operations, and MIS, the team lacks a Human Resources position (refer to next section).

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#### Executive Director: Sadina Bina

Ms. Bina has been with EKI since its inception as a World Vision program in 1996. She started as a Loan Officer and progressively graduated to the Executive Director position, in 2001. Her prior work experiences were in bookkeeping, financial management and foreign loan approval. She received a B.A. Business and Administration and a B.A. Financing and Bookkeeping (Sarajevo University, 1989).

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Branch Managers do not yet belong to the senior Management Team. They are in complete control of the daily management of operations and basic liquidity, and participate in a portion of global management through informal meetings with the Operations Manager or annual planning meetings. As EKI grows, the need to include them more formally in the Management Team will increase, in order to preserve a small central Management Team. EKI has already identified this need, and is gradually including them more portions of the decision-making process. For example, there are plans to choose two senior branch managers to become part of the EKI senior Management Team.

### Organization of the management team

Directors are located in three different branches, separated by a drive of up to 3 hours, but communication is very efficient and roles are clear thanks to monthly management meetings and daily telephone/email contacts. Operations do not suffer from this dispersed method of institutional organization and benefit from advantages such as closer supervision of branches and Directors may remaining in their hometown. However, the overall global strategy may suffer from this disperse organizational structure, as Directors do not share the same vision and are not fully aware of this fact (cf. supra).

## Human Resource Management

### Organization of human resource management

EKI is currently building a human resource department to manage its team of over 100 staff. A Training Officer was recruited in July 2003 and is meant to assume the position of HR Director once his training reaches its conclusion. Despite the present lack of an HR department, EKI has succeeded in creating a strong internal culture based on performance and does not face specific HR challenges. As EKI grows, decentralizes, develops new products, and changes its target clientele, an HR department will increase in importance.

### Skills management and performance evaluation

EKI has succeeded in building a motivated and skilled team through clear recruitment procedures, internal promotion of staff to key management roles, and on-going training. On-going training is planned for managers and loan officers through external and internal training sessions. Overall, staff are satisfied with their salaries, although some staff in Sarajevo complain because of a higher cost of living. Incentives, although complex, are well explained to the staff and motivate them to meet the institution's goals.

Improvements may still be made, mainly regarding the training of newly recruited staff and on-going training for operational staff. Field training is efficient but not supervised by HQ; it could be more standardized to guarantee that all staff benefit from a complete training curriculum. EKI is also reviewing its evaluation process.

# Information Management Systems

## Management Information System (MIS) and Equipment

Description of the MIS	
<b>Network</b>	<ul style="list-style-type: none"> <li>Local Area Network within each branch, linked to a central server through “ISDN dial up” or Leased VPN Internet lines. This constant connection allows branches to work on line with the central server. Information is available any time at the HQ level. The end-of-day process starts at 4 pm.</li> </ul>
<b>Accounting</b>	<ul style="list-style-type: none"> <li>Software: Sun System (Off-the-shelf software with flexibility for producing data useful for analytic purposes and accounting)</li> <li>Main accounting operations are centralized at the HQ level (salaries, fixed asset purchases, etc.). Information on loan disbursements and repayments is entered into the accounting system via the journal vouchers prepared at each branch.</li> <li>Daily reconciliation with portfolio information (using Excel as an interface between Sun and eMerge); daily settlements and clearance between branches and with banks.</li> <li>Monthly financial statements including provisions and depreciation detailed by branch, with allocation of the HQ expenses.</li> </ul>
<b>Activity information</b>	<ul style="list-style-type: none"> <li>Software: eMerge, developed by Temenos (software selected by WV for all its affiliates)</li> <li>Information is entered at the branch level by the MIS officer, approved by the branch manager, and validated daily by the “end-of-day process” at HQ.</li> <li>Daily activity reports are sent to all Directors. eMerge can produce up to 40 different reports. Monthly reports are shared among branches.</li> </ul>

### Security

Main risks linked to information security are mitigated. The risk of data loss is effectively controlled by extensive back-up and storage procedures<sup>2</sup>. The maximum data loss would be only one day for eMerge information, in case of total destruction of the Server hardware.

A wider risk is portfolio data ownership, as eMerge is not fully owned by EKI but by WV. EKI is only paying for the licenses, but not for the global contract with Temenos. In the event of WV’s departure due to conflict or the natural end of the collaboration, it is not clear what would happen to the database.

### Ease of system use

The information flow is straightforward and the system is user friendly. It allows immediate access to information at the branch level, daily consolidation at the HQ level, and constant

<sup>2</sup> Daily back-ups of data from the server and on the MIS Director laptop; tape and backup HDDs; regular updates of antivirus software; important hard copies stored in locked rooms; individual passwords changed frequently; only MIS officers have access to eMerge.

communication. Data is effectively shared within the institution. The MIS team had to develop Excel spreadsheets to compute specific ratios and perform some checks on information, but because these are well managed and feed automatically into eMerge, the process does not slow down the system. There is some loss in efficiency at the disbursement/repayment level; the information sent by banks sometimes includes mistakes, making it necessary for MIS officers to check the information and call the bank to correct the mistakes. However, MIS officers are well trained and operate quickly.

The system is becoming saturated as the institution grows; specific enquiries take time and the generation of full reports sometimes takes up to five minutes. Since this limitation is not due to the software, but the hardware capacity, EKI has already planned to buy a new server and increase its communications capabilities. The MFI will also need to buy more licenses soon, as the 13 currently owned will not be sufficient.

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

The MIS plan is simple but appropriate. It includes upgrading the database used by eMerge, adding a multi-currency device, as well as buying a new server.

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

The MIS team, composed of three staff, has all the necessary skills to manage the information system. However, EKI is very dependent on eMerge consultants for systems upgrades. This has already generated some additional costs and delays in software adaptation. The training of an assistant to the MIS Director is currently underway to lower the key person risk for the MIS Director, the only one fully capable of managing eMerge.

## **Information on Activities**

#### **Information quality**

The portfolio information is available by branch, product and LO as well as being accurate, up-to-date, and very detailed. Reports are well presented, all key indicators are monitored, and information is highly disseminated and well-analyzed. There is still room for improvement in the following areas:

- ❑ Very light under-estimation of the PAR<sup>3</sup>: since clients may have two loans at the same time, their total outstanding balance should appear in the PAR as soon as one of the loans becomes delinquent, which is currently not the case. However, it will not have a major impact on the PAR given the high quality of the portfolio, and the fact that only 150-300 clients have two or more active loans.
- ❑ Information on group loans: EKI is able to monitor individual performance of group loans clients, but is not in a position to monitor indicators for group loans as a whole. However, these loans represent less than 1% of the outstanding portfolio and EKI has no plan to increase loans of this type.
- ❑ Market information (refer to the “G” section).

#### **Information dissemination**

The information is very well distributed at all levels of the institution through email, the organizational website, and internal newsletters. Branch managers receive information on their own branch and on other branches.

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<sup>3</sup> (NB: EKI disagree with this statement and underline that, if client has two loans at the same time, each loan has separate repayment schedule (due dates must be at least five calendar days away).)

## Financial and Accounting Information

### Information quality and financial analysis

Accounting information is timely and of high quality. The external auditor has never had problems. Consolidated financial statements are generated monthly (approximately a week after the end of the month), issued by branch, and include provisions, depreciation and write offs. EKI achieves this level of quality despite a number of administrative burdens that complicate the accounting process such as reporting for tax purposes in both political/administrative entities, several cantons, and municipalities where EKI has field offices in the Republic of Srpska.

