

Partner

Bosnia and Herzegovina

February 2004

Global Rating

A
Trend: Stable

Started by Mercy Corps/Scottish European Aid in April 1997, Partner is a locally registered microfinance organization in Bosnia and Herzegovina since December 2000 and is one of the largest providers in BiH. Headquartered in Tuzla, this multi-ethnic and inter-entity organization currently provides individual loans to 11,935 clients, 56% of which are female, in both entities, the Federation and the Republika Srpska, as well as Brcko District.

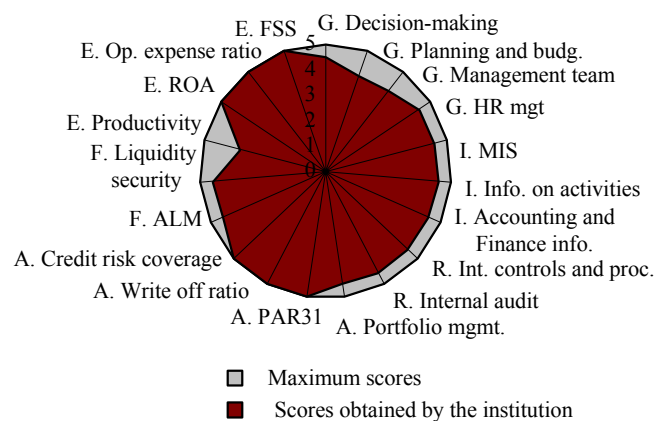
Rating Plus Summary

Environment Competitive; changes soon to legal environ.
Maturity **Young:** 7 years of operations
Scale **Large:** Portfolio of over 12 million EUR
Target market **Broad:** Avg. out. loan 63% of GNP per capita

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

Area Scores

Governance and decision making **a**
Information management and systems **a**
Risk Management **a**
Activities: products and services **a**
Financing and liquidity **a**
Efficiency and profitability **a**



	2001	2002	2003
ACTIVITIES			
Number of employees	68	76	93
Total assets (K EUR)	7 345	10 328	13 568
(K BAM)	14 365	20 200	26 536
Outstanding loans (K EUR)	6 814	9 513	12 131
Active borrowers	6 777	7 139	11 935
Active clients (borrowers + savers)	6 777	7 139	11 935
Annual effective interest rate	See notes		
PAR _{30 days}	0.2%	0.3%	0.6%
Risk coverage ratio	1062%	725%	451%
Write-off ratio (after 120 days)	0.3%	0.2%	0.2%
GROWTH			
Portfolio growth	37.2%	39.6%	27.5%
Asset growth	38.4%	40.6%	31.4%

	2001	2002	2003
PERFORMANCE			
Staff productivity	100	94	128
ROA	13.6%	9.9%	9.7%
AROA	4.7%	1.7%	3.8%
ROE	16.9%	12.8%	13.4%
AROE	5.9%	2.2%	5.3%
Portfolio yield	35.7%	31.9%	29.1%
Operating expense ratio	20.1%	18.6%	15.8%
Operational self sufficiency	174.2%	156.8%	158.1%
Financial self sufficiency	117.8%	106.7%	117.2%
FINANCING			
Commercial loans / Assets	0.0%	0.0%	3.7%
Leverage	0.22	0.34	0.42
Exchange Rate BAM/EUR	1.96	1.96	1.96

(a) Partner offers four basic products based on business type and loan size. The smaller sized family loans have the highest average effective interest rate at 42.9% and the agriculture loans with the lowest average effective interest rate at 24.5%. The other two products for regular business loans, short-term and long-term, have average effective interest rates of 28.4% and 28.3% respectively.

Rating Scale

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

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

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

Ratio Formulas

Personnel productivity	Active borrowers / Total personnel (end of period)
Loan officer productivity	Active borrowers / Total Loan Officers (end of period)
Return on assets	ROA: Net operating income before donations / Average assets
Adjusted return on assets	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), the goal of which is to support and enable the development of financially strong microcredit programs. The rounds of LIP financing for fewer and fewer MFIs have spurred consolidation within this sector through takeovers/mergers, a trend that will likely continue according to many local actors. Other actors such as KfW and USAID have been funding MFIs in addition to numerous other national development agencies.

Started by Mercy Corps/Scottish European Aid in April 1997, Partner is a locally registered microfinance organization in Bosnia and Herzegovina since December 2000 and is one of the largest providers in BiH. Headquartered in Tuzla, this multi-ethnic and inter-entity organization currently provides individual loans to 11,935 clients, 56% of which are female, in both entities, the Federation and the Republika Srpska, as well as Brecko District.

Partner received a final rating of A with a stable trend.

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

- ❑ Partner has had a Board of Directors in place even prior to its local registration in 2000. The current Board includes a mix of older and newer members who play a sufficient oversight role. A Committee structure is underway to further improve the Boards contributions to Partner and the efficiency of the general meetings.
- ❑ Partner has a highly organized business planning process involving the appropriate actors that results in highly detailed budgets and program projections tracked monthly. Partner has come close or exceeded its business plan goals in the past. Future expansion plans are very ambitious and a challenge to meet with increasing competition and further expansion into rural areas.
- ❑ The management team now covers all the key positions and has developed a successful track record thus far. To meet the needs of an increasingly demanding market, Partner plans to add two new positions to improve skills and capacity in the credit department.
- ❑ Partner has always maintained a professional approach to staff recruitment, investment, evaluation, and remuneration. The recently created HR Manager position will also address issues of worker efficiency and career development.

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

- ❑ Partner uses two off-the shelf software programs for accounting and loan tracking and has been paying both software providers to develop easier data transfer between the systems. With the hiring of an MIS manager in 2003 and the move to its new headquarters, computer hardware, software, and security systems have also seen notable improvements.
- ❑ Portfolio information is accurate and up-to-date. The system provides appropriate information by product, loan officer, etc. and is available to those who need it.
- ❑ The accounting and finance information is accurate and up-to-date with monthly statements and indicator analysis. Goals for the future include product based costing analyses and easier data transfer between business planning, loan tracking, and accounting software.

Risk analysis received the rating **a**:

- ❑ Partner has a solid internal control system and has eliminated many potential risks of fraud and cash handling by using banks to handle all transactions.
- ❑ Partner invested early in an Internal Auditor position reporting directly to the Board of Directors. Audit procedures and reports are well document. To meet the demands of

growth, the Internal Auditor will be training other Partner staff to assist in audits as needed.

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

- ❑ Partner has positioned itself as the MFI “at your doorstep” with a vast office network and procedures to disburse loans quickly. Partner is also working to capture more of the agriculture loan market during its expansion.
- ❑ Portfolio management is adequate and growing increasingly specialized by product. Recent policy changes to ease the loan oversight work of Regional Managers should be monitored to ensure that the impact on portfolio quality is not problematic.
- ❑ Like many MFIs in Bosnia, Partner has consistently strong portfolio quality, 0.6% PAR31. This risk is fully covered by a conservative loan loss provision policy.

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

- ❑ Partners initial funding through founder Mercy Corps and through the LIP has been complemented more recently by loans through KfW, USAID, Raffeisen Bank, in addition to negotiations with other sources. Funding sources to meet growth in 2004 have been identified.
- ❑ Liquidity management is sufficient and a Funds Coordinator is dedicated to monitoring fund needs for each office. Partner’s security margin goal was recently lowered as it was not met and deemed unnecessarily high.

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

- ❑ Partner has proven consistently profitable with an ROA over 9% over the last several years. Partner is also financially self-sufficient after adjustments, and has continued to lower its operating expense ratio, 15.8% in 2003.
- ❑ Strong competitive pressure to decrease interest rates coupled with increases in the cost of funds will require Partner’s vigilance in decreasing the operating expense ratio.

Overall summary:

- ❑ **Key strengths include:** A position as one of the top three MFIs in BiH covering a considerable part of the country through an extensive office network, appropriate internal controls; portfolio management that results in excellent portfolio quality and continued strong financial performance.
- ❑ **Areas for improvement include:** Improving Board involvement through Committees and clearer positioning in the market.
- ❑ **The principal risks include:** Successful management of the merger underway with BosVita (thus far positive), managing growth and risks related to increasing the portfolio in agricultural products, and maintaining the same strong level of profitability despite several downward pressures on profitability.

Funding needs:

- ❑ Partner is seeking additional financing of 27 million EUR through 2008, of which approximately 6.6 million EUR is already either committed or under negotiation with funders and approximately 1.6 million EUR would be added upon merging with BosVita.
- ❑ Planet Rating believes that Partner is a profitable institution with solid operations and financial management and a proven track record to support commercial rate debt.

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

Changes Since the August 2002 Rating

The rating for Partner has improved from G4* (B+) to A¹. The major changes since the 2002 rating are described below.

The rating for **G** improved from **b** to **a**:

- ❑ The Board has made progress towards further clarifying their responsibilities by developing Working Regulations and creating recently Board committees (HR, Strategy, and Audit Committee), with staffing soon to be finalized. In order to avoid potential conflict of interest of both Board members and Partner employees, the Board introduced a Conflict of Interest Statement and a Code of Conduct.
- ❑ Partner has strengthened its management team by adding an MIS manager and more recently a Human Resources manager.
- ❑ Partner has nearly finalized a merger with BosVita, a much smaller MFI with similar products operating in the same area.
- ❑ The organizational chart anticipates two new positions in the Credit Department and a segregation of legal and administrative activities. It is expected that these changes will allow the management team to better separate strategic management from the operations.

The rating for **I** remains unchanged (**a**):

- ❑ Partner filled the new position of MIS manager in April 03 and now has a clear MIS plan.
- ❑ Partner has upgraded its network, added 24-hour Internet at HQ, and new hardware. Several accounting-related software items have been integrated into the general ledger software. The loan tracking software now allows data exchange via email.
- ❑ Security improvements include a firewall, mirror hard drive for backups during the day, and better password security in the loan tracking software.

The rating for **R** improved from **b** to **a**:

- ❑ The Internal Auditor continues to provide quarterly reports and focus on credit risk, financial audit, and other procedural controls. Partner has received additional technical assistance on internal control from the LIP II program.

The rating for **A** remains unchanged (**a**):

- ❑ Partner has made several improvements to loan products after product research, including smaller loan sizes for the new target of family businesses, grace periods for a lower priced agricultural loan, an overall interest rate reduction, and decreasing interest rate for renewing clients.
- ❑ Partner has adopted an “at your doorstep” approach to clients to develop its competitive advantage using its vast network of offices as close as possible to clients and by providing mobile phones and more vehicles for LOs to make them more accessible to clients.

The rating for **F** improved from **c** to **a**:

- ❑ Partner has diversified its funding base to include commercial rate loans from Raiffeisen Bank and Blue Orchard as well as loans from KfW and an additional USAID source.

The rating for **E** remains unchanged (**a**):

- ❑ Overall profitability remains strong, although it is unlikely to reach 2001 levels given the downward pressure on interest rates due to market conditions.
- ❑ Experienced loan officers have become significantly more productive in terms of number of clients, with average caseloads up from 150 to 200, although the portfolio size per loan officer has remained the same with the introduction of the smaller family business loans.
- ❑ Operating costs as a percent of the loan portfolio have dropped significantly, from 18.6% in 2002 to 15.8% in 2003 as expenses came in under budget in 2003.

¹ The GIRAFE method was changed in January 2003. The rating corresponding to G4* is B+ in the new rating scale.

Rating Plus

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

Environment Nine years after the Dayton Agreement ended the conflict between Bosnia and Herzegovina, the country still relies on foreign aid. BiH is still undergoing the transition from a centrally planned system to a

	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%

Source: Central Bank of Bosnia and Herzegovina

free market economy. Only a few of the privatization initiatives have created the conditions needed for sustained business development. Much needs to be done to improve the legislative environment or to eliminate administrative barriers to investment. BiH has just been rated B3+ by Moody's Investors Service, which makes Bosnia more secure for foreign investments.

