

SBACD Egypt - April 2004

Global Rating

C-
Trend: Uncertain

The Sharkia Businessmen's Association for Community Development (SBACD) was founded as an NGO in 1996. After signing the Cooperative Agreement with USAID in November 1996, SBACD disbursed its first SME loan in late 1997 and its first group loan in 2001. In March 2004, SBACD has an outstanding portfolio of 2.7 million USD for 10,300 individual loan (SME) clients and 3,650 group loan (Bashayer) clients in the Sharkia governorate.

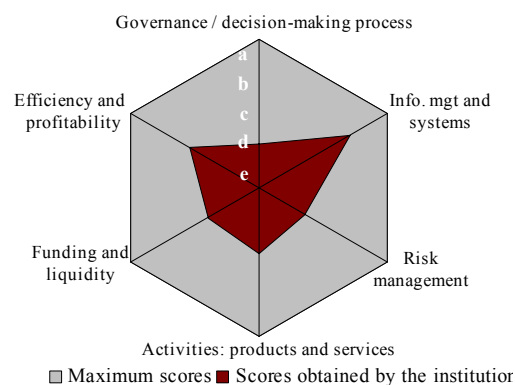
Rating Plus Summary

Environment	Unfavorable legal environment, large market and adequate infrastructure
Maturity	Mature: 7 years of operation
Scale	Medium: Portfolio of 2.7 million USD
Target market	Broad: Avg. out. loan 22% GNP per capita

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

Area Scores

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



	Dec. 2001	Dec. 2002	Dec. 2003		Dec. 2001	Dec. 2002	Dec. 2003
ACTIVITY				PERFORMANCE			
Total number of staff	274	295	342	ROE	(6.1%)	(3.9%)	0.0%
Total assets (K USD)	8,130	8,875	7,925	Liabilities / Equity ^(b)	60.9%	78.1%	57.7%
(K EGP)	37,398	41,267	49,001	ROA	(3.7%)	(2.3%)	0.0%
Outstanding portfolio (K USD)	3,216	3,720	2,725	Operational self-sufficiency	70.9%	80.3%	100.3%
(K EGP)	14,789	17,152	16,834	Financial self-sufficiency	69.3%	78.6%	98.2%
Number of active borrowers	10,650	10,856	13,226	Portfolio Yield	22.9%	23.3%	27.9%
Number of depositors	n/a	n/a	n/a	Operating expense ratio	15.8%	14.7%	16.0%
Annual effective interest rate	Note (a)			Staff productivity	39	37	39
PAR 31-365	26.6%	12.5%	6.7%	Funding expense ratio	9.7%	10.0%	10.9%
PAR > 365	0.0%	0.0%	3.2%	GROWTH (in EGP)			
Write-off ratio	0.0%	13.6%	6.0%	Loan portfolio growth	10.1%	16.9%	(2.6%)
Risk coverage ratio	77.4%	87.5%	96.6%	Savings growth	n/a	n/a	N/a
Exchange rate	4.60	4.65	6.18	Asset growth	16.1%	10.3%	18.7%
1 USD= xx EGP							

(a) The individual loan product has a nominal flat 16% annual rate (i.e. rate calculated on initial loan amount) or 28.3% annual effective interest rate and this product covers approximately 96% of the portfolio. The group loan product has a nominal flat 26% annual rate or 46% annual effective interest rate.

(b) It is to be noted that the amount of equity is larger than it would ordinarily be given that USD deposits exclusively used to guarantee overdrafts are part of the balance sheet rather than being off balance sheet items. Without these deposits the amount of equity is minimal and the very high leverage ratio is not to be considered.