The Finance Director performs regular financial analysis, including conservative adjustments. Branches are considered as profit centers and HQ expenses are allocated according to the size of the branch portfolio.

However, as EKI offers very different products, this financial analysis should be strengthened and it is absolutely necessary that it be done at the product level (ABC approach). Interest rates have been set according to competition and donors requests, not according to internal cost analysis. EKI is now strengthening its operations in rural areas, and the cost structure could potentially change significantly. A detailed profitability analysis per product has become necessary. It is important to note that EKI's Finance Director is aware of this issue, and closely monitors the global profitability, in order to review interest rates if needed. However, as agriculture loans are granted on a long term basis and do not have variable interest rates, EKI will be able to increase interest rates for new loans only, and will be forced to maintain (potentially unprofitably low) rates on old loans regardless of changes in market conditions.

### Finance department skills

The Finance Director has all the necessary skills to manage and improve the Finance department. She has five years of experience as a finance director in the microfinance sector and is a financial analysis certified trainer for the MFC. However, her team is comprised of only three accountants and is too small to sufficiently carry-out all of its assigned tasks. The current excess workload prevents them from working on necessary improvements for EKI's financial management, such as analysis per product and liquidity management. EKI is aware of this issue and is working on developing the Finance Department's capacity.

# Risk Management

## Procedures and Internal Controls

### Internal Controls

The control system successfully minimizes most of the internal risks; operations manuals formalize all relevant procedures, clearly indicate the separation of duties, include limits for both lending<sup>4</sup> and purchasing decisions, frequent systematic controls, EKI cannot borrow money without the approval of the Board of Directors, portfolio quality controls are performed daily at the branch and LO levels, loan disbursements and repayments are made through banks.

This internal control system can be improved. Not all procedures are strictly defined/followed, clients visits are too infrequent and not entirely formalized, guarantors are not well monitored, and MIS security could be improved.

- ❑ Staff sometimes do not strictly adhere to procedure, and as some informal flexibility is authorized at the branch level, it is difficult to identify which procedure require strict application and which do not. This is particularly problematic regarding the level of collateral that should be available per type of loan (refer to the section “A”). The recent manual and product definition updates should improve standardization (manuals will be uploaded on the Intranet so that updates are readily available). Internal controls should also be reinforced by formalizing client visits.
- ❑ Since there are no formal procedures monitor LO client assessments<sup>5</sup>, LOs may create fictitious clients or make clients pay extra fees. However, as EKI’s system relies heavily on guarantors, creating fictitious clients would also require real guarantors for this fictitious client (making this type of fraud more difficult).
- ❑ As EKI’s system relies heavily on client collateral, the institution should be able to monitor the percentage of loans covered by collateral (per type of collateral), and track guarantors information. Name and quality are two indicators that could be used to check if the guarantor has already a track record with the MFI and monitor the overall level of collateral for a branch/LO/type of loan, etc. EKI is now developing such a database.
- ❑ The information system may be improved to lower the risk of fraud; the accounting treatment of partial payments should be automatic, systems should prevent a client from being registered twice (with different ID number), and from taking two loans of the same type at the same time.

### Cash security

All disbursements and repayments are made through banks, thereby ensuring the physical security of funds, apart from minor amounts of petty cash on hand.

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<sup>4</sup> Credit limits: up to 3,000 KM at the branch level; up to 5,000 KM with a senior Management Team member; higher loans are approved by the Executive Director; loans for 30 ,000 KM require Board of Directors approval.

<sup>5</sup> Only one LO visits the client’s business. There is no formal second visit to control the LO’s work: the Branch manager rarely visit clients; the Operations manager visit some clients when conducting market survey; the external auditor does not visit any; the internal controller only visit few of them and does not keep a strict list of all the clients who have been visited by a second person.

## Internal Audit

### **Risk identification**

The Management Team clearly identified operational risks. At the Board level, the standing Audit Committee is responsible for reviewing the Internal Controller's reports and approving her action plan. The team is also aware of the general strategic risks linked to the three-year business plan, mainly the risks associated with Human Resources in a context of strong growth and diversification, but need to perform a more comprehensive risk analysis (cf. section "G" on Planning).

### **Internal audit quality**

EKI created the Internal Controller position in October 2003, and this person reports directly to the Board. The Internal Controller performs thorough audits of the branches, provides recommendations, monitors them adequately, and compares achievements with objectives. She visits branches frequently on one-day missions. She is skilled, experienced, and clearly understands the importance of her role in such a decentralized institution. However, she lacks adequate time to visit as many clients and review as many files as is necessary. The audit quality would benefit from having a second auditor (recruitment under way) and from reviewing audit procedures to make them more efficient. Potential improvements include at least one visit during several days instead of only one-day visits and sending two auditors instead of one.

## Activities: products and services

### Marketing and competition

Market size is difficult to assess, as the last census took place in BiH before the war. The World Bank estimated the total population to be 4.1 million in 2003. With external refugees returning regularly and internal migration, it is difficult to know the exactly population by region.

The Bosnian microfinance environment is highly competitive, notably in urban areas where MFIs have been operating for years and banks also offer consumer loans. Some urban markets seem to be at or near saturation, therefore many MFIs are seeking to expand their rural outreach. By the end of 2003, the 10 leading MFIs served almost 82,000 clients with a total portfolio of approximately 81 million EUR, mainly in urban areas. Although portfolio quality remains strong, the entire sector is concerned about the potentially high level of client cross-indebtedness. Microfinance clients "shop around" to find the products best suited to their individual needs or in many cases, take loans from more than one institution at a time. Bosnian MFIs therefore must leverage strong competitive advantages to maintain their market position.



The methodology could be improved and formalized to mirror EKI's product development:

- ❑ The level of collateral that has to be mobilized is not well-defined or closely monitored, especially for SME loans. The Operations Director has been working on this point and the new Operation Manuals should help improve the process of standardization. Guarantor information is also not easily accessible (refer to section "R").
- ❑ For SME and agriculture loans, the fact that the financial analysis is based only on two previous months may lead to mistakes in the case of seasonal activities. However, seasonal fluctuations are taken into account by the LO during his/her analysis and that cash flow projections are made for the entire length of the loan.
- ❑ The institution would benefit from having a database where all information on the prices of goods, especially agricultural products, is available (this is under construction).
- ❑ Legal recourse is not centralized. As most of the portfolio is backed by collaterals, LOs lose time in mobilizing these resources, and from a legal standpoint may not be the most appropriate persons to do so. A lawyer may increase the efficiency of this process. EKI plans to employ a lawyer in 2005 who will assist LOs, but also ensure the maintenance of a standard where LOs are entirely responsible for loan recovery.

#### **Loan Officer skills**

LOs are skilled and experienced. They are often highly educated (university degrees) and most of those working in rural areas have previous experience in rural activities. LOs are trained on site (one week in another branch then join their respective branch). Their objective is to reach a caseload of 150 clients after six months. Training, nevertheless, can be improved to ensure that all procedures are applied appropriately, and guarantee that LOs understand all of EKI's different loan methodologies (refer to section "G").