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

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

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

Maturity and Scale Partner is considered Eastern Europe and Central Asia Large in the MBB given a portfolio size of over 12 million EUR thanks to initial capital provided by Mercy Corps as well as retained earnings and several concessional rate loans. Although Partner has been locally registered since the end of 2000, the operations have been in place since 1997. Although still considered "young" for peer group purposes, Partner has well mastered systems for credit and finance.

Target Clientele Partner's average loan at disbursement is 96% of GNP per capita and average outstanding loan at 63%, placing it in the Broad category for the MBB.

- ❑ 56% of active Partner clients are women and 62% are rural clients. To reach these rural clients, Partner has invested in an extensive branch network.
- ❑ The average loan size at disbursement decreased considerably in 2003 with the introduction of the family business loan, of smaller loan size and shorter duration. The average therefore combines some very small loans less than 1,500 BAM (25% of clients), and much larger loans up to 20,000 BAM.
- ❑ Working in both entities and the Brcko District, Partner reaches displaced persons and returnees for over 25% of active clients.

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Acronyms



ALM	Asset/Liability Management
AMFI	Asocijacija Mikrofinansijskih Institucija (BiH Association of Microfinance Institutions)
BAM	Konvertibilna Marka (local currency, also called BAM)
BiH	Bosnia and Herzegovina
BPRM	Bureau of Population, Refugees and Migration
EBRD	European Bank for Reconstruction and Development
EIR	Effective interest rate
EU	European Union
EUR	Euro
EURIBOR	Euro Interbank Offered Rate
HR	Human Resources
GNP	Gross National Product
GDP	Gross Domestic Product
HQ	Headquarters
HR	Human resources
IAS	International Accounting Standards
IFAD	International Fund for Agricultural Development
IFC	International Finance Corporation
IRC	International Rescue Committee
KfW	German Development Bank
LAMP	Linking Agricultural Markets to Producers
LID	Implementing agency for LIP, now Odraz Foundation in the Federation
LIP	Local Initiatives Project of the World Bank
LIP II	Local Initiatives Project of the World Bank Round II
LO	Loan officer
LTS	Loan Tracking Specialist
MBB	MicroBanking Bulletin
MIS	Management Information System
MC/SEA	Mercy Corps/Scottish European Aid
MFI	Microfinance institution
MFC	Microfinance Center for Central and Eastern Europe and the Newly Independent States
MFI	Microfinance institution
NGO	Non Governmental Organization
PAR	Portfolio at risk
ROA	Return on assets
ROE	Return on equity
RS	Republika Sprska
SME	Small and medium sized enterprise
UNDP	United Nations Development Program
UNHCR	United Nations High Commissioner for Refugees
USAID	United States Agency for International Development
USD	United States Dollar
USDA	United States Department of Agriculture

Microfinance Environment

The country

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

History of the sector

Microfinance sector highly organized

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

World Bank LIP program the leading funder of microfinance in BiH

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

USAID and KfW also key lenders to MFIs

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

Banking sector

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

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

Many banks reticent to lend to MFIs

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

Microfinance regulatory environment

The LIP implementing bodies in the RS and the Federation along with the World Bank are engaged in a long-term effort to develop the legal and regulatory framework for different types of savings and loan institutional structures. Until now, only the law on microcredit organizations has been passed in both the Federation and the RS. The law is simple and provides for registration of specialized credit-only, non-government, non-profit institutions with minimal regulation and no formal government supervision. There are different local interpretations as to the latitude of the law to provide microcredit beyond development of entrepreneurship loans and there have been no actions taken against MFIs known to provide other types of loans.²

Legal reforms under discussion to increase opportunities for MFIs

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

Microfinance Providers

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

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

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

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

through consumer loans. The competition among the MFIs is intense and some urban markets are at or near saturation, therefore many MFIs are seeking to expand their rural outreach.

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

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

Institutional Presentation

Mission Partner provides financial services to economically active people who do not otherwise have access to commercial sources of funding. Partner's mission is to: a) Support micro-entrepreneurs to start or expand their businesses; b) Encourage the transition to a market economy, c) Promote women in business and offer easy access to credit in rural areas; and d) Increase employment, improve living standards and create better economic opportunities in Federation, Republic of Srpska and Brcko District. Partner fulfills its mission by providing high quality loan products, training and technical assistance and preserving financial sustainability.

Legal form, supervision Partner registered December 11, 2000 with the Federation Ministry of Social Welfare, Displaced Persons, and Refugees as a Microcredit Organization headquartered in Tuzla under the Federation law enacted July 2000. Subsequent to the enactment of the December 2001 RS microcredit law, Partner registered with the RS Ministry of Finance its RS branch offices. Partner is not subject to any banking supervision.

Networks Partner is a member of local, regional, and international networks. These include AMFO, the local association of MFIs in Bosnia and Herzegovina, MFC, the Microfinance Centre for Central and Eastern Europe and NIS, and the Mercy Corps network of associated MFIs. Partner is also a member of Tuzla Canton Chamber of Commerce.

Founder and Ownership As a local non-profit microcredit organization, Partner has no owners. The Founder of Partner is Mercy Corps, and this relation is explained in the Founding Agreement dated November 15, 2000 and recently extended to November 15, 2004. Partner must fulfill basic performance requirements and preserve the same general target population to continue using Mercy Corps funds previously granted for loan capital as well as the associated earnings. A decision will be made regarding capitalization, per the November 15, 2003 Partnership Agreement, Partner and Mercy Corps will decide on the form of capitalization which may be through a direct grant or an equity participation if later legally allowable.

A Board of Directors has been in place since prior to local registration. Partner's statutes, last revised on December 18, 2003, anticipate 7 to 13 Board members with representation from the Federation, RS, and the Brcko District as well as two members appointed by the Founder, as stipulated in the Partnership Agreement. Associate members who finance Partner also participate in Board meetings and reserve the right to appoint the representative from their institution for tenures as seen appropriate. The addition of the Associate members is required by LIP. There are currently nine Board members and two Associate members.

Board of Directors	Position	Since	Profession
Bahrija Tanovic	President	Oct. 1998	Graduated Economist; Director of Tuzla Canton Agency for Privatization
Fadil Merdic	Member	Feb. 2003	Graduated Engineer of Agriculture, currently employed by Kakanj Town hall as Professional Collaborator for Agriculture
Zdravko Danilovic	Member	Feb. 2000	Labor Engineer; currently retired; formerly journalist and public servant
Branka Ilic	Member	Jul. 1998	Graduated Economist; currently retired; formerly with various businesses including banks
Pamela Eser	Member	Sep. 2000	MBA; Director of Mercy Corps Microenterprise and Economic Development; Director of MC/SEA predecessor to Partner
Richard M.Thwaites	Member	Nov. 2002	Mercy Corps Country Director, BiH
Stanko Dusanic	Member	Feb. 2000	Political Science; experience in journalism and municipal government

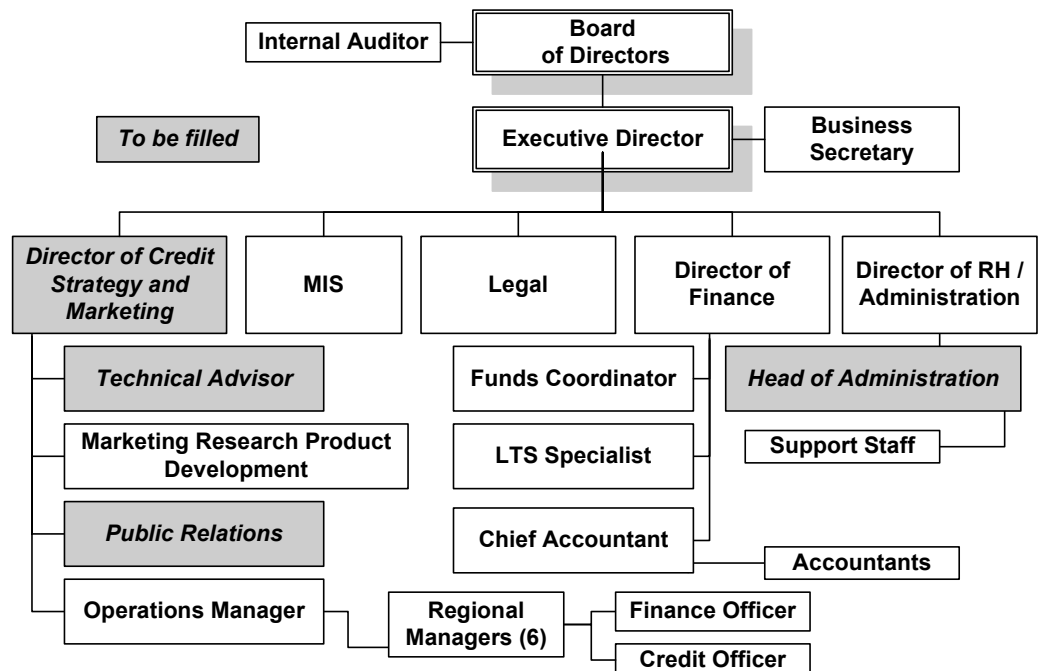
Board of Directors	Position	Since	Profession
Fehmo Huremovic	Member	Sep. 1998	Graduated Economist; currently retired; formerly with several Tuzla based businesses
Sasha Barnes	Member	Feb. 2003	UMCOR, Sarajevo, Bosnia and Herzegovina,
Raiffeisen Bank representative	Associate Member	Feb. 2003	Raiffeisen Bank
Odras representative	Associate Member	Feb. 2003	Odras Foundation

Team and structure

Partner has its headquarters in Tuzla for management and centralization of information generated by the regions. The 26 field offices, that house one or more loan officers, are grouped into 6 regions. The regional offices are managed by a Regional Manager, who is responsible for strategic planning of the region, supervision and support of loan officers, general oversight of credit activities, and for the Finance Officer of the region. Loan information and accounting for the regions is managed by this regional Finance Officer and all information and supporting accounting documents are regularly transferred to headquarters for consolidation.



All loan approvals, disbursements, and repayments are decentralized to the regions where loans are approved by a credit committee. There is no cash handling as Partner works with local banks to serve as teller windows for disbursement and repayment. Regional offices manage data entry and loan officers have access to all needed client information in a timely manner. Partner anticipated a target structure of one Regional Manager for a maximum of 12 loan officers, although the organizational structure is being updated with the addition of BosVita staff.

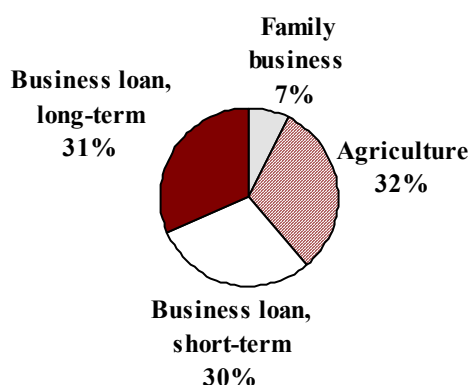


Human resources	2001	2002	2003
Number of employees	68	76	93
% Loan officers	65%	62%	66%
Turnover (exits/ period average staff)	9%	1%	1%

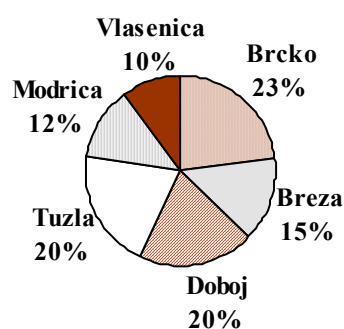
Loan Products Please refer to the appendix for more details on these loan products.

Partner offers three loan products for business purposes: the family business loan, the agriculture loan, and the loan product for trade, services and production businesses. In the past, loans were distinguished by loan size but were not necessarily targeted to different market segments. In 2003, Partner redesigned the products by purpose and target groups with corresponding interest rates, loan sizes, and loan terms. Partner also introduced a “loyalty package” for returning clients including decreasing the interest rate from cycle to cycle, longer loan terms and an increase in loan sizes. In January 2004, Partner lowered interest rates and made less strict requirements for loan renewal for clients who had experienced late payments.