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Rating Scale			
Factors	Area Rating	Global Rating	Explanation
4 to 5	a	A+ 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.
3 to 4	b	B+ 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.
2 to 3	c	C+ C C-	Minimum required Procedures are functional but with certain failings. There are minor risks in the medium term for operations, but these risks are being managed and monitored.
1 to 2	d	D	Insufficient Procedures are in place, but with failings, and certain problems are only partially addressed. There are medium-term risks for operations.
0 to 1	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 Middle East North Africa (MENA)			
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 % of assets	Net outstanding portfolio / total assets (end of period)
Operational self-sufficiency	Revenue from operations / (Financial expense + Loan loss expense + Operating expense)
Financial self-sufficiency	Revenue from operations / (Financial expense + Loan loss expense + Operating expense + Adjustments)
Risk coverage ratio	Loan loss reserves / Portfolio at risk (31-365 days)
Write-off ratio	Loans written off / 13-month average gross outstanding portfolio

Executive summary

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

The Sharkia Businessmen's Association for Community Development (SBACD) was founded as an NGO in 1996. After signing the Cooperative Agreement with USAID in November 1996, SBACD disbursed its first SME loan in late 1997 and its first group loan in 2001. In March 2004, SBACD has an outstanding portfolio of 2.7 million USD for 10,300 individual loan (SME) clients and 3,650 group loan (Bashayer) clients in the Sharkia governorate.

Overall summary:

- ❑ **Key strengths:** SBACD has in place a well-functioning MIS, with good hardware as well as efficient portfolio tracking and accounting software packages, and appropriate credit procedures for the target clientele of small loans.
- ❑ **Areas for improvement:** SBACD has numerous areas for improvement, notably a greater separation of tasks between the Board (that has an interventionist role in operations) and management, stricter application of existing procedures to improve portfolio quality and reduce the potential for fraud, HR practices such as over-hiring that lead to low productivity and motivation, streamlining of procedures to increase productivity, a greater emphasis on financial analysis to improve performance and development of a financing plan with more diversified sources.
- ❑ **Principal risks:** SBACD faces both internal and external risks. External risks include the general macroeconomic environment, fluctuations in the EGP/USD exchange rate given that financing comes exclusively from overdrafts back by USD deposits (although the current negotiated rate is lower than the actual exchange rate), and risks of political interference. Internally, the most notable risks are related to the centralized management with the Board, the lack of financing opportunities for the future, and the lack of measures to achieve stable profitability.

SBACD received a final rating of C- with an Uncertain trend.

Governance and decision-making received the rating d:

- ❑ SBACD's governance suffers from a common problem in Egypt, a Board too actively involved in operations that does not have sufficient perspective to serve its strategy setting and oversight role. This operational involvement also leads to numerous exceptions to the procedures as defined by the institution. The Board receives regular and reliable information on the microfinance activities and other "special projects" that provides a clear picture of SBACD's performance.
- ❑ Although not recorded in a formal business plan, SBACD has a clear strategy of serving the Sharkia governorate through the existing four-office branch network. Given the large market and lack of competition, the lack of a formal business plan has not been detrimental;

rather the main problem has been the lack of business analysis and operational changes to secure financial success. Budgeting and planning estimates are very basic.

- ❑ The management team covers all key positions, although there is some overlap in functions, notably with Internal Inspection. The management team has more of an implementation than true management role. Managers, including branch managers, would benefit from more autonomy in decision-making and advanced training with an international perspective.
- ❑ SBACD considers employment of staff as part of its social mission, leading to excessive staff hiring managed by the Board. Ongoing training is not considered a priority. Staff turnover is concentrated with group loan coordinators, a problem typical of the Businessmen's Associations offering this product.

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

- ❑ SBACD has a well-conceived MIS with remote access to the loan tracking information, managed in EQI's El Mohassil. The accounting software covers basic needs.
- ❑ Portfolio information is accurate, up-to-date, and sufficiently detailed although the focus is on a very limited number of the available indicators. Improvements would include greater analysis of client business data and the market.
- ❑ Financial statements for SBACD programs are available monthly, including detail by branch and product. The finance department has tools to calculate several financial ratios but does not have any financial targets beyond covering costs.