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

EKI established a simple global diversification rule (microloans should represent less than 60% of the outstanding portfolio), which is insufficient to supervise EKI's highly diverse portfolio. EKI faces risks linked to loan maturity (up to 36 months) and to microentrepreneur activities (trade, agriculture, service). These two risks are not directly reflected in EKI's product offerings as products are categorized according to business type (unregistered, registered in trade, registered in agriculture) not risk type. For instance, in August 2004, agriculture loans represented 32% of the outstanding portfolio, but agriculture businesses represented 63% of the portfolio. Moreover, the existing diversification rule is not applied because of the increasing demand for microloans. The Management Team is aware of concentration risks of this nature and performs frequent portfolio composition monitoring. The MIS can provide them with information per branch, per activity, per maturity, which assist the monitoring process.

## Portfolio at risk (PAR)

### Write-off ratio

EUR , unless otherwise stated	Dec. 2001	Dec. 2002	Dec. 2003	August. 2004
Loan portfolio	7,376,142	11,283,845	15,238,368	17,616,832
BAM (local currency)	14,426,258	22,068,945	29,803,200	34,455,000
Evolution	20.0%	53.0%	35.0%	15.6%
Average over the period	6,893,017	8,658,654	13,239,530	16,337,115
Number of active borrowers (1)	6,367	8,999	13,323	17,493
Evolution	-	41.3%	48.0%	31.3%
Average outstanding loan per client (2)	1 158	1 254	1 144	1 007
% of GDP per capita	78.5%	80.6%	71.0%	61.3%
Average amount disbursed	1 838	1 879	1 634	1 479
% of GDP per capita	124.5%	120.7%	101.4%	90.0%
PAR 31-365	0.6%	0.2%	0.3%	0.3%
PAR > 365	0.0%	0.0%	0.0%	0.0%
Write-off ratio	0.0%	0.5%	0.3%	0.3%
Risk coverage ratio	400.2%	891.7%	719.2%	639.2%
PAR 31 net of loan loss provision / Equity	(14.8%)	(12.0%)	(8.0%)	(7.1%)

- (1) Borrowers may have two active loans at one time. Usually between 150 and 300 clients are in this situation.
- (2) The outstanding loan increased from 2001 to 2002 as EKI launched its fixed assets agriculture product in September 2002 (average amount of 10,000 BAM with grace period).

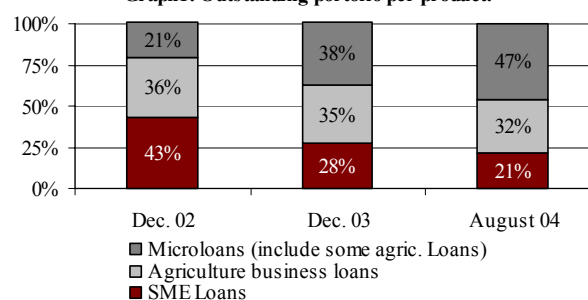
Information per product has been available only since 2002, when EKI installed eMerge. So detailed analysis was performed starting in 2002.

EKI's portfolio experienced rapid growth in 2002 thanks to new funds obtained from WV. It continued to grow at a regular pace of 30% annually, reaching over 17 million EUR in August 2004.

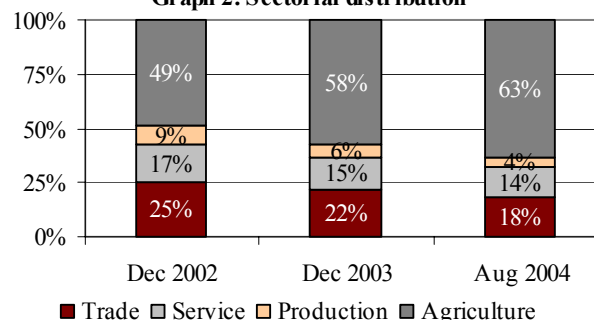
Graph 1 illustrates the complete change in the composition in EKI's target clientele within only 2.5 years, shifting from SME to micro lending. Outstanding loan disbursements decreased from 1900 EUR in 2002/2003 to less than 1500 EUR in 2004.

EKI's activities remain concentrated in the agriculture business (63% of the outstanding portfolio; cf. Graph 2), and this trend will increase as the institution's main strategy for the following three years is to expand into rural areas.

**Graph1. Outstanding portfolio per product.**

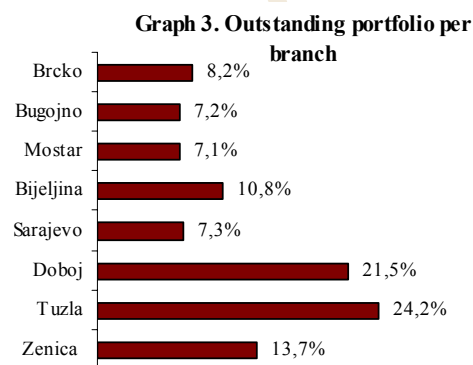


**Graph 2. Sectorial distribution**



Portfolio quality is very high, with a PAR30 under 0.3% and no rescheduled loans. It has slightly improved after EKI's repositioning in the microenterprise market. EKI, like other Bosnian MFIs, rarely has long-term delinquency. The write-off ratio is also very low (under 0.5%), even though the write-off policy is very conservative. Each month, EKI writes off all loans over 120 days in arrears. There is no major difference regarding the portfolio quality between products. Delinquency is much higher before the end of the month, as the incentive policy and the branch organization (repayments are planned only up to the 23<sup>rd</sup> of the month) encourage LOs to deal with delinquent loans during the last week of the month. PAR>1 often goes up to 10% during the month and decreases when LOs mobilize collateral.

Portfolio composition and size vary according to branches. Two of the oldest branches, Doboj and Tuzla, comprise almost half of the portfolio and continue to grow faster than the other branches (around 1.5 million BAM a year). Zenica, the oldest branch, grows only by 25% per year (around 700 KBAM); younger branches grow at a more rapid pace (30% to 100%) but will take time to reach the size of the three main branches. All branches exhibit very high portfolio quality.



## Credit risk coverage

### Coverage by provisions

*(Provisioning methodology in the appendices)*

EKI has a very conservative provisioning policy, that includes a provision on the healthy portfolio of 2%, and that does not allow reserve decreases despite higher levels than what policy dictates. Given that EKI is entering different markets, this policy could be redefined on a per market basis. However, EKI monitors provisioning levels monthly, and could react quickly if a drop in the quality of one its products was observed. This conservative policy, this close monitoring, and the very good quality of the portfolio, all resulted in a high risk coverage ratio of more than 600% in 2004.