Portfolio by Product



Portfolio by Region



External audits and reporting Since 1999, the accounts of Partner and its predecessor under MC/SEA have been audited by Revik d.o.o. Sarajevo, a local partner of PriceWaterhouseCoopers Netherlands. These external audits have all provided a clean opinion on Partner’s financial data. The same firm has audited 8 other Bosnian MFIs in the past and has been in communications with World Bank actors on microfinance issues.

BosVita to join with Partner Partner and BosVita, another local MFI of smaller size serving similar clients in the Tuzla area, will be merging by June 1, 2004. This operation has been approved by the respective MFI Boards and preparations are well underway. Please see the end of this report for more details on BosVita and the merger, which is referred to as a “joining” by both parties.

Governance and Decision Making

Decision making

Open decision-making process

Decision-making process

The decision-making process is open and clearly defined, bringing together the appropriate actors. The Board provides sufficient supervision to ensure compliance and validate Partner's mission and strategy. In general, Partner solicits the input of staff for important documents through meetings and comment periods, prior to final decisions. Decisions which are made by the Board, many of which are required by law and incorporated into Partner's statutes, include adopting business plans, budgets, programs, and all other reports important for business performance.

Committed Board seeking to be more effective through committees

Skills and engagement of governance bodies

The Board has taken initiatives to strengthen its role by developing Working Regulations and creating key committees (HR, Strategy and Audit). The HR committee has been staffed and has as its first task is to set up criteria and select members for the other two committees. The full Board meets at least quarterly for meetings that are well documented in minutes. Partner has been working to overcome the challenges of cultivating a non-profit Board through occasional exchange visits and retreats.

On occasion, Board members have directly facilitated the work of Partner (recovery of funds held at a bank that went bankrupt; assistance with local registration in Brčko). Although only three Board members have prior microfinance experience, two of which are Mercy Corps representatives, the Board has grown knowledgeable over time about the specificities of the work. Per LIP program guidelines, Partner has added Associate Board members with non-voting rights who represent funders (Odraž Foundation managing LIP and Raiffeisen Bank).

Extensive management information; Goal to reduce Board information packets through greater use of committees

Management information

Partner has ample management information for the management team and the Board. Detailed quarterly reports with financial and portfolio performances are submitted to the Board as well as any other appropriate documents. The management team has access to monthly financial statements and other portfolio reports. An Internal Auditor, reporting directly to the Board, provides quarterly reports regarding the quality of financial reports as well as an audit of credit operations and tax calculations. In some cases Board members receive too much information and it is expected that with the new sub-committees, the information packets for the full Board meeting will be more manageable.

Strategic decisions communicated to all staff

Communication of strategic decisions

Partner clearly communicates strategic decisions given the participatory nature of the decision-making process, regular meetings, and transparency of data and key documents. All-staff meetings are another forum for communication, four of which were held in 2003. The business plan is made available on the intranet, which all staff has access to. Staff members are also clearly informed of their own individual performance goals that flow from the overall strategy.

Planning

Major risks identified, measures vis à vis strategic positioning could be stronger

Risk identification

Partner has addressed several key risks in its business plan and strategy. The biggest risk at present is competition, which Partner seeks to address through a series of operational goals such as faster service, loyalty advantages, and an office network that brings Partner "to your

doorstep.” (please refer to Section A). The strategic positioning in terms of target market is not sufficiently clear, however even if not openly stated in the business plan, Partner is orienting activity increasingly towards agriculture and rural areas, an area where banks will be least likely to compete. Other risks include access to sufficient funding, lack of improvement in the legal and macroeconomic environment, and potential client cross-indebtedness. Partner has been able to secure funding for 2004 and is now working on sources for 2005 and beyond. Internal weaknesses that Partner seeks to improve include MIS needs and overburdened staff, notably credit and accounting, these issues being addressed in the current plan.

Budgeting and projections

Thorough planning process with close monitoring of results

Partner has a very thorough business planning process, involving the relevant actors and a clear timetable and process for achieving the final product. Regional Managers, all trained with Microfin, an Excel-based business planning tool, play an active role in providing operational estimates that are then negotiated with management. These operational goals are also broken out by loan officer. Partner closely monitors its actual performance as compared to planned results for both financial and operational achievements. Partner also has a separate set of goals in its Balanced Scorecard. The Balanced Scorecard is a tool for executive strategy which facilitates decision-making processes and measures success on other organizational and quality indicators towards achievement of strategic targets.

Feasibility of current strategy

Vigilance necessary to meet ambitious client growth and operating efficiency targets

Partner seeks to reach over 38,000 clients and a portfolio size of over 54 million by 2008 by continuing to expand geographic coverage, including for agriculture clients, and achieving a higher client retention rate. Presumably other MFIs in Bosnia have plans to expand their client base ambitiously, and given the already competitive nature and small size of the market, Partner will need to be very vigilant to maintain this position, especially since Partner’s interest rates are not lower than its major competitors. Partner seeks to distinguish itself through the competitive advantages such as proximity to clients (“at your doorstep”), client loyalty incentives, fast loan disbursement, and easy guarantee mechanisms. Partner also plans to significantly decrease its operating expense ratio with very optimistic assumptions of portfolio per loan officer (see discussion in Section E). It should be noted that Partner has achieved ambitious goals for client growth in the past. Although in 2002 Partner was 20% under its client number target, in part due to a delay in receipt of funding in the first semester of 2002, in 2003 Partner met its target of over 67% client growth. Partner remains open to merger possibilities that would either accelerate achievement of these targets or modify the planned coverage area. (Please refer to the end of this report for a description of a merger with a smaller MFI, BosVita, already underway.)

Key Aspect	Expected Changes
Services offered and geographic coverage	<ul style="list-style-type: none"> <input type="checkbox"/> Expand operations in Northwest and Southeast Bosnia <input type="checkbox"/> Open a new regional office in 2005 and a seventh region subsequently <input type="checkbox"/> Open local offices in existing and new regions (list already determined) <input type="checkbox"/> Hire of 31 credit officers, 7 new HQ staff and 12 new regional staff members <input type="checkbox"/> Consider of other non-loan financial products with expected legal changes
Operational methods	<ul style="list-style-type: none"> <input type="checkbox"/> Use technology to enable quicker loan disbursements
Structure and statutes	<ul style="list-style-type: none"> <input type="checkbox"/> Seek appropriate merger partners <input type="checkbox"/> Possible transformation upon passage of anticipated new microcredit law
Supervision	<ul style="list-style-type: none"> <input type="checkbox"/> There is no supervision current or planned for microfinance entities in Bosnia other than local law
Financing	<ul style="list-style-type: none"> <input type="checkbox"/> Raise an additional 27 million EUR to reach a portfolio size of 54 million EUR by 2008 (mostly from commercial sources)

Source: Business Plan 2004 to 2008, December 2003

Management Team

*Entirely local team
has successfully
managed Partner;
Increasing
sophistication
required to compete*

Skills and experiences of management team

The management team has successfully led Partner as it became a locally registered and managed microcredit organization. Several key members of the management team have achieved their position through internal promotion and thus have learned on the job what they did not have the opportunity to learn in other positions or educational experiences. Board members are very satisfied with overall Partner performance and therefore have confidence in the Executive Director's abilities to lead the team. The increasing demands on MFIs to be more competitive and sophisticated will require increasing upgrades in skills. Partner is seeking to address this through ongoing training and the creating of new positions in credit and marketing

Executive Director:

The Executive Director, Senad Sinanović, started with the organization in 1997 as the first loan officer and subsequently as a Regional Manager and then Credit Manager before reaching his current position through hard work and internal promotion. Although he has not attended university or worked in other positions prior to starting with MC/SEA, Partner's founding organization, he has complemented his on-the-job training with microfinance seminars at Boulder and Bank Academy in Frankfurt in addition to MFC trainings, LID trainings and management coaching.

*All key positions
covered with new
MIS manager*

Definition of roles and separation of tasks

The management team has expanded in 2003 to include a Human Resource Manager and MIS Manager, who complement the Executive Director, the Finance Director, the Director of Credit Operations, Marketing Manager and the Assistant to the Executive Director for Legal issues/Head of Admin. The new positions address areas of weakness identified by Partner in the past, notably for MIS matters.

*New positions
expected to improve
skills and capacity in
credit department*

The new organizational chart will most notably improve the skills and capacity of the credit department, by creating two new credit department positions of a Technical Advisor and an overall Credit Strategy and Marketing Manager. Furthermore, the legal and administrative matters will be separated to allow each to specialize further in these tasks. It is expected that some of these management positions will be filled after a review of current management team skills within both Partner and BosVita.

*Clear communication
within management
team*

Communication within management team

The management team has clear communication both informally and through formal meetings. The team is up to date on the activities of the other departments and all are working towards the common goals outlined in the business plan.

Human Resource Management

*Clear and effective
approach to skills
management*

Skills management: recruitment, training, and internal promotion

Partner's approach to human resources is to develop a loyal team through training on the job and opportunities for internal promotion. The team covers all the basic needs of Partners, with occasional external consultants for major initiatives (organizational chart update, merger).

- Staff is recruited in the region where they will work through public announcements. Selected candidates are interviewed by a relevant team within Partner and then approved in the end by the Executive Director. The Executive Director has been removed from the recruitment process for easy cases.

- ❑ Partner trainings for new recruits are clearly formalized for loan officers (5 days of classroom training, 17 days with another loan officer/Regional Manager on-the-job) and less formalized for other staff. In the second month of employment, new recruits disburse 10-15 loans under close supervision of the Regional Manager. This includes visit to each client and loan business analysis together with Regional Manager.
- ❑ Training plans are based on the needs of the organization and the individual ambitions of employees as expressed in an all-staff questionnaire.
- ❑ The top management team discusses the training plan for external trainings. The more extensive trainings unfortunately require working knowledge of English and are therefore not accessible to all staff. To overcome this problem, Partner has adopted a strategy of requiring trained staff to in turn train other employees.
- ❑ Numerous staff members have been with the program for many years, grown via internal promotion, and consequently feel a strong sense of responsibility for Partner's future.
- ❑ Staff turnover has been quasi-nonexistent over the last couple of years, at approximately 1%.
- ❑ Other than pension and insurance registration complications across various political and administrative districts, Bosnian law does not pose any constraints on Partner's Human Resource management.

Per the Balanced Scorecard goals, Partner also seeks "to be the most innovative employer". Therefore, Partner measures its progress on a number of parameters to achieve this goal: employee suggestions implemented, the trainings per staff, comparisons of salary structure, technology solutions implemented to improve working conditions, etc.

Performance evaluation

Annual performance evaluation for all staff

Performance is evaluated on an annual basis for all staff through forms that include employee expectations for performance and actual achievements. In addition to supervisor evaluations, employees complete Individual Balance Score Card accompanied by a self-evaluation letter. The monthly incentive policy for loan officers serves as an ongoing performance evaluation. Other staff may receive financial awards in a given month if recommended by supervisors.

Skills of Human Resource Manager

HR Manager new to position

The Human Resource Manager has only recently begun her position and has prior experience with Mercy Corps on personnel issues. She has worked in several international organizations and has been exposed to human resource approaches not typically found in older Bosnian organizations. Her goals cover basic HR work and strategies for efficiency improvements, including: to identify strategies to improve work efficiency through analyses of time allocation, notably for loan officers, and overall report/paperwork reduction, to improve a career development plan which is part of Individual Balance Score Card, and to improve the incentive system. The upcoming merger will also be a focus for human resources with the integration of BosVita staff. Although human resources is a major consideration for the merger, it is not expected that staff will be fired as the stated goal of both parties is to keep qualified and appropriate staff.

Information Management and Systems

Management Information System (MIS) and Equipment

Description

Partner maintains a comprehensive computing system that satisfies its basic needs but seeks to further upgrade the speed of data transmission from the regions to headquarters and the ease of data exchange between software programs.