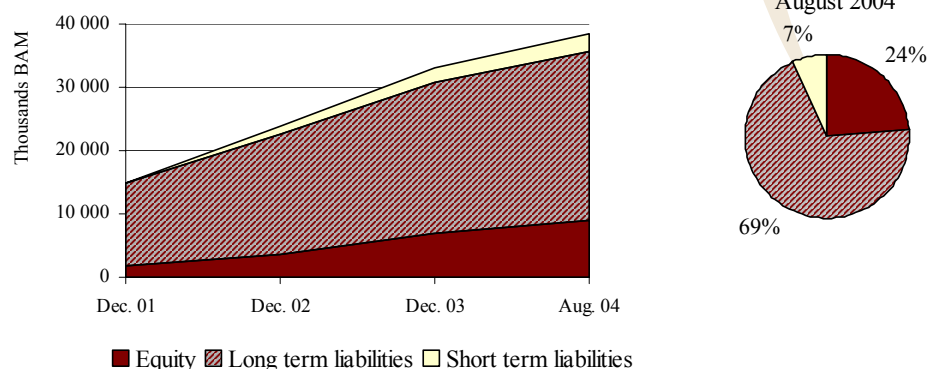
### Coverage by guarantees

Strong guarantees are requested of loan clients as an additional measure of risk coverage. Although their actualization is not always easy, these guarantees help EKI put more pressure on delinquent clients or serve as an actual source of payment. Salary withholdings and bills of exchange are the most effective methods employed. Mobile property is less easy to access. Mortgages are too costly to be used, given that collateral home property still not clearly defined legally in BiH. (Refer to the paragraph on “lending methodology” for more information on the guarantee process’s strengths and weaknesses.)

# Financing and liquidity

## Financing Strategy

### Description of the funding structure



EKI has a long-term funding base of 24% donated equity, 69% long-term liabilities and 7% short-term liabilities. EKI's portfolio growth was mostly financed by donations and concessional loans provided by WV and other international agencies. Other important sources of funds have been World Bank LIP and KfW, and more recently, a loan from Raiffeisen BiH. EKI is now negotiating to secure access to several other diverse sources of funds, loans, and donations.

WV is EKI's main funder, with a loan representing 40% of EKI's total assets in August 2004<sup>6</sup>. This loan bears no interest, is renewed every five years, and entails very strict conditions set with EKI's Executive Director. This sound relationship, based on mutual confidence, that EKI and WV have developed guarantees that WV will not withdraw this loan if it could endanger the institutional health of EKI. However, given the strict conditions, this loan has been classified as a liability and rather than quasi-equity. If EKI were to begin to borrow money in international capital markets, it would then be appropriate to revise this loan statute, primarily whether it could be classified as equity.

### Asset & Liability Management Procedures

EKI does not face any major risks related to its asset/liability structure, but may increasingly do so. The team will need to formalize its ALM strategy and create an ALM committee soon.

- For now, funding maturity is adequate. Long term funds account for more than 90% of assets; more than 45% of assets are short term. However, the portfolio is increasingly long term (40% of the outstanding portfolio was above 12 months in Dec. 2002; 60% in August 2004), and as EKI is expanding to rural areas this trend will continue.
- EKI already borrows funds in hard currency, but as the Bosnian Convertible Marka (BAM) has a fixed parity to the Euro, there are no daily exchange rate fluctuations to monitor. EKI has protected itself against a devaluation by labelling loan contracts with borrowers in Euros, a technique widely applied by MFIs and banks in Bosnia. However, it is not clear

<sup>6</sup> WV received donations to develop its microfinance activity and is still receiving some. When the project localized and became EKI, WV, instead of transferring these donations to EKI, preferred to on-lend them this amount.

that this technique is legally enforceable, and that clients will be able to cover the cost of a potential devaluation.

- Interest rate fluctuation is not yet an issue. Assets are all bearing a fixed interest rate. Some liabilities bear a floating interest rate (linked to the EUR Libor: KfW, USAID, Raiffensen and Blue Orchard loans) and accounted for around 20% of total assets in December 2003 and August 2004. However, the risk is mitigated by the fact that most of these loans remain concessional loans (please refer to the appendices), and that the Libor fluctuations have not been important.

### **Financing Strategy**

EKI's financing strategy is clear and the team anticipates future needs. EKI anticipates a need of 17 Mo EUR for the next three years, of which 6 Mo EUR is already committed or in negotiation. Their leader position in the BiH market, their professional approach, their positive image in the sector and the support received from WV helped them successfully start diversifying sources of funds (local and international) and funding instruments (commercial loans, subsidized loans, subsidies, guarantees). EKI also anticipated the funding strategy to finance its expansion to rural areas. It is expected that donors will be adding funds to the microfinance sector for agricultural loans (above all the USAID LAMP program, but also IFAD). Nevertheless, small capitalization might lower their negotiation power at the international level (cf. supra).

## **Liquidity Management**

### **Cash-flow projections and resource optimization**

EKI never faced any liquidity crisis, thanks to a conservative liquidity planning. Annual cash flow projections, generated with Microfin and based on the annual operations plan, are used to anticipate funding needs during the year, branch per branch. Monthly liquidity plans, updated the last week of the month, are used to supply branches with the necessary funds. Branch Managers are then in charge of managing daily liquidity to disburse loans, and repay their borrowings.

These procedures protect EKI from liquidity risks but do not optimize liquidity management. With more than 30 bank accounts, 8 branch managers in charge of their own liquidity, important amounts of liquidity remain not invested. Branch Managers use an in-house developed Excel tool, fed by eMerge, that is useful to anticipate funding needs but not to manage liquidity. EKI is aware of these issues and is already working on new procedures to improve liquidity management: idle cash limits are set for branches and are taken into account in the incentive system; a new process will be developed to enable inter-branch loans (information on branches liquidity will be centralized and published on the Intranet daily).

# Efficiency and Profitability

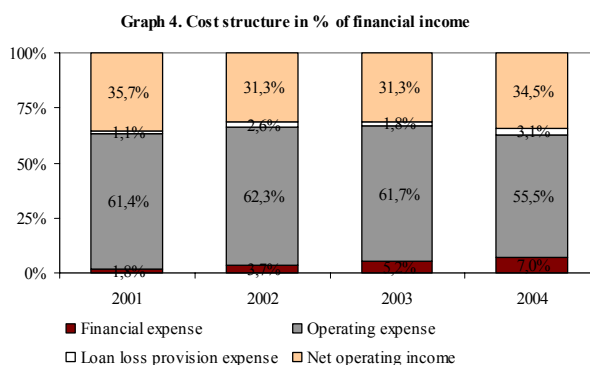
Profitability analysis	Dec. 01	Dec. 02	Dec. 03	August 04
ROE	NA	53,2%	35,8%	32,0%
Liabilities / Equity	NA	586,0%	373,6%	322,1%
ROA	10,1%	7,1%	6,6%	7,2%
<b>Profit generation</b>				
Operational self-sufficiency	155,5%	145,5%	145,6%	152,6%
Portfolio Yield	28,3%	26,1%	23,1%	23,0%
Operating expense ratio	17,5%	16,3%	14,3%	13,0%
Staff productivity	94	107	131	158
Loan officer productivity	187	205	251	296
Average outstanding loan per client (EUR)	1 158	1 254	1 144	1 007
Funding expense ratio	0,5%	1,0%	1,2%	1,6%
Cost of savings	NA	NA	NA	NA
Cost of liabilities	4,4%	3,5%	3,0%	4,1%
Loan Loss Provision expense ratio	0,3%	0,7%	0,4%	0,7%
PAR>30	0,6%	0,2%	0,3%	0,3%
Write-off	0,0%	0,5%	0,3%	0,3%
<b>Asset management</b>				
Net Outstanding Loan Portfolio / Assets	94,7%	90,2%	88,0%	87,9%
Non-portfolio income	0,4%	0,0%	0,0%	0,0%
<b>Adjusted ratios</b>				
Adjustment expense ratio	9,8%	10,9%	7,8%	7,1%
AROE	4,0%	(17,7%)	(2,9%)	3,8%
AROA	0,3%	(2,4%)	(0,5%)	0,9%
Financial self-sufficiency	101,1%	90,5%	97,5%	104,3%

Data for Dec 2004 and August 2004 are based on an eight-month period from April 2001 through Dec 2001 and January 2004 to August 2004 respectively. A simple annualization of relevant ratios was performed for ease of comparison.

EKI's performance will be compared with that of the group **ECA Large** (Eastern Europe and Central Asia Large) of the MBB n°9 (July 2003) that includes: BESA, PSHM (Albania), Kamurj (Armenia), FINCA-AZE (Azerbaijan) MI-BOSPO, EKI, Mikra, Mikrofin, Partner, Prizma, Sunrise, Women for Women (Bosnia and Herzegovina), NOA (Croatia), Constanta (Georgia), ACF, KCLF (Kazakhstan), KEP (Kosovo), BTF, FINCA Kyrgyzstan, XacBank (Mongolia), AgroInvest (Montenegro), FM (Poland).

## Overview of the profitability

EKI is a profitable institution; it covers all its operational and financial costs with its own revenues. The institution has generated a ROA above 6.5 % since FY 2001, and in August 2004, the ROA reached 7.2% (before adjustments). Given the high leverage, though decreasing from 766% in 2001 to 322% in 2004, ROE is much higher than ROA (above 30%). This high leverage is mainly due to concessional and not commercial loans. Financial performance structure changed between 2001 and 2002, because of a shift in target markets (from SME to microenterprise). This resulted in a decrease in the overall profitability (ROA going from 10% to 7% in only a year).



In comparison with its MBB Peer Group, EKI has a higher level of operational self-sufficiency (around 150% in the last few years compared to 134% for its peer group), coupled with lower operating expenses ratio (13.0% compared to 16.4% respectively) and similar portfolio yield (23.0% and 22.4% respectively). This is consistent with EKI's scale of operations and maturity (8.5 years of operations, 17,000 clients and a portfolio of 17.5 million EUR, compared to an average of only 5 years, 7,133 clients and 10.7 million EUR for its peer group).

EKI's results are based on the following factors:

#### **Portfolio yield and effective interest rate**

Average portfolio yield is around 25% but a decreasing trend is evident (from 28.3% in 2001 to 23.0% in 2004). The decrease of the portfolio yield from 2001 to 2004 is due to the change in the portfolio composition, shifting from high interest rate SME products to lower interest rate microloans and subsidized agricultural loans. EKI will have to pay particular attention to the evolution of the composition of its loan portfolio, given that interest rates have been set according to the market and to funding sources (cf. agricultural loans), not according to a costing basis. The plans to expand to rural areas in the coming years will create a clear downward pressure on the portfolio yield, unless EKI reviews its interest rates. This is clear in the 2003 performance: EKI's portfolio yield decreased faster than its operating expense ratio (3% less compared to only 2%), resulting in a decrease in the overall financial performance.

This portfolio yield is in line with EKI's interest rates, thanks to the very low PAR and write-offs. EKI's rates are similar to those charged by its NGO competitors (around 28% APR for microloans), but its global portfolio yield is lower, as the institution is offering subsidized agricultural loans (around 15% APR, representing around 13% of the outstanding portfolio).

#### **Operating expense ratio**

The operating expense ratio has continually declined over time, from 17.5% in FY 2001 to 14.3% in FY 2003, reaching 13.0% in FY 2004 (simple annualization estimates). This ratio is lower than the "ECA Large" peer group (16.4%), and much lower than the "all ECA" peer group (34%), which reflects EKI's ability to manage costs, notably administrative and rent expenses, which remain stable while the outstanding portfolio increases.

EKI has succeeded in maintaining a high efficiency while downscaling. Since 2002, with the launch of the microloan product, the average loan disbursed decreased from 1,900 EUR to 1,500 EUR (average for SME loans is 3,500 EUR, for microloans 1,000 EUR). This could have had a negative effect on cost management (small loans are usually more expensive to manage). However, in 2001, EKI was already losing market share in the SME market; this 2002 strategic change enabled them to enter a different market where they successfully developed a profitable system.

The productivity increased quickly, at the Loan Officer level as well as at the global level; the average caseload for Loan Officers (LOs) increased from 168 active clients and 190,000 EUR portfolio in 2002 to 296 clients and 300,000 EUR in August 2004 (151 active clients for its Peer Group). Staff productivity also increased from 92 to 162 active clients and 100,000 EUR to 160,000 EUR. These staff productivity gains are due to an increase in client maturity, development of LOs expertise, and especially to the development of the microloans product.

#### **Funding expense ratio**

This ratio has followed an upward trend since 2001, although it remains at low levels (increase from 0.5% in 2001 to 1.6% in 2004). EKI finances its portfolio mainly with donations and

borrowings at concessional rates (international lenders with subsidized interest rates but in hard currency). Commercial local loans accounted for less than 8% of the total assets in August 2004. The cost of liabilities has remained stable at around 4% for the last 3 years.

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

The level of the loan loss provision expense ratio remains very low over the period (less than 0.7%), which is consistent with the overall exceptional portfolio quality.

#### **Adjusted performance**

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

EKI's figures were adjusted for cost of funds (more than 95% of total adjustments), inflation (very low given the inflation rate at only 0.9%), and in-kind donations (e-Merge costs paid by WV). The loan loss provisioning policy was considered sufficient. No adjustments were made for technical assistance or training provided by WV, since EKI covered most of these costs through annual fees paid to WV.

After adjustments, EKI experienced losses until 2003 (except in 2001, when EKI was more profitable, working on the SME market), but breaks even after that time with a financial self-sufficiency of 104% in August 2004. These losses after adjustments are mainly due to the application of a commercial interest rate to the WV loan. If WV were to transform this loan into donations (thereby becoming equity), the annualized AROA would increase from (-0.5%) to approximately 3.5% for 2003 and from 0.9% to 4.5% for 2004.

#### **Asset management**

As of August 2004, the outstanding portfolio accounted for more than 87% of total assets, whereas it accounted for more than 94% of all assets in 2001. This downward trend must be carefully monitored, as it could reflect a lack of efficiency in liquidity management (refer to "F" area). However, for 2004, this is due to the fact that EKI received funds from SIDA and Blue Orchard (in August) that could not be immediately invested. At the end of September, the Blue Orchard loan was completely disbursed and EKI was about to receive the second tranche of the loan. Fixed assets remain very low as a percentage of total assets (less than 4%).

#### **Evolution of profitability**

EKI should closely monitor its profitability structure in the coming years, as many factors will influence this, producing different consequences:

- Gains in economies of scale should continue, as some branches still operate with excess capacity. For instance, the average caseload per client could increase to 350-500 depending on the product, while it stands at less than 300 today.
- The decrease in the portfolio yield must be cautiously monitored; the development of agricultural loans may lead to an even lower yield, and the current process of redesigning the SME loan product may also have important consequences on the global portfolio yield, since EKI will have to lower interest rates to compete with banks. EKI needs to clearly define how they will lower costs to maintain the profitability of these two products profitable, while concurrently decreasing interest rates. The interest rates on microloans might also be subject to downward pressures, due to competition and increased numbers of repeat clients.
- Funding costs will increase as EKI moves from concessional to commercial borrowings.
- Operating costs might be affected by new legislation, notably through requirements for collateral, Euro denominated borrowings, and new taxes.
- The transformation process will entail definite costs.