Computing Resources

Access to Internet: 24-hour access at headquarters, dial-up access in regional offices
Network: Local area network at headquarters and in each regional office; field officers have single posts
Software used: Kredits for Loan Tracking; Finansije for Accounting

Basic maintenance and internet/mail in-house; other maintenance and software outsourced

The MIS department was created in 2003 with the hiring of an MIS manager. The Loan Tracking Specialist who monitors the consolidation, integrity, and security of the loan tracking system at headquarters is a member of the finance department. Simple computer maintenance is handled by either the MIS manager or via contract with maintenance providers. Partner now maintains the Internet and email server, previously managed by two separate external companies. An internally maintained Intranet site has also been built.

Oracle-based accounting software integrated with other accounting packages

Partner uses several software packages to manage its accounting and payroll needs. Finansije is a locally developed general ledger accounting software formerly in Access and now in an Oracle platform. The software meets local and international accounting standards. Partner contracted the software provider to create a user module to generate reports. This module has already been incorporated into Partner's system. Software to manage fixed assets, petty cash, inventory, and salaries are linked to the accounting system.

Kredits, off-the-shelf software meets loan tracking needs

Kredits, an Access-based software developed in the United States, is used for loan tracking. The Loan Officer enters client and loan data the day of Credit Committee and the Finance Officer enters repayments. These repayments are entered upon receipt of bank statements either the same day or the next day. Therefore, each day in each region loan tracking data is reconciled with cash. The system also automatically generates loan contracts upon input of the loan data.

Security

Good MIS security, key risks addressed

With the move to a new headquarters, software upgrades and the hiring of an MIS manager, Partner has further strengthened MIS security. Backups occur nightly for all information on the headquarters server and throughout the day via mirroring (two hard disks on the server in the event of a data loss during the day). Partner stores the backups from headquarters in the bank safe. Loan tracking data is entered in the regional offices and transferred to headquarters, in the past weekly and in the future at a greater frequency (possibly daily). There are also daily back-ups at the regional office and weekly these data are transferred to headquarters.

Passwords are required on software. The loan tracking software is used by the greatest number of individuals but Kredits now includes nine access levels and an audit trail to control potential data manipulation.

Ease of system use

The system of data production and transfer is well mastered by Partner staff. Several of the planned improvements address areas where data transfer could be streamlined. One challenge

System easy to use and well-mastered by staff; goal to render system even easier

already achieved is the transfer of loan data to headquarters weekly via CD ROM delivery. With recent upgrades by the Kredits developer, Partner is now able to export/import data from the regions to headquarters with file sizes compressed down to approximately 200-400 KB, although this data transfer problem had been a challenge to Partner for over two years.

MIS plan and future improvements

Upon arrival, the MIS manager analyzed the status of MIS needs and then developed an action plan. Many upgrades in computing infrastructure were already performed in 2003 with the move to newly constructed headquarters. The goal of the 2004 MIS plan is to ensure a system that satisfies staff needs and in particular improves loan officer and accounting staff productivity. Such plans include the introduction of a single software which will allow one data entry about for credit activities in Regional Offices to be monitored at headquarters and automatically posted in the General Ledger at the client level.

MIS Plan focused on improving computer stock and ease of data transfer/integration

The MIS plan includes improvements both to software and hardware. Hardware improvements include a firewall, 32 desktop computers, 7 server desktop computers, 5 laptop computers, printers, hardware maintenance, peripherals, etc. Software improvements planned in 2004 include data transfer between loan tracking and accounting software, as both outside developers are working on this functionality. There is also a plan to acquire a software that will enable greater report generating capacity for data exchanged between the loan tracking system in Kredits, business planning data in the Excel model Microfin, and the accounting software.

MIS manager has strong management orientation

Skills of MIS manager

The MIS manager hired in 2003 has a diversity of experiences in both technology and other management positions. Unlike counterparts in many MFIs, her role as an MIS manager is not to develop software but to plan for and oversee the implementation of technology projects that support Partner's work. The combination of technical knowledge and management skills is clearly an asset for Partner.

Information on Activities

Regular, reliable, and up-to date loan data

Information quality

Loan portfolio information is of high quality and available typically the same day or next day in the field, and in consolidated form at headquarters on a weekly basis under the supervision of the Loan Tracking Specialist. Very recent improvements in the import/export facility of the loan tracking system should increase the frequency of data transfer. Kredits offers numerous loan tracking reports and statistics on loans and clients. Key data on outstanding and disbursed loans, or on portfolio quality are readily available. Data on client businesses and guarantors is also entered into the system. Actual portfolio performance is compared with loan portfolio goals per month by loan officer and office. In addition to the quantitative data, Regional Managers provide a simple narrative monthly report on notable events.

Marketing manager improving Partner's market information

The marketing department, created in 2002, has initiated several market studies to obtain more information on clients via focus groups and an Exit Monitoring System, the purpose of which is to understand exit patterns and identify priorities for further research and program improvements. To supplement these analyses, Partner could take advantage of the rich loan tracking data through analysis of client level data for marketing and product design purposes.

Information dissemination

All parties needing portfolio performance information have access to monthly reports. The different access levels to the loan database enables users to only consult the data they are

authorized to consult. The Intranet is a new medium to communicate important Partner data, events, human resource matters and strategic goals.

Financial and Accounting Information

Quality of information

Accounting information timely and accurate despite complications for administrative reporting

Partner's accounting information is timely and of high quality. The external auditor has never had problems or significant non-IAS adjustments to the accounting information and provides a clean opinion. All accounting data is processed at headquarters: Regional offices send weekly their invoices, bank statements and petty cash vouchers to headquarters.

Partner achieves this level of quality despite a number of administrative burdens that complicate the accounting process. Partner must report for tax purposes to both entities, the Brčko District, several cantons, and 12 municipalities where Partner has field offices in Republic of Srpska. Given funder requirements and the need to work with banks closest to the branch offices, Partner must manage 15 bank accounts for loan transactions and 4 accounts for expenses, down from 34 accounts in 2002. A goal for 2004 is to get the number of bank accounts down to 3 for loan purposes with improvements to the MIS and electronic banking options.

Monthly statements available with quarterly analysis; Activity Based Costing planned

Despite these challenges, Partner produces monthly financial statements, both globally and by region. This requires monthly calculations of reserves, loan write-offs amortization expenses. The internal financial statements conform to microfinance best practices and facilitate performance ratio calculations and analysis with quarterly calculations of microfinance adjustments. After several years of producing financial statements in Excel, since March 2004 Partner is now able to generate financial statements directly from the software since March 2004. It is expected that Partner will introduce an Activity Based Costing approach in 2004, a condition of LIP funds, to refine financial analysis as the product offerings and pricing become more diverse.

Financial management and skills of finance department

Knowledgeable finance team; goal to ease work burden with technology improvements

The financial department has skilled staff. The Finance Director has many years of experience in finance and accounting positions. She serves as a trainer for the MFC for Business Planning and Financial Projection (Microfin), and Fundamental Accounting for Managerial purposes and has attended the training programs with New Hampshire College, MFC and LID/Odras Foundation.

The current work overload for the accounting staff at headquarters is expected to decrease with planned technology improvements, notably the capacity to import directly into the accounting system the loan tracking data on disbursements and repayments. The finance team as well as regional managers are also seeking to reduce the work for business planning given limitations of the Microfin planning model to handle the level of detail in projections as required by Partner. Given the need to meet portfolio yield targets through an appropriate product distribution with varying interest rates, close monitoring of this information is critical.

Risk Management

Procedures and Internal Controls

Procedures conceived with internal control principals

Quality of procedures to limit risks

Partner maintains an integrated control system that successfully minimizes internal risks. There are key manuals for credit, internal audit, accounting, purchasing, and MIS that provide detailed procedures. An internal control manual outlines many major risks for credit and the policies in place to mitigate those risks, and this has been complemented by further suggestions to mitigate already identified as well as newly enumerated risks (a total of 60). A recent external evaluation of the internal control system by the LID technical assistance provider made several recommendations that are being implemented to further strengthen the system.

Credit and fraud risk minimized by bank partnership and credit committees

A clear segregation of duties, minimal cash carrying limits, and credit procedures serve to limit most employee fraud and credit risk with respect to loans. Loan officers are responsible for identifying and analyzing clients, and either Regional Managers approval for family business loans or Credit Committees for other loans. Loan disbursements/repayments are handled through banks.

The Internal Auditor typically finds that the internal control system has proven effective and that procedures are being applied. Failings of the internal control system that Partner has addressed through policy changes include, guarantee forms not completed, and in one exceptional case a fictional loan. In one incident, a loan officer and bank officer colluded to disburse a loan to the loan officer instead of client, resulting in a change in banks.

Procurement policies to limit risk

Other limits in purchasing and fixed asset acquisition prevent inappropriate expenditures on such items. Fixed asset purchases and service procurement over 500 BAM must be based on at least three bids, only specified parties may take possession of assets, there are clearly noted authority levels for requesting such expenses, etc. The head office centralizes all supply purchasing.

Pay incentives and transparency enable Partner to monitor performance

Systematic controls

Although there are no stated systematic controls for poor performance, policies, procedures, and transparency with regard to financial and portfolio performance serve to mitigate potential risks. Loan officers receive incentive pay that promotes strong portfolio quality. The status of their portfolio is known daily to Regional Managers and at least weekly to headquarters. Financial performance and expenditures are closely monitored at the regional level and overall Partner level with comparisons to budgets, limiting potential for excessive spending or under collection of expected revenues.

Internal Audit

Internal Auditor since 2001 reports to Board, enabling audit of headquarters

Internal audit procedures

Partner has wisely invested in a full-time Internal Auditor since 2001, reporting directly to the Board of Directors, who performs a very thorough audit of operations both in the regions and at headquarters. The internal control and internal audit manuals developed with the assistance of Shorebank Advisor Services focus attention on those risks most relevant to Partner.

The comprehensive audit covers credit risk, financial information, and compliance with internal procedures. MIS is one area for further education and improvement with regard to audit procedures. The audit manual outlines in detail procedures for audit and the approximate percent of time that should be allocated to the major risks (60% to credit operations, 20% to financial information, 10% to information systems, 5% to human resources and 5% to general administration). During the audit of the credit business activities, each of the 6 regions receives two visits per year. Given the increase in operations, the Internal Auditor will need assistance to maintain this schedule and will therefore train other Partner staff to assist in some of the audits. This was deemed a more cost effective solution than hiring a second auditor.

Comprehensive audit procedures

There are special procedures for both regional and headquarters audits. During each regional visit, the auditor selects at random a sample from the loan tracking system to review approximately 80 files (formerly about 100) and performs approximately 25 client visits per audit of the region. In addition to the random sample, the auditor will specifically target between 5 and 10 delinquent clients to visit. He will also review the execution of credit committee decisions as well as accounting data and tax payments. Headquarters audits include a verification that loan tracking and accounting information are consistent, a verification of bank balances, analyses of loan portfolio and reserves, and a verification of compliance with loan and grant contracts.

Quality of internal audit

The auditor has been with the program since inception and has held other positions (Finance Officer, Funds Coordinator) that make him well acquainted with the operations. He is focused on ensuring compliance with procedures but has also identified strategies to address the major findings of his audits.

Detailed reports now tracking implementation of recommendations

The Internal Auditor provides detailed quarterly reports to the Board describing the methods used and the internal audit reports. The reporting has improved progressively over time to the current report size of less than 15 pages that detail the methods used, the findings, and any recommendations. The Internal Auditor has also started to track recommendations from the last visit and to identify whether there has been improvement. Any major items are reported to the Executive Director before the report is submitted to the Board so that operational measures may be taken as soon as possible to address any problems. Given the already detailed nature of the reports, one possible improvement is an overall summary of key findings and recommendations such that the Board and appropriate managers could more easily track key issues.

Approach to risk management and internal controls

Partner has invested heavily in the internal audit function and has analyzed many key risks in the development of its policies and procedures. These issues are discussed generally among staff. Partner organizes a session once a year to revise current and potential risks.

Activities: Products and Services

Portfolio Management

	Market, competition, and competitive advantages
<i>Highly competitive market requires vigilance to attract and maintain clients</i>	The Bosnian microfinance environment is highly competitive, notably in urban areas where MFIs have been operating for years and banks are offering consumer loans. Microfinance clients will “shop around” to find the products most suited to their needs or, in many cases, take loans from more than one source at a time. Bosnian MFIs therefore must have increasingly strong competitive advantages to maintain their position.
<i>Partner has clear advantages over smaller MFIs but not necessarily over its same-sized peers</i>	Partner is clearly a top player in the market, notably given its size and office network outreach, and has many advantages over the numerous smaller MFIs in Bosnia. However, the lack of a truly distinctive strategic position and unique advantages as compared to its same-sized MFI peers does not guarantee a competitive edge. Partner’s “At Your Doorstep” marketing approach is a notable distinction designed to market Partner as the provider with the closest branches and most accessible loan officers, who also have company cell phones and shared company cars. The disbursement of family loans takes only 3 days on average and the agriculture/business loans approximately 7 days for new clients, 5 days for renewing clients. Partner is competitive on disbursement timing but others are similar or not far behind. The effective annual interest and loan terms are generally similar to other programs. Partner did lower interest rates in 2004, however other MFIs did as well therefore the rates will not necessarily attract clients from same-sized competitors who could afford to have a lower effective rate either due to a cheaper cost of funds or greater operating efficiency.
<i>Marketing efforts intensifying</i>	Client tracking and product development have grown essential for Partner to develop and maintain competitive advantages. The marketing department is therefore of increasing importance to develop new products and improve credit policies to retain clients. The budget is used for radio ads, newspaper ads, flyers, and giveaway products (such as baseball caps). The department has one manager who also works with a research team of 15 other Partner staff on particular studies. Partner also participates in the Ford Foundation funded ImpAct program through the MFC, which promotes the MicroSave tools for market research in the aid of product development. Partner is the first MFI in the region to adapt a Consumer Protection Code, which is hoped to encourage client feedback and promote a positive image of transparency.
<i>Product changes to better target clients and prepare for further expansion in rural areas</i>	Partner has made several advances in terms of product offerings and durations to better retain existing clients and attract new clients. As described in the institutional presentation, Partner now has a product targeted to families with small businesses, a product for larger businesses, and a product for agriculture clients. The research to develop more targeted agriculture projects is very important in preparation for increased expansion to the rural areas, where Partner sees the future of its growth and where funders like USAID and KfW are targeting their funds. In the past, Partner had essentially one product with terms varying slightly by loan amount. Partner is considering other products such as a short-term working capital loans to accompany existing clients with large business loans.
	Client retention is a major consideration for Partner, given its financial strategy of making loan officers more profitable with an increasing average loan size as clients stay longer with the program. To better motivate its clients, Partner instituted a policy to decrease the interest rate by cycle and changed the cap on the number of days late in a cycle before becoming ineligible

for a future loan. These changes were in direct response to a low client retention rate, which in 2003 was 55% based on a formula that considers clients who retook a loan during the year. Partner is working on institutionalizing the Exit Monitoring System for all clients so as to better understand and address the nature of this phenomenon. One result of this data is that many clients “rest” for a period of several months given the seasonality of their business but then retake a loan. This problem is not unique to Partner, as such rates are lower in Eastern Europe than in some other regions around the world.

Effective selection and delinquency monitoring contribute to high quality portfolio

Client selection, portfolio monitoring and delinquency management

Partner’s client selection, information system, loan officer incentive system and close monitoring of portfolio quality have contributed to a high quality portfolio.

- ❑ Clients should meet income/asset guidelines, have a business that will produce revenue with a potential for growth and provide financial information about their business.
- ❑ Loan officers spend approximately two hours for new clients and one hour with repeated clients, exclusive of travel time, during the loan application process for the individual loan product. The household loans are a simpler analysis and approval process. For larger loans, loan officers will spend additional hours performing cash flow projections.
- ❑ Loan officers are required to do a loan follow-up visit to verify that the loan was used for the stated purpose.
- ❑ Given the pre-selection by loan officers, the Committee rarely rejects candidates but may reduce the loan size from the request.
- ❑ Partner recently instituted the Senior Credit Officer position to manage loans over 7,000 BAM. This position is currently in place in two regions.
- ❑ Loan officers know of client delinquency within 24 hours from the regional Finance Officer (in person or by fax). If a client is late, the loan officer is able to contact the client very quickly to know the reason. The time-consuming delinquency cases are those who have more long-term repayment problems.
- ❑ The number of court cases pending is 59.

Loan officer skills

Loan officers adequately skilled through on-the-job training

Loan officers are adequately trained to perform their assignments. Although loan officers may not be college educated, they are eager to learn the necessary skills. Partner believes that the most educated profile is not necessarily the most adapted for a successful loan officer career. There are ongoing trainings for technical and managerial aspects of work (using guarantees, time management, communication, etc.). Loan officers are learning from other field officers for one month before issuing loans under supervision. There is a great reliance on other loan officers to coach as new officers must spend time with other officers in the field before issuing loans since there are too many new loan officers for the Regional Managers to coach directly.

Portfolio diversification policies

Partner has a portfolio policy to monitor the short-term versus long term portion of the portfolio. In addition, Partner has sectoral and product goals for the portfolio in its operational projections. In 2003, Partner virtually met its goal of 7% production, 32% animal husbandry and agriculture, 31% trade, and 30% services. Because the products have very different effective interest rates (family business loan, agriculture loan, business short-term, and business long-term), there are targets set by product to achieve the overall portfolio yield desired.

Portfolio at Risk Write-off Ratio

EUR (unless otherwise stated)	Dec. 2001	Dec. 2002	Dec. 2003
Number of active borrowers	6 777	7 139	11 935
% Change	24%	5%	67%
Outstanding portfolio (end of period)	6 814 110	9 513 135	12 130 890
BAM	13 327 240	18 606 075	23 725 959
% Change	37%	40%	28%
Average outstanding portfolio	5 618 161	7 567 726	10 748 121
Average loan at disbursement	1 568	1 900	1 524
% of GNP/capita	106%	122%	95%
Average outstanding loan	1 005	1 333	1 016
% of GNP/capita	68%	86%	63%
PAR >31	0.2%	0.3%	0.6%
Write-off ratio (after 120 days)	0.3%	0.2%	0.2%

Partner's portfolio continues to grow at a strong pace, reaching over 12 million EUR at end 2003. The portfolio has been growing steadily, with seasonal dips typically in January and late summer based given local holiday and vacation schedules.

Overall portfolio quality remains high

Portfolio quality has only slightly deteriorated and remains very high at under 1%. Bosnian MFIs typically have a high quality portfolio. Partner, like other Bosnian MFIs, rarely has long-term delinquency. Note that the incentive policy for loan officers in the past was extremely strict, allowing 0% PAR but this cap has been raised to 1% in support of greater loan officer efficiency. Recent policy changes to remove late penalty fees and no longer require Regional Manager visits to clients with loans over 10,000 BAM should be closely monitored for their impact on portfolio quality, if any.

Although Partner does have a conservative write-off policy and each month writes off all loans over 120 days in arrears, the write-off ratio remains minimal at approximately 0.2% annually. Since Partner began operations, it has recovered approximately half of all amounts written off. There are currently no rescheduled loans, although this may be allowed in exceptional cases upon approval by the Director of Credit Operations and the client will be excluded from taking a subsequent loan.

Minor regional and product differences in portfolio quality

Doboj, Tuzla, and Modrica have disproportionately higher PAR than the other regions, although still very low in absolute values. Among products, the agriculture loan has the lowest PAR. The other products have virtually the same PAR rates but given the small size of the family loans, it is the business loans that account for over 70% of the portfolio at risk greater than one day.

Average loan size rose in 02 and dropped in 03 with family business loan

The average loan size, which had remained relatively constant through 2001, grew considerably in 2002 and then declined in 2003. In 2002, Partner disbursed a greater than expected number of larger loans and fewer than expected number of smaller loans. The policy to raise the minimum loan size from 1,000 to 1,500 BAM could have also played a role. The drop in 2003 is attributable in large part to the introduction of the new family loan that has an average size at disbursement of 1,100 BAM.

Credit risk coverage

Coverage by provisions

Conservative provisioning

Partner has very conservative loan loss provisioning and write-off policies, a condition for participating in the LIP program. The 2% provision on the healthy loan portfolio provides additional coverage for other economic risks.

Provisions		Risk Coverage	Dec. 2001	Dec. 2002	Dec. 2003
Healthy portfolio	2%	Risk coverage ratio	1062%	725%	451%
PAR 1 – 30	20%	PAR > 30 days net of loan loss provision/ equity	Non applicable (PAR fully provisioned)		
PAR 31 – 60	60%				
PAR 61 – 90	80%				
PAR 91 – 120	100%				
Write-off 120 days					

All loans require guarantees; mainly a source of pressure for repayment

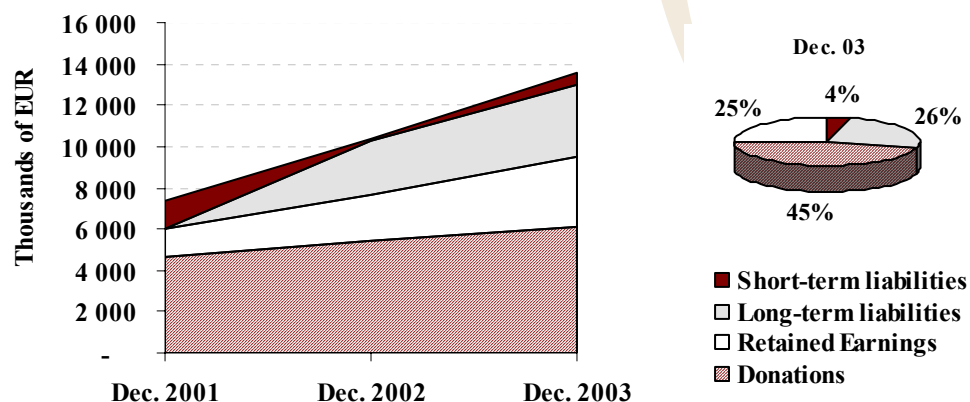
Partner requires at least one source of guarantee for loans up to 5,000 BAM. For loans from 5,000 BAM to 10,000 BAM, the client must provide two guarantees and for loans over 10,000 BAM, the number of guarantees is based on the loan officer's analysis. These guarantees could include a salary withholding (the most desirable form of guarantee), a bill of exchange, a pledge on moveable or non-moveable property, or a Verified Endorser statement (salary withholding from a third party). In practice, Partner uses the guarantors more as leverage to pressure clients to repay loans and rarely resorts to actually collecting from guarantors, in part due to low delinquency over 30 days and in part due to administrative hassles. Many of these guarantors are also clients, although Partner has yet to formally track the number of times any one person serves as a guarantor or the ultimate financial responsibility for a client given his/her loans and guarantee obligations.

- ❑ Salary withholdings must be approved by the employer, who is financially liable for paying the amount if the employer over issued such guarantees, a violation of the law.
- ❑ When executing a bill of exchange, the holder may take the bill to a bank, but if the funds are not available then the bill is simply returned within 24 hours unpaid. After 24 hours expires, Partner initiates a court process. Partner's experience shows that some of its cases initiated through the court last over 5 years.
- ❑ Moveable property may also be pledged but is a challenge to execute since the court does not have appropriate mechanisms, MFIs do not like to force property sales and culturally it is not well accepted to purchase such items. A law on a movable property register, expected in the near future, will provide additional opportunities to simplify procedures and help strengthen guarantee coverage.
- ❑ Mortgages are far too costly to use as collateral and administrative costs motivate many homeowners to not register their deed after purchase

Funding and Liquidity

Asset Liability Management and Financing Strategy

Description of capital structure



Capital structure mainly long-term; Mercy Corps funds under Founding Agreement the principal funding source

Partner has a long-term funding base of 25% retained earnings, 45% donated equity and 26% long-term liabilities.