# Appendices

## Financial statements and notes

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

The financial statements and additional data provided by EKI are sufficient to produce financial statements that comply with CGAP Disclosure Guidelines. Data provided for August 2004 are from internal financial statements. Other data are from audited financial statements.

1. The Financial Statements presented include a balance sheet, income statement, and accompanying notes.
2. The financial statements provided include 2001 (8 months), 2002 and 2003 (full years) and 2003 (8 months up to August).
3. The MFI only offers financial services, therefore no non-financial services are included in this statement.
4. Portfolio reporting

- i. Loan loss provision expense: expenses related to actual or anticipated loan losses are shown separately from other expenses in the income statement (“loan loss expense”).
- ii. The loan loss reserve is shown as a negative asset in the balance sheet. It is calculated monthly by the finance manager according to the methodology described in the table.
- iii. Loans are written off monthly from the loan loss reserve and the loans outstanding.
- iv. The following table reconciles these movements:

Provisioning methodology	
Aging	% Provision (% outstanding balance)
current loans	2%
1 – 30 days	10%
31 – 60 days	25%
61 – 90 days	50%
91-120 days	75%
Over 120 days	100%
Write off	100%

	2001	2002	2003	August 2004
LL reserve, beginning of year	462 402	337 711	472 662	647 533
+ LL expense during the year	79 200	211 767	246 303	206 450
- Reversal of provision				
- Write-off of delinquent loans	203 892	76 102	71 431	91 733
LL reserve, end of year	<b>337 711</b>	<b>473 662</b>	<b>647 533</b>	<b>762 250</b>

5. Interest income and expense are recognized on a cash basis.
6. Portfolio quality
  - i. Indicators: Portfolio quality and the calculations of such are displayed in the tables in Section A and the calculations are based on standard portfolio at risk calculation of: (outstanding loan principal for loans in arrears over X days)/(total portfolio outstanding).
  - ii. Renegotiations of loans: the MFI does not refinance nor reschedule loans.
  - iii. Insider loans: the MFI does not allow employees or Board members to borrow funds.
7. Donations
  - i. Revenue from donations is shown separately from income generated by operations in the income statement.
  - ii. Main Donations appearing in the 2004 balance sheet:

Main grants, as of August 2004, BAM	Amount Granted
World Vision (Initial Investment)	800,000
USDA – Know How	237,389
UNDP	1,931,556
CRIC	31,012
<b>Total</b>	<b>2,999,957</b>

- iii. Donations accounting methodology: Grants for operations to be used in the current operating period are recorded in the income statement. Grants for fixed assets and for loan funds are recorded directly in the balance

sheet. Please note that the financial statements disclosed in this report have been modified for presentation to better reflect donations.

- iv. In-kind donations: Please refer to the Appendix on Adjustments for details on in-kind donations that Planet Rating has identified.

## 8. Details of liabilities

### i. Main Loans, as of August 2004.

Main Loan Providers	Currency	Initial Amount	Outstanding Dec. 2003 (BAM)	Outstanding August 2004 (BAM)	Interest rate	Maturity Date	Guarantee mechanism, details on any arrears and other comments
World Vision International	BAM	12 702 507	12 702 507	12 821 146	0%	January 2008 (but long term commitment)	
World Vision Canada	USD	150 000	252 278	252 278	3%	October 2008	Guarantee fund
World Bank, LIP2	EUR	1 883 469	3 683 745	4 172 702	5%	March 2017	
USAID Business Finance	BAM	3 000 000	2 166 667	1 416 667	LIBOR	May 2005 and May 2006	
KfW RLP	EUR	1 450 000	2 493 683	2 210 088	EUR LIBOR	March and September 2008	
KfW SME	EUR	1 000 000	1 955 830	1 858 039	EUR LIBOR	September 2008	
Raiffeisen Bank1	BAM / EUR	2 000 000	936 250	1 023 358	8,35%	September 2004	Cash collateral 30% of the initial loan amount
Raiffeisen Bank2	BAM / EUR	520 000	520 000	456 140	10%	September 2008	Tuzla branch, business space
Raiffeisen Bank3	BAM / EUR	1 000 000	-	1 000 000	6,3%+EUR Libor	June 2007 (with quarterly Repayments)	40% of loan value secured with EKI fixed assets
Blue Orchard	EUR	250 000	-	488 958	6% + EUR Libor	August 2004 to Feb. 2006	Promissory Note
SIDA	BAM	450.000	-	450 000	0%	Capitalized within the next 4 years	For housing
USAID LAMP	USD	1 600 000	-	1 924 176	0%	Capitalized in June 2006	
<b>Total (BAM)</b>			<b>24 710 960</b>	<b>28 073 551</b>			

- ii. Deposits: none.

## 9. Other significant Accounting Policies

- i. Interest income and expense and other operating income and expenses are recognized on an cash basis.
- ii. Depreciation of fixed assets: The depreciation of fixed assets on a flat basis using the following schedule:

Asset Class	Useful Life	Depreciation Rate
All fixed assets except vehicles (data processing equipments)	3 years	33.33%
Vehicles	5 years	20%

- iii. Inflation accounting: none
- iv. Currency mismatch: please refer to the F area for more information on potential mismatch.
- v. Accounting treatment of unrealized gains or losses due to foreign currency fluctuations: Assets and liabilities denominated in foreign currencies are translated into BAM at the average official exchange rate ruling at the balance sheet date. Gains and losses, resulting from the foreign currency transactions are included in the income statement for the year as gain and losses.

## Specific notes to the Income Statement

### Balance Sheet

1. **Short Term Investments:** cash collateral for the Raiffeisen Bank loan
2. **Short Term Gross Loan Portfolio:** Includes past due loans. For 2001: includes long term loans.
3. **Accounts receivable and other assets:** SIDA Housing Loan Program starting from 2002. It has not been included in the global portfolio, following EKI's financial statements, as it is considered as a pilote test (follows very strict rules and benefits from specific funding).
4. **Long Term portfolio:** information not available for 2001.
5. **Short term borrowings:** Details on funding sources can be found in the general appendix.
6. **Accounts Payable and Other Short Term Liabilities:** Salaries payable, audit fee payable, accrued interest, other liabilities.
7. **Long term borrowing:** Concessional rate loans from MEERO (repaid in 2001), Cospe (repaid in 2003), WV, LID (5% annual pay monthly).
8. **Other Long Term Liabilities:** WV lent to EKI the donations received by WV (WV International, KfW, LID WB) prior to EKI's localization.
9. **Donated equity:** Includes all donations received by the local EKI MFI since 2001 (donations for operating expenses and donations for credit fund).

### Income Statement

1. **Other Operating Revenue:** 2004 foreign exchange gain.
2. **Others:** The most important costs in this category are taxes, bank fees, marketing, fees to Board of Directors, education of employees.
3. **Donations:** donations for operations exclusively (donated capital can be found in the BS).