- The majority of the 45% donated equity is technically a 0% liability from founder Mercy Corps and is classified as such in the audited financial statements. However, it is expected by all parties that these funds will become equity and classifying this as a liability gives a very different image of the capital structure.
- Long-term loans on the balance sheet at the end of 2003 were all at concessional interest rates (LID funds at 5%, USAID funds at 12-month EURIBOR, Mercy Corps funds at 0%).
- In 2003, the short-term loan is a commercial rate credit line at 8.25% from Raiffeisen Bank.
- Since 2003, Partner has contracted a loan with KfW at a concessional rate of 12-month EURIBOR.
- It should be noted that a requirement of the LIP loan is a leverage ratio of 3 and that 25% of the portfolio be financed by commercial sources. Partner will therefore have to seek additional commercial rate funding to reach this goal given that only 4% of the portfolio is financed at commercial rate end 2003.

ALM management not formally monitored but risks have been minimized

Asset/liability management procedures

Partner does not have a formal ALM policy but an ALM team may be put in place later this year. Partner monitors the portfolio for possible mismatches in maturity, as the portfolio in 2002 changed from 15% to 44% in long-term loans (final term of greater than 12 months). Of the current 48% of loans initially issued for terms beyond 12 months, the percent of principal falling due beyond 12 months is a considerably smaller percent of the outstanding portfolio. In comparison, virtually all of Partner's resources are long-term in either equity or loans, thereby eliminating this risk at present. Some Partner obligations are EUR denominated or variable rate, however local currency is pegged to the Euro. The weighted average loan term is 14 months, therefore Partner does have minor interest rate risk exposure.

Financing strategy

Partner seeking to significantly increase commercial rate debt

Partner seeks to take advantage of any remaining concessional loan opportunities but plans to finance the most of the portfolio growth of 27 million EUR through 2008 with local and international commercial sources. Expected new sources include the anticipated USAID LAMP funds of 1.6 million USD, 0.5 million EUR from KfW, 1 million EUR from Blue

Orchard, an additional 2.5 million EUR from Raiffeisen Bank, 0.25 million EUR from USDA and an additional 1 million EUR from LIP in 2004.

Liquidity Management

Physical security of liquidity

All disbursements and repayments are made through Partner banks, thereby ensuring the physical security of its funds apart from minor amounts of petty cash on hand. There are no plans to internalize cash handling.

Cash flow projections

Cash flow projections used to manage liquidity; complicated by numerous bank accounts

Partner uses Microfin to anticipate major periods of cash needs. While staff reported only a handful of times over the last several years when they had to wait for loan disbursement, Partner experienced one serious shortage early 2002 when two funders were unexpectedly delayed at the same time. Partner must carefully oversee liquidity to ensure ample funds in each of the regions for disbursements during the month given the 15 different bank accounts used for loan transactions. Regions submit monthly plans and the Finance Department's Funds Coordinator will oversee any necessary transfers between regions in compliance with grant agreements.

Prudential norms and security margins

Internal goal for liquidity revised downward

Partner's current policy is to maintain cash on hand to cover 4 weeks of expenses and 1 week of disbursements as a liquidity cushion. At the end of 2003, Partner was only at 26% of its prior goal (8 weeks expenses and 2 weeks disbursements) in part due to funder conditions and also given the shadow cost of such a goal in light of the cost of maintaining a balance on the credit line. Partner therefore changed the policy to in 2004.

Efficiency and Profitability

Ratio	Dec. 2001	Dec. 2002	Dec. 2003	Formula
Productivity				
Staff productivity	100	94	128	Active borrowers / Number of personnel (end of period)
Loan officer productivity	154	152	196	Active borrowers / Number of loan officers (end of period)
Profitability				
ROA	13.6%	9.9%	9.7%	Net operating income before donations / Average assets
Adjusted	4.7%	1.7%	3.8%	ROA after adjustments to net income
ROE	16.9%	12.8%	13.4%	Net operating income before donations / Average equity
Adjusted	5.9%	2.2%	5.3%	ROE after adjustments to net income
Liabilities/Equity	21.7%	34.2%	42.4%	Total liabilities (savings + borrowings) / equity (end of period)
Portfolio Yield	35.7%	31.9%	29.1%	Portfolio revenue / 13-month average gross outstanding portfolio
Without accrued interest	34.0%	30.5%	27.7%	
Operating expenses				
Over outstanding loans	20.1%	18.6%	15.8%	Operating expense / 13-month average gross outstanding portfolio
Over total assets	17.9%	16.0%	14.2%	Operating expense/ Average assets
Funding expense ratio	0.7%	0.8%	1.7%	Interest and fees paid on funding liabilities / 13-month average gross outstanding portfolio
Loan Loss Provision expense ratio	0.0%	1.1%	1.2%	Net loan loss expense / 13-month average gross outstanding portfolio
Adjustment expense ratio	10.0%	9.6%	6.5%	Total adjustments / 13-month average gross outstanding portfolio
Outstanding Loan Portfolio / Assets	92.8%	92.1%	89.4%	Portfolio / Total assets
Operational self-sufficiency	174.2%	156.8%	158.1%	Revenue from operations / (Financial expense + Loan loss expense + Operating expense).
Financial self-sufficiency	117.8%	106.7%	117.2%	Operating self-sufficiency after adjustments to expenses

Partner is a member of the ECA Large (Eastern Europe Central Asia) peer group for the MicroBanking Bulletin (MBB). Other members of this group include: Besa Foundation (Albania), Mikrofin and EKI (BiH), and Fundasz Mikro in Poland.

Operational self-sufficiency

Partner covers operating costs and maintains a high profit margin despite declining portfolio yield

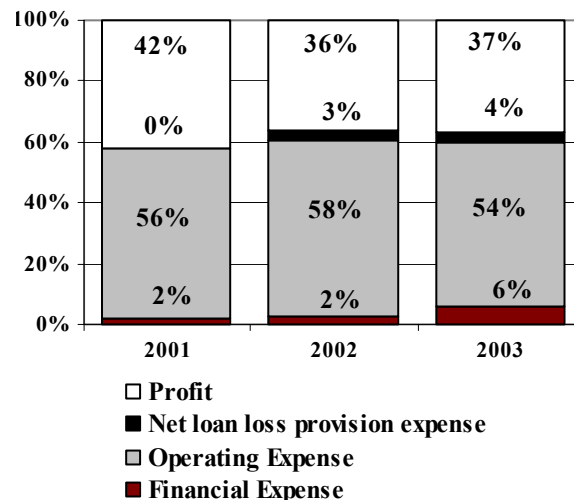
Partner has maintained very strong operational self-sufficiency despite a declining portfolio yield. The profit margin has remained the same over the last couple of years because the increase in financial expense was compensated by a decline in operating expenses. Despite having a smaller portfolio, Partner has a higher level of operational sustainability and profitability than the average of its MBB peers.

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

Very strong ROA/ROE

The return on assets and equity are also strong and higher than that of its peers, averaging 10% and 13% respectively over the last couple of years. Partner invests approximately 90% of assets in the revenue-generating portfolio. This percent has declined recently because Partner is investing slightly less in the portfolio as a percent of assets with the addition of the new headquarters building as an asset. As Partner continues to seek additional

Expenses and Profit as a % of Revenue



financing through liabilities and increases its leverage, if it maintains this level of profitability the ROE would trend upward.

Portfolio yield trending downward significantly

Portfolio yield and effective interest rate

With competitive pressures in Bosnia, Partner along with other MFIs continues to decrease its effective interest rates resulting in continued portfolio yield decline, from almost 36% in 2001 to only 29% in 2003. Partner has decreased the overall interest rate level, added interest rate incentives for repeat clients, and introduced loan products with a greater variation in effective interest rates, notably a higher priced small family loan and a lower priced agriculture loan as compared with the basic business loan. Partner has maintained a strong financial position despite this trend.

Notable LO productivity improvements

Personnel productivity

Both overall staff and loan officer productivity have increased substantially over the past three years, from 100 and 154 to 128 and 196 respectively. This success is due almost entirely to the increasing productivity of loan officers, which is even more noteworthy because from 2002 to 2003, Partner increased its pool of loan officers by 30%, which ordinarily would weigh down such productivity ratios. In the past a goal of 200 clients per loan officer was considered high, now the expectation for a general loan officer in 2004 is 250 to 300 and the senior loan officer over 200. In 2003, Partner introduced the small-sized family loan product, which is less time consuming than other loans to administer and facilitates this productivity growth.

Efficiency improving measures under consideration

Loan officers with high caseloads are already complaining of a heavy administrative burden. To assess the possibility of an additional administrative position in the regions to relieve this burden, the Credit and Human Resource departments are studying work time logs.

Notable improvements in operating efficiency

Operating expense ratio

Partner's operating expense ratio has decreased from 20% in 2001 to only 15.8% in 2003. Partner's expenses came in well under budget, contributing to this strong performance. Some of the major budget items include:

- Salaries, bonuses, benefits, and training are 67% of operating costs in 2002 and 64% in 2003. In 2003, Partner came in significantly under budget on bonuses contingent upon Partner reaching a portfolio goal of 26.3 million BAM. Versus the actual 23.7 million BAM.
- Expenses associated with the fleet of over 50 vehicles constitute 5% of operating expenses, exclusive of depreciation. It was deemed by Partner more efficient to own its own fleet than to require loan officers to use their own vehicles.
- Depreciation for all assets is 7% of operating expenses.
- Bank fees for managing loan disbursements and repayments constitute 4% of operating expenses. Partner has been able to negotiate lower fees as a percent of the overall portfolio and should be able to continue to do so in the future.

Major expense is provision on healthy portfolio

Loan loss provision expense ratio (cost of risk)

Partner's loan loss provision expense averages just over 1%. This ratio is higher than it ordinarily would be given Partner's high portfolio quality, PAR31 <1% over the last three years, because there is a 2% provision on the healthy loan portfolio for general risk.

Financially self-sustainable

Adjustment expense ratio and financial self-sufficiency

According to Planet Rating's adjustment methodology, Partner has achieved financial self-sufficiency for several years, indicating that it could cover its costs in the absence of subsidies. The rates are 118% in 2001, 107% in 2002, and back up to 117% in 2003.

Cost of funds 95% of adjustment

The standard adjustments include: the cost of funds, inflation, loan loss provisions, and in-kind donations. In the case of Partner, 95% of the adjustment expense is due to cost of funds. The

in-kind donations are minimal, the loan loss provision adjustment is not necessary, and the inflation adjustment using Central Bank data is also minimal. The adjustment expense ratio has declined from around 10% in 2001 and 2002 to only 6.5% in 2003 given that portfolio growth is funded by liabilities with increasing interest rates. The shadow cost of funds was lowered from 12% in 2001 and 2002 to 10% in 2003 to take into account the fact that Partner and others are able to access commercial rate funds at less than 10%. Please refer to the annex for further details on these adjustments.

Management of non-portfolio productive assets

Minimal short-term investment opportunities

Partner's cash resources are invested as soon as feasible in the portfolio, limiting opportunities for financial gain with other interest bearing time deposits, which they have not held since 1999. With a long-term deposit, such as cash collateral for a loan, Partner would be able to obtain a rate of 5% to 6%. Otherwise, the short-term investments would yield minimal returns. The need to work with numerous banks for its credit operations and funder constraints limits Partner's opportunities to negotiate meaningful interest on its current accounts despite considerable cash on hand, averaging over 1 million BAM month-end in 2003.

New HQ building used as collateral for portfolio loans

Partner also invested and has now taken possession of a new headquarters building. The building is being used as collateral for loans with Raiffeisen Bank with a ratio of 1 to 3, a favorable transaction in the country context.

Profitability outlook

Significant downward pressure on profitability for all Bosnian MFIs

As is true for all MFIs in Bosnia, it will be increasingly difficult to maintain such high levels of profitability over the long term with constant competitive pressure to reduce interest rates.