EKI	Income Statement	Notes	BAM				EUR				Evolution			
			Dec. 2001	Dec. 2002	Dec. 2003	August. 2004	Dec. 2001	Dec. 2002	Dec. 2003	Aug. 2004	2002/2001	2003/2002	2004/2003	
	<b>Financial Revenue (a)</b>		<b>2 557 724</b>	<b>4 421 792</b>	<b>5 989 783</b>	<b>4 984 190</b>	<b>1 307 764</b>	<b>2 260 861</b>	<b>3 062 574</b>	<b>2 548 415</b>	<b>73%</b>	<b>35,5%</b>	<b>(16,8%)</b>	
	Financial Revenue from Loan Portfolio		2 546 298	4 421 792	5 989 783	4 907 465	1 301 921	2 260 861	3 062 574	2 509 185	73,7%	35,5%	(18,1%)	
	Interest		2 238 174	3 804 098	5 249 035	4 336 256	1 144 378	1 945 034	2 683 830	2 217 126	70,0%	38,0%	(17,4%)	
	Fees and Commissions		297 230	607 944	730 844	571 209	151 974	310 842	373 680	292 059	104,5%	20,2%	(21,8%)	
	Penalty Revenue		10 894	9 750	9 904	0	5 570	4 985	5 064	0	(10,5%)	1,6%	(100,0%)	
	Financial Revenue from Investments		11 426	0	0	0	5 842	0	0	0	(100,0%)	-	-	
	Other Operating Revenue	1				76 725				39 229	-	-	-	
	<b>Financial Expense (b)</b>		<b>46 718</b>	<b>164 545</b>	<b>312 884</b>	<b>346 592</b>	<b>23 887</b>	<b>84 132</b>	<b>159 978</b>	<b>177 212</b>	<b>252,2%</b>	<b>90,2%</b>	<b>10,8%</b>	
	Interest paid on borrowings		46 718	164 545	312 884	346 592	23 887	84 132	159 978	177 212	252,2%	90,2%	10,8%	
	Interest paid on deposits		0	0	0	0	0	0	0	0	-	-	-	
	Net Inflation Adjustment Expense		0	0	0	0	0	0	0	0	-	-	-	
	Other Financial Expenses		0	0	0	0	0	0	0	0	-	-	-	
	<b>Financial income [c=a-b]</b>		<b>2 511 006</b>	<b>4 257 247</b>	<b>5 676 899</b>	<b>4 637 598</b>	<b>1 283 877</b>	<b>2 176 729</b>	<b>2 902 597</b>	<b>2 371 203</b>	<b>69,5%</b>	<b>33,3%</b>	<b>(18,3%)</b>	
	<b>Net Loan Loss provision expense (d)</b>		<b>28 352</b>	<b>116 628</b>	<b>104 972</b>	<b>155 172</b>	<b>14 496</b>	<b>59 632</b>	<b>53 672</b>	<b>79 339</b>	<b>311,4%</b>	<b>(10,0%)</b>	<b>47,8%</b>	
	Loan loss provision expense and write off		79 200	211 767	246 303	206 450	40 495	108 276	125 935	105 558	167,4%	16,3%	(16,2%)	
	Recovery from Loans written off		50 848	95 139	141 331	51 278	25 999	48 645	72 263	26 218	87,1%	48,6%	(63,7%)	
	<b>Operating expense (e)</b>		<b>1 569 470</b>	<b>2 756 925</b>	<b>3 695 042</b>	<b>2 765 108</b>	<b>802 470</b>	<b>1 409 615</b>	<b>1 889 274</b>	<b>1 413 799</b>	<b>75,7%</b>	<b>34,0%</b>	<b>(25,2%)</b>	
	Personnel Expense (includes fringe)		923 081	1 731 131	2 565 437	1 872 446	471 971	885 127	1 311 707	957 381	87,5%	48,2%	(27,0%)	
	Administrative Expense		646 389	1 025 794	1 129 605	892 662	330 499	524 488	577 567	456 418	58,7%	10,1%	(21,0%)	
	Depreciation and amortization		28 933	46 578	93 791	96 255	14 793	23 815	47 955	49 215	61,0%	101,4%	2,6%	
	Consulting fees		76 941	8 384	43 393	86 448	39 340	4 287	22 187	44 201	(89,1%)	417,6%	99,2%	
	Administrative expenses		90 312	93 655	94 585	78 092	46 177	47 886	48 361	39 928	3,7%	1,0%	(17,4%)	
	Communication expenses		66 844	145 694	208 051	156 788								
	Occupancy expenses		151 253	235 751	274 777	194 194								
	Travel		72 694	97 973	161 436	128 018								
	Fees to World Vision		8 658	13 031	10 850	6 365								
	Others	2	150 754	384 728	242 722	146 502	77 080	196 711	124 104	74 906	155,2%	(36,9%)	(39,6%)	
	<b>Net Operating Income Before Taxes and Donations</b>		<b>913 184</b>	<b>1 383 694</b>	<b>1 876 885</b>	<b>1 717 318</b>	<b>466 911</b>	<b>707 482</b>	<b>959 651</b>	<b>878 064</b>	<b>51,5%</b>	<b>35,6%</b>	<b>(8,5%)</b>	
	Income Taxes (g)													
	<b>Net Operating Income Before Donations [h=f-g]</b>		<b>913 184</b>	<b>1 383 694</b>	<b>1 876 885</b>	<b>1 717 318</b>	<b>466 911</b>	<b>707 482</b>	<b>959 651</b>	<b>878 064</b>	<b>51,5%</b>	<b>35,6%</b>	<b>(8,5%)</b>	
	Non Operating Revenue (i)		0	0	0	0	0	0	0	0	-	-	-	
	Non Operating Expense (including related taxes) (j)		0	0	0	0	0	0	0	0	-	-	-	
	<b>Net Income Before Donations [k=h+i-j]</b>		<b>913 184</b>	<b>1 383 694</b>	<b>1 876 885</b>	<b>1 717 318</b>	<b>466 911</b>	<b>707 482</b>	<b>959 651</b>	<b>878 064</b>	<b>51,5%</b>	<b>35,6%</b>	<b>(8,5%)</b>	
	Donations (l)	3	139 309	12 964	12 184	37 171	71 229	6 628	6 230	19 006	(90,7%)	(6,0%)	205,1%	
	<b>Net Income (after Taxes and Donations) [m=k-l]</b>		<b>1 052 493</b>	<b>1 396 658</b>	<b>1 889 069</b>	<b>1 754 489</b>	<b>538 139</b>	<b>714 111</b>	<b>965 880</b>	<b>897 070</b>	<b>32,7%</b>	<b>35,3%</b>	<b>(7,1%)</b>	

EKI	Notes	BAM				EUR				Evolution		
		Dec. 2001	Dec. 2002	Dec. 2003	Aug. 2004	Dec. 2001	Dec. 2002	Dec. 2003	Aug. 2004	02/01	03/02	04/03
<b>Balance sheet</b>		<b>14 871 393</b>	<b>23 937 915</b>	<b>33 140 764</b>	<b>38 339 751</b>	<b>7 603 739</b>	<b>12 239 449</b>	<b>16 944 863</b>	<b>19 603 104</b>	61%	38%	16%
<b>ASSETS</b>		<b>14 871 393</b>	<b>23 937 915</b>	<b>33 140 764</b>	<b>38 339 751</b>	<b>7 603 739</b>	<b>12 239 449</b>	<b>16 944 863</b>	<b>19 603 104</b>	(7%)	29%	1%
<b>Short Term Assets</b>		<b>14 753 598</b>	<b>13 767 858</b>	<b>17 736 838</b>	<b>17 996 348</b>	<b>7 543 511</b>	<b>7 039 502</b>	<b>9 068 840</b>	<b>9 201 528</b>	102%	14%	42%
Cash and Due from Banks		490 409	988 763	1 122 423	1 592 857	250 746	505 554	573 895	814 427	-	-	0%
Short Term Investments	1	0	0	605 427	605 427	0	0	309 555	309 555	(16%)	na	22%
ST Net Loan Portfolio		14 088 547	11 811 008	14 357 904	14 835 209	7 203 470	6 038 965	7 341 192	7 585 238	40%	37%	18%
ST Gross Loan PF	2	14 426 258	12 283 670	15 005 437	15 597 459	7 376 142	6 280 637	7 672 276	7 974 977	-	-	-
(Loan Loss Reserve)		337 711	472 662	647 533	762 250	172 672	241 672	331 083	389 738	-	-	-
Interest Receivable		0	0	0	0	0	0	0	0	-	-	-
On loan portfolio		0	0	0	0	0	0	0	0	-	-	-
On investments		0	0	0	0	0	0	0	0	-	-	-
Other assets	3	174 642	968 087	1 651 084	962 855	89 294	494 983	844 199	492 307	454%	71%	(42%)
<b>Long term assets</b>		<b>117 795</b>	<b>10 170 057</b>	<b>15 403 926</b>	<b>20 343 403</b>	<b>60 229</b>	<b>5 199 947</b>	<b>7 876 023</b>	<b>10 401 576</b>	51%	51%	32%
LT Net Investments		0	0	0	0	0	0	0	0	-	-	-
LT Gross Loan Portfolio	4	na	9 785 275	14 797 763	18 857 541	0	5 003 208	7 566 092	9 641 855	-	51%	27%
Net Fixed Assets		117 795	384 782	606 163	1 485 862	60 229	196 739	309 931	759 721	227%	58%	145%
Other Long Term Assets		0	0	0	0	0	0	0	0	-	-	-
<b>LIABILITIES AND EQUITY</b>		<b>14 871 393</b>	<b>23 937 915</b>	<b>33 140 764</b>	<b>38 339 751</b>	<b>7 603 739</b>	<b>12 239 449</b>	<b>16 944 863</b>	<b>19 603 104</b>	61%	38%	16%
<b>Liabilities</b>		<b>13 154 857</b>	<b>20 448 222</b>	<b>26 143 223</b>	<b>29 256 087</b>	<b>6 726 075</b>	<b>10 455 170</b>	<b>13 367 023</b>	<b>14 958 629</b>	55%	28%	12%
Short term liabilities		97 818	1 279 470	2 468 240	2 655 894	50 014	654 193	1 262 010	1 357 958	1 208%	93%	8%
Demand Deposits		0	0	0	0	0	0	0	0	-	-	-
Compulsory Deposits		0	0	0	0	0	0	0	0	-	-	-
ST Time Deposits		0	0	0	0	0	0	0	0	-	-	-
ST Borrowings	5	0	841 800	1 928 150	1 916 070	0	430 412	985 863	979 686	-	129%	(1%)
Interest payable		0	0	0	0	0	0	0	0	-	-	-
Other ST Liabilities	6	97 818	437 670	540 090	739 824	50 014	223 781	276 148	378 272	347%	23%	37%
Long term liabilities		13 057 039	19 168 752	23 674 983	26 600 193	6 676 060	9 800 978	12 105 012	13 600 671	47%	24%	12%
LT Time Deposits		0	0	0	0	0	0	0	0	-	-	-
LT Borrowings	7	1 558 020	7 072 345	10 719 047	10 644 847	796 615	3 616 088	5 480 646	5 442 707	354%	52%	(1%)
Other LT Liabilities	8	11 499 019	12 096 407	12 955 936	15 955 346	5 879 445	6 184 890	6 624 366	8 157 964	5%	7%	23%
<b>Equity</b>		<b>1 716 536</b>	<b>3 489 693</b>	<b>6 997 541</b>	<b>9 083 664</b>	<b>877 664</b>	<b>1 784 279</b>	<b>3 577 841</b>	<b>4 644 475</b>	103%	101%	30%
Paid-In Capital		0	0	0	0	0	0	0	0	-	-	-
Donated equity	9	1 040 542	1 053 506	2 668 506	3 037 127	532 029	538 657	1 364 406	1 552 882	1%	153%	14%
Retained earnings without donations and reserves		675 994	2 436 187	4 329 035	6 046 537	345 636	1 245 622	2 213 434	3 091 593	260%	78%	40%
Current year		913 184	1 383 694	1 876 885	1 717 318	466 911	707 482	959 651	878 064	52%	36%	(9%)

## Adjustments

	Dec. 2001 (8 months)	Dec. 2002	Dec. 2003	August 2004 (8 months)
<b>Adjustment for the cost of funds = (a*b)-c</b>	<b>878,830</b>	<b>1,819,510</b>	<b>1,967,800</b>	<b>1,457,388</b>
Average amount of borrowings (a)	11,569,350	16,533,796	22,806,843	27,059,698
Shadow price of borrowings (b)	8.0%	12.0%	10.0%	6.7%
Interest expense on borrowings (c)	46,718	164,545	312,884	346,592
<b>Adjustment for inflation = (d-e)*f</b>	<b>5,549</b>	<b>7,055</b>	<b>42,733</b>	<b>41,968</b>
Avg. Equity (d)	1,084,200	2,603,115	5,243,617	8,040,603
Average fixed assets (e)	159,294	251,289	495,473	1,046,013
Inflation rate (f)	0.6%	0.3%	0.9%	0.6%
<b>Adjustment for in-kind donations</b>	<b>0</b>	<b>18,720</b>	<b>18,720</b>	<b>12,480</b>
Staff and technical assistance	0	0	0	0
MIS (maintenance costs and consulting services)	0	18,720	18,720	12,480
<b>Adjustments for provisions</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>
<b>Other adjustments</b>				
<b>Total adjustments</b>	<b>884,379</b>	<b>1,845,286</b>	<b>2,029,254</b>	<b>1,511,835</b>
Net income before donations	913,184	1,383,694	1,876,885	1,717,318
Adjusted net income before donations	28,805	(461,592)	(152,369)	205,483
<b>Adjusted net income before donations (EUR)</b>	<b>14,728</b>	<b>(236,012)</b>	<b>(77,906)</b>	<b>105,063</b>

## Board of Directors members

Name	Position on Board	Education	Current position	Date elected to Board
Mr. Sead Mucić	Chairman	Bachelor in Economics	Regional Director, UPI Bank	February, 2001
Dr Richard Reynolds	Member, World Vision representative	D.Phil. by Research in Management Studies, M.A. Development Economics and B.Sc. (Hons) Agricultural Economics	Technical Advisor, Vision Fund	April, 2004
Ms Sue Birchmore	Member, World Vision representative	B.Sc. Mechanical Engineer	World Vision National Director, Bosnia and Herzegovina	November, 2002
Ms Zlata Gafić	Member	Bachelor of Comparative literature and English language		February, 2001
Mr. Stevo Sotonica	Member	Bachelor in Management	Coordinator at the local NGO	February, 2001
Mr. Novak Radojčić	Member	Bachelor of Political Sciences	Coordinator for the international organizations at the Municipality of Dobož	February, 2001
Ms Meliha Ferhatbegović	Member	Bachelor in Economics	Senior Official at the Ministry of Finance and Treasury	April, 2004