- ❑ Partner's own projections include assumptions for a portfolio yield of less than 24% in 2004, with continued declines in future years.
- ❑ Given the differences in interest rates by product and the interest rate incentives to retain clients, some lower interest products may be "subsidized" by higher interest products, thereby requiring tighter portfolio management to prevent drift into lower priced products.
- ❑ The funding expense ratio will only continue to increase, as all new portfolio funding will come at a cost that is increasingly approaching commercial rates.
- ❑ Future growth will be in the more costly to serve rural areas as urban areas are already saturated.
- ❑ The percent of loan officers over total staff will remain constant, thereby having no positive impact on profitability.

Dramatic increase in portfolio size per loan officer underpins strategy to remain profitable

Future profitability gains will come only from increasing efficiency in operations and economies of scale. Partner expects to maintain its operational self-sufficiency of over 140% and financial self-sufficiency between 115 to 120% over the next four years. The assumptions for reaching this performance are based on a significant decline in the operating expense ratio due to a dramatic increase in portfolio size per loan officer. The average productivity of loan officers is expected to more than double by 2008. The average portfolio per loan officer is expected to triple by 2008, including 25% growth in 2004 alone.

These financial simulations are based in large part on Partner's assumptions of increasing client fidelity and hence over time, somewhat larger average loan sizes and possibility longer term loans. This increase is despite the introduction in 2003 of the family loans with an average size of only 1,100 BAM and a much shorter average loan term. Partner also plans to use technology improvements to more quickly disburse loans and increase loan officer capacity to reach its goals .

Partner has recently performed financial analysis of the impact of integrating BosVita, through the upcoming merger. The analysis shows that Partner's indicators financial indicators in 2004, as compared with those approved by the Board of Directors, will experience a minor

decline in the short term, although clearly the merger will help Partner meet its portfolio objectives. It is expected that operational sustainability will be decreased by 4 percentage points, financial sustainability by 3 percentage points, adjusted return on assets by 0.7 percentage points and adjusted return on equity by 1.9 percentage points. Accordingly, the operating expense ratio will increase only 0.3 percentage points.

Joining of BosVita

*“Joining”
approved by
both Boards*

On February 10, 2004, Partner and BosVita signed a Letter of Intention (LOI) and Memorandum of Understanding (MOU) to merge, which both institutions refer to as a “joining.” The MOU specifies that the entity will preserve the name and logo of Partner, will initially provide the products offered by Partner, and that a new organizational structure will be approved during the merger process. The Partner Board gave the final approval for the merger on March 12, 2004 and BosVita’s Board on March 15, 2004. It is expected that the legal merger will take place by June 1, 2004 with a harmonization of procedures to be completed by the end of 2004. The microcredit law anticipates MFI mergers, thereby facilitating the legal actions necessary to execute this transaction.

*Competition and
funding
constraints
encouraged
BosVita to merge*

BosVita, also headquartered in Tuzla, BiH, began operations initially as an economic development program of the IRC in 1996 to serve predominantly returnees and registered as a local organization in 2001 after creation of the microcredit law. Although BosVita met all the necessary performance requirements to receive LIP funds in the past, BosVita will not be eligible to receive such funds in the future as the next round of LIP funds will be restricted to the largest few MFIs and BosVita is simply too small in scale to be eligible. With few alternative funding options given its size and capital structure, as well as increasing competition, BosVita sought to merge with another MFI to continue to fulfill its original mission of serving economically active individuals. Prior negotiations with Prizma, with operations concentrated in Eastern Bosnia, did not come to fruition.

*Favorable
conditions for a
merger*

The conditions at both institutions favor such a merger. Partner seeks to grow in size and add experienced staff and clients while BosVita seeks to preserve its mission, which it is unable to do alone, by integrating into a larger organization. Both Partner and BosVita have relatively similar organizational cultures, as noted by organizational analyses performed by the Adizes Institute, despite the differences in organizational size. The loan products and target population are comparable and the service areas overlap, Partner’s being of course considerably larger, which will give the combined entity a stronger market share in the area. A consultant from Adizes Institute has been hired to assist with the merger process, and with whom both MFIs have worked before. To ensure open communication and successful integration, Committees with membership from both MFIs have been formed to address the practical issues.

GIRAFE Overview

*Governance and
Decision
Making*

BosVita has a team of 19 employees, led by a Director, Finance Manager, and Credit Manager. There are 11 loan officers (4 of which were hired in the first half of 2003) and the remaining five employees are support staff. Legal, Accounting and MIS services are outsourced. The Director has a university degree in Economics and the Credit Manager possesses an engineering background. Credit staff have learned their respective positions on the job. Staff is located in the headquarters in Tuzla and in two branch locations in the Federation and RS.

The five-member Board of Directors is entirely local and is composed of a lawyer, 3 consultants from governmental agencies, and an NGO consultant. All members of the BosVita Board will be transferred to Partner during the merger.

*Information
Management
and Systems*

BosVita developed its own loan tracking system through an outside consultant, who has made upgrades to the DOS-based software when necessary. Accounting information is managed in a local software. Microfin is used for business planning. Given its small size, all of BosVita’s

information management is centralized at headquarters. Financial statements are available on a monthly basis. The developer for the loan tracking system is working on how to best export the data so as to import to the Partner Kredits loan system. External Audit reports from PriceWaterhouseCoopers show a clean opinion with regard to accounting information.

Risk Management BosVita has a basic internal control system that eliminates cash handling by staff via a partnership with local banks for loan disbursements and repayments. Prior to entering into the merger process, BosVita's initial plan in 2004 was to hire an Internal Control Officer in order to strengthen this area as the organization grew.

Activities: Products and Services BosVita offers a basic loan product with generally similar conditions to Partner, with the exception of one loan product that specifically targets displaced persons returning to their pre-war homes. The average loan size, however, is much smaller. Of the outstanding portfolio, 45% is in loans issued from 1,500 to 3,000 BAM whereas only 2% are in loans issued over 10,000 BAM. BosVita reports that over-indebtedness of clients and the lack of business opportunities in general caused the PAR31 to increase from 0.8% in 2002 to 2.8% in 2003. It is planned that BosVita loan officers receive training from Partner to better analyze businesses with larger loan amounts.

Funding and Liquidity BosVita's capital is approximately 60% from loans and other liabilities with the balance in donated equity and retained earnings. Long-term loans are concessional rate from the LIP program and the IRC. The IRC loan will be converted to a grant in May 2004.

Efficiency and Profitability Performance declined from 2002 to 2003 on several indicators (ROE, ROA, staff productivity, loan officer productivity). The drop in profitability is due in large part to an interest rate decline that significantly lowered BosVita's portfolio yield. Furthermore, approximately 4 out of 11 LOs are under capacity and the average portfolio of 340,000 BAM is just below the average of 383,000 BAM at Partner. Since signature of the "joining" agreement, Partner has made estimates of the financial impacts of the merger on its financial performance as described in Section E of the GIRAFE report.

BosVita Key Data and Indicators

	Dec. 2002	Dec. 2003		Dec. 2002	Dec. 2003
Active clients	992	2 061	ROA	2.5%	4.0%
Outstanding port. EUR	1,124,965	1,694,033	Portfolio yield	43.1%	26.8%
Avg. loan term (months)	10	13.4	Operating Expense Ratio	37.4%	17.6%
PAR31	0.8%	2.8%	Operational self-sufficiency	113%	121%
Write-off ratio	1.5%	1.0%	Financial self-sufficiency	108%	103%
Average loan size at disbursement EUR	1 094	1 322	Leverage	0.62	0.59

Appendices

Product Descriptions

Loan Conditions	Family Business	Agriculture	Business, Short-term	Business, Long-term
Loan term	1 to 15 months	1 to 24 months, including grace period up to 9 months	1 to 12 months	13 to 24 months
Average loan term	9.6 months	13.2 months	11.2 months	18.1 months
Grace period	none	up to 9 months depending on purpose	none	none
Loan sizes	300 / 1,400 BAM	1,500 / 20,000 BAM	1,500 / 20,000 BAM	1,500 / 20,000 BAM
Eligibility (guideline)	Max 350 BAM monthly income per family member; First loan may not exceed 5,000 BAM; Same household and same business loans prohibited; No more than 4 employees including client			
Repayment Frequency	Monthly			
Interest rate	18% nominal flat annual rate	11.47% nominal flat annual rate (average) 11.76% in cycle 1 to 9.6% in cycle 6.	13.49% nominal flat annual rate (average) 14% inc cycle 1 to 11% in cycle 5	13.48% nominal flat annual rate (average) 14.5% cycle 1 to 11.5% cycle 5
Up Front fee	40 BAM	2%	2%	1%
Penalty fee (after 3-day grace period)	None			
Global effective interest rate (typical Loan)	42.9%	24.5%	28.4%	28.3%

Financial Statements and Notes

PARTNER	Notes	BAM			EUR			% Change	
		Dec. 01	Dec. 02	Dec. 03	Dec. 01	Dec. 02	Dec. 03	Y2 / Y1	Y3 / Y2
BALANCE SHHET		14 365 458	20 199 528	26 536 024	7 344 942	10 327 855	13 567 654	41%	31%
ASSETS		13 936 334	18 735 418	24 214 809	7 125 535	9 579 267	12 380 835	34%	29%
Short Term Assets		13 936 334	18 735 418	24 214 809	7 125 535	9 579 267	12 380 835	34%	29%
Cash and Bank Deposits		719 063	363 219	800 613	367 651	185 711	409 347	(49)%	120%
Net Short Term Financial Assets		0	0	0	0	0	0		
Net Short Term Loan Portfolio		13 025 713	18 171 313	23 101 647	6 659 941	9 290 845	11 811 685	40%	27%
Gross Short Term Loan Portfolio	1	13 327 240	18 606 075	23 725 959	6 814 110	9 513 135	12 130 890	40%	28%
(Loan Loss Reserve)	2	301 527	434 762	624 312	154 168	222 290	319 206	44%	44%
Interest Receivable		186 947	200 886	288 009	95 585	102 711	147 257	7%	43%
Other Short Term Assets		4 611	0	24 540	2 358	0	12 547	(100)%	
Long term assets		429 124	1 464 110	2 321 215	219 408	748 588	1 186 818	241%	59%
Net Long Term Financial Assets		0	0	0	0	0	0		
Gross Long Term Loan Portfolio	1	0	0	0	0	0	0		
Net Fixed Assets	3	429 124	1 464 110	2 321 215	219 408	748 588	1 186 818	241%	59%
Other Long Term Assets		0	0	0	0	0	0		
LIABILITIES AND EQUITY		14 365 458	20 199 528	26 536 024	7 344 942	10 327 855	13 567 654	41%	31%
Liabilities		2 559 330	5 152 182	7 898 357	1 308 565	2 634 269	4 038 366	101%	53%
Short term liabilities		2 559 330	137 373	1 080 294	1 308 565	70 238	552 346	(95)%	686%
Demand Deposits		0	0	0	0	0	0		
Short Term Deposits		0	0	0	0	0	0		
Short Term Borrowings	4	2 502 000	0	985 000	1 279 252	0	503 623	(100)%	
Other Short Term Liabilities	5	57 330	137 373	95 294	29 312	70 238	48 723	140%	(31)%
Long term liabilities		0	5 014 809	6 818 063	0	2 564 031	3 486 020		36%
Long Term Deposits		0	0	0	0	0	0		
Long Term Borrowings	6	0	5 014 809	6 818 063	0	2 564 031	3 486 020		36%
Equity		11 806 128	15 047 346	18 637 667	6 036 377	7 693 586	9 529 288	27%	24%
Paid-in Capital		0	0	0	0	0	0		
Donated equity	7	9 155 781	10 680 967	12 009 796	4 681 277	5 461 092	6 140 511	17%	12%
Retained earnings without donations		2 650 346	4 366 379	6 627 871	1 355 101	2 232 494	3 388 777	65%	52%
Current year		1 682 354	1 716 033	2 261 492	860 174	877 394	1 156 283	2%	32%
Previous year		967 992	2 650 346	4 366 379	494 926	1 355 101	2 232 494	174%	65%

Partner Income Statement	Notes	BAM			EUR			% Change	
		Dec. 2001	Dec. 2002	Dec. 2003	Dec. 2001	Dec. 2002	Dec. 2003	Y2 / Y1	Y3 / Y2
Financial revenue (a)		3 949 017	4 737 618	6 142 823	2 019 100	2 422 306	3 140 775	20%	30%
Revenue from portfolio		3 921 537	4 719 413	6 119 827	2 005 050	2 412 998	3 129 018	20%	30%
Interest received on loans	8	3 921 537	4 719 413	6 119 827	2 005 050	2 412 998	3 129 018	20%	30%
Fees and commissions received on loans	8	0	0	0	0	0	0		
Penalty revenue on loans	8	0	0	0	0	0	0		
Revenue from other financial assets		0	0	0	0	0	0		
Other revenue from financial services	9	27 480	18 205	22 996	14 050	9 308	11 758	(34)%	26%
Financial Expense (b)		72 526	116 227	347 360	37 082	59 426	177 602	60%	199%
Interest paid on borrowings		72 526	116 227	347 360	37 082	59 426	177 602	60%	199%
Interest paid on deposits		0	0	0	0	0	0		
Other expenses related to financial services		0	0	0	0	0	0		
Financial income [c=a-b]		3 876 491	4 621 391	5 795 463	1 982 019	2 362 880	2 963 173	19%	25%
Operating expense (d)		2 209 706	2 759 869	3 312 527	1 129 805	1 411 099	1 693 668	25%	20%
Staff expense (includes fringe)	10	1 456 284	1 851 864	2 119 251	744 586	946 843	1 083 556	27%	14%
Non-staff operating expense (administrative expenses)		753 422	908 005	1 193 275	385 219	464 256	610 112	21%	31%
Depreciation and amortization		126 175	172 762	233 800	64 512	88 332	119 540	37%	35%
Consulting, auditing and rating		64 702	79 611	89 567	33 082	40 704	45 795	23%	13%
Rent, utilities, office supplies and others		562 545	655 632	869 908	287 625	335 219	444 777	17%	33%
Operational income before provision [e=c-d]		1 666 785	1 861 522	2 482 936	852 214	951 781	1 269 505	12%	33%
Net Loan Loss provision expense (f)		(15 569)	145 489	224 866	(7 960)	74 387	114 972	--	55%
Loan loss provision expense and write off	11	(1 227)	157 232	254 409	(627)	80 391	130 077	--	62%
Recovery from Loans written off		14 342	11 743	29 543	7 333	6 004	15 105	(18)%	152%
Net operating income before taxes and donations [g=e-f]		1 682 354	1 716 033	2 258 070	860 174	877 394	1 154 533	2%	32%
Income Taxes (h)		0	0	0	0	0	0		
Net Operating Income Before Donations [i=g-h]		1 682 354	1 716 033	2 258 070	860 174	877 394	1 154 533	2%	32%
Non-operating revenue (j)		0	0	8 036	0	0	4 109		
Non-operating expense (including related taxes) (k)		0	0	4 614	0	0	2 359		
Net Income Before Donations [l=i+j-k]		1 682 354	1 716 033	2 261 492	860 174	877 394	1 156 283	2%	32%
Revenue From Donations (m)	12	47 077	100 215	33 080	24 070	51 239	16 914	113%	(67)%
Net Income		1 729 431	1 816 248	2 294 572	884 244	928 633	1 173 196	5%	26%

General notes to financial statements per CGAP Disclosure Guidelines

1. The financial statements presented include a balance sheet, income statement, and accompanying notes.
2. The financial statements provided include three full years of data.
3. Partner is not considered a multi-service institution.
4. Portfolio reporting
 - (1) The loan loss reserve is shown as a negative asset in the balance sheet. It is calculated monthly and additional amounts added to the reserve are expensed in the income statement through a separate account. The schedule of provisions by age category is presented in the section Credit Risk Coverage.
 - (2) Loans are written off as a matter of accounting practice on a monthly basis when the loan has a payment in arrears greater of 120 days or greater.
 - (3) Partner accrues interest on a monthly basis per client and deducts a provision of 2% of such accrued interest.
5. Portfolio quality
 - (1) Portfolio quality and the calculations of such are displayed in the tables in Section A and the calculations are based on standard portfolio at risk calculation of: (outstanding loan principal for loans in arrears over X days)/(total portfolio outstanding).
 - (2) Partner may reschedule loans on a limited basis but they are tracked separately and there are no outstanding rescheduled loans.
6. Donations
 - (1) Revenue from donations is shown separately in the income statement.
 - (2) All grant revenue for operating expenses is passed through the income statement.
 - (3) Please refer to the appendix on Adjustments for details on in-kind donations.
 - (4) These financial statements segregate the equity received from donations from the equity earned from profits since the beginning of operations.
7. Details of liabilities
 - (1) Partner has no savings collection.
8. Other significant Accounting Policies
 - (1) Partner’s accounting is performed on an accrual basis.
 - (2) The depreciation of fixed assets on a straight-line basis using the following schedule:

Asset Class	Useful Life in Years
Vehicles	20%
Computer equipment	33%
Building	1.3%
Furniture	12.5%
Intangible assets	20%
Other equipment	7-20%

Specific notes to the financial statements

Statements are audited in 2001 and 2002 by a PriceWaterhouseCoopers correspondent in BiH. The figures for 2003 are Partner unaudited figures. Note that Planet Rating did not keep the auditors adjustments to “mark to market” liabilities at interest rates considerably below market value. The loans are therefore recorded at their nominal value and there is no interest income recognized as a result of such imputed subsidies. Any grant cash donations for the loan fund have been recorded directly on the Balance Sheet by Planet Rating and not recorded on the Income Statement as done by the Auditor. Please refer to the notes for discussion of external auditor adjustments to the loan portfolio.

Balance Sheet

1. 2001 and 2002 figures based on auditor's adjusted portfolio calculation for a declining interest rate method. In 2003 these are unadjusted figures, therefore the portfolio size is somewhat smaller than the audited figures will be. Partner tracks internally the full principal amount outstanding of all long-term loans, regardless of principal due date. The percent of the outstanding portfolio attributable to loans with an initial final term date beyond 12 months was 15% in 2001, 44% in 2002, and 48% in 2003, although the amounts falling due beyond 12 months make the actual percentage of the portfolio as long term considerably less.
2. Note that in 2001, the auditor re-evaluated the loan loss reserve based on a historical analysis of the actual portfolio risk. However, internally Partner maintains a more conservative loan loss policy as described in the CGAP disclosure notes.
3. In 2002, fixed assets include computers, furniture/equipment, and vehicles. Starting in 2002, headquarters under construction is included in this amount. In 2003, construction was completed and Partner moved into the new headquarters. Partner has a fleet of over 50 vehicles.
4. In 2001, a loan at 3% from the Local Initiatives Department, now the ODRAZ Foundation, without specified maturity at the time but subsequently converted to a longer term loan. In 2003, a revolving credit loan from Raiffeisen Bank at 8.25%. All loan amounts are shown at nominal and not market value.
5. In 2001, 6 375 BAM in interest payable and 50 955 BAM in other expenses. In 2002, 14 989 BAM in interest payable, and 122 384 BAM in other accrued expenses, notably liabilities toward employees and audit fee payable. In 2003, 24 941 BAM in interest payable and 70 354 BAM in other accrued expenses.
6. In 2002, 3 441 533 from LID at 5%, 341 328 from LID funded by UNHCR at 5%, 398 615 BAM from UMFIR at 0% and 833 333 BAM from USAID Line of Credit I (max 1 million BAM) at 12-month EUROLIBOR. In 2003, 500 000 BAM (max 1 million BAM) from USAID Line of Credit I and 1 500 000 from USAID Line of Credit II (max 2 million BAM) at 12-month EUROLIBOR, 4 419 449 BAM from LID at 5% and 398 615 BAM from UMFIR at 0%. All loan amounts are shown at nominal and not market value. See Note 7 for Mercy Corps liability reclassified as equity for analytical purposes.
7. This amount includes Mercy Corps funds that are a 0% liability per the Founding Agreement but are expected to be capitalized as well as a UNHCR grant reclassified by external auditors in 2002 as a liability but since capitalized in 2003.

Income Statement

8. This amount includes interest received, up-front loan fees, and penalty revenues. Note that the unaudited figures are based on a flat interest rate basis. In comparison with the audited figures, this amount underestimates the revenue that would be calculated on a declining interest rate basis. Although not specified in the audited figures, Partner's unaudited 2003 figures show that 86% of portfolio revenue is from interest, 13% from fees, and only 1% from late fees. Given new product pricing, this shifts revenue somewhat more towards fee income, as in 2002 the percentages were 89%, 10%, and 1% respectively.
9. These other amounts are primarily client overpayments, a maximum of 20 BAM per client. In 2003 this includes also reimbursements of maternity leave payment from the government for an amount of 10,741 BAM and income from currency exchange at the amount of 259 BAM, and other income (from Insurance Company) at the amount of 72 BAM. Includes training expenses.
10. The loan loss provision expense was adjusted by the auditors in 2001 after a re-evaluation of the actual credit risk of the loan portfolio.
11. These funds are cash donations to cover operating expenses. In 2001 this amount is from USAID. In 2002 this amount include 11 537 BAM from the Microfinance Center for an Impact project and 88 678 BAM from Mercy Corps to support training services. In 2003 this includes mainly donations from Mercy Corps of 18 058 BAM and CGAP of 14 615 BAM.

Adjustments

Partner	Dec 2001	Dec 2002	Dec 2003
Adjustment for the cost of funds = A * F - G	1,047,063	1,302,062	1,287,534
A. Funding needs = (b - c)	9,329,903	11,819,077	16,348,942
b. Avg monthly difference between portfolio and savings	10,988,168	14,801,186	21,021,498
% savings that may be on lent	0%	0%	0%
c. Equity that used to finance the portfolio= d * e	1,658,266	2,982,108	4,672,557
d. Avg equity, net of donations	1,950,901	3,508,363	5,497,125
e. % of equity that may be on lent	85%	85%	85%
F. Shadow price of borrowings	12%	12%	10%
G. Interest expense on borrowings	72,526	116,227	347,360
Adjustment for inflation = (H + I - A - M) * N	2,113	1,983	0
H. Avg. equity net of donations	1,950,901	3,508,363	5,497,125
I. Average donated equity	8,008,710	9,918,374	11,345,381
M. Average fixed assets	394,896	946,617	1,892,663
N. Inflation rate	0.9%	0.3%	0.9%
Adjustment for in-kind donations	36,234	115,229	71,002
a. Staff and technical assistance	31,745	33,669	29,443
b. Other	4,489	81,560	41,559
Adjustments for provisions	-	-	-
Loan losses	-	-	-
Other risks	-	-	-
Other adjustments	-	-	-
Total adjustments	1,085,410	1,419,274	1,358,536
Net income before donations	1,682,354	1,716,033	2,258,070
Adjusted net income before donations	596,944	296,759	899,534

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

- Inflation adjustment: to account for the net effect of inflation on equity and fixed assets. Note that in 2003, that adjustment is 0 as the calculation would have required a negative adjustment.
- Cost of funds adjustment: to estimate the cost that the institution would have paid if it financed itself at market rates. This adjustment accounts for the cost savings received from donated funds or concessional loans.
- In-kind donations: to account for the hidden cost of resources received that do not appear on financial statements, such as free consulting services, trainings, or use of property. In the case of Partner, these expenses are for technical assistance and trainings.
- Loan loss provision adjustment: to standardize loan loss provision adjustments to the international standards similar to those used in the MicroBanking Bulletin (MBB). Partner's own adjustments are already more conservative than the MBB, therefore no adjustment was made.