Risk analysis received the rating **d**:

- ❑ Upon discovery of frauds in a 2001 audit, SBACD has either strengthened procedures or improved their application. The system is well conceived but the discretionary nature of many decisions and the high number of controls detract from the system's effectiveness.
- ❑ SBACD does not have a comprehensive approach to risk identification. The internal audit department serves more of an operational role, preventing a true audit role given their active involvement in all loan decisions.

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

- ❑ SBACD has appropriate portfolio management procedures, albeit with a very basic financial analysis, that has proven successful for smaller loan amounts.
- ❑ Exceptions to loan procedures and weak analysis led to portfolio quality problems for the SME product. Portfolio quality has progressively improved with a PAR31-365 from over 26% in 2001 to only 5.3% in March 2004 (with an additional PAR365 of 2.0%). Write-offs are still high, with 13.0% in 2002 and 6.1% in 2003. As with several Businessmen's Associations, the group lending product has no arrears, due to a strong repayment system and strict incentive policy for group loan coordinators.
- ❑ Credit risk coverage is appropriate, with almost 100% of loans in arrears covered by provisions and a system of guarantee checks recognized by the courts.

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

- ❑ SBACD has been financed entirely by USAID operating subsidies and local bank overdrafts backed by USAID provided USD fixed deposits. SBACD is expected to reach its capacity on existing agreements by mid 2005, although it would have reached limits in 2003 but for the devaluation of the EGP increasing capacity on the overdrafts. SBACD has not negotiated terms on these overdrafts as advantageous as other Businessmen's Associations, and does remain exposed to risks related to fluctuations in the EGP/USD exchange rate.
- ❑ It is not clear if any new financing sources will be available in the future and there is no financing strategy in place to address this.

- ❑ With one minor exception, SBACD has had ample overdraft resources and therefore has not produced detailed cashflow projections and kept cash-on-hand to a minimum.

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

- ❑ After almost seven years of operation, SBACD was first able to cover costs in 2003 through progressive improvement in financial performance. Although SBACD expects to continue to improve this trend in the future, it will need closer financial analysis and access to additional funding, neither of which has been addressed as yet.
- ❑ SBACD, like several other Businessmen's Associations, has the strange position of having poor productivity ratios (staff productivity at 39 and loan officer productivity at 74) yet a low operating expense ratio, (16.0%) which is attributable in large part to a relatively lower salary scale in Egypt. Compared to several peers in Egypt, SBACD underperforms on productivity and efficiency indicators.

Funding needs:

- ❑ SBACD is seeking 3 million USD in additional financing for 2005.
- ❑ Planet Rating believes that SBACD has a vast market and several good systems in place but lacks the profitability, financial planning skills and rigour with respect to operations at this time to manage commercial debt without significant guarantees.

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

Rating Plus

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

Operating Context

Economic and Political Environment: Stable

- After a period of heavy borrowing, Egypt increased its domestic production (GDP growth rate reached 5.2% annually for the 1995-2000 period). Agriculture accounts for 17% of GDP, industry for 34% and services for 49%. The internal political situation is stable. Population growth continues at almost 2% annually.

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

Source: IMF / World Bank / oanda.com.

- Egypt received a Coface rating of B given expectations that weaknesses in the political and economic environment will likely affect an already poor debt repayment record.
- Egypt is ranked 120 out of 175 in the 2003 UNDP Report, with a net primary school enrollment at 88% and adult illiteracy nearly at 35%.
- The legal framework for microfinance does not exist, rather MFIs operate as NGOs under the Ministry of Social Affairs, are not permitted to collect savings, have difficulty accessing bank funding without excessive collateral given their legal status, and have governance structures not well suited to microfinance.

Infrastructure: Favorable

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

Institutional Development (MBB Indicators)

Maturity: Mature Scale: Medium

- SBACD disbursed its first loan in 1997 and has therefore been operating for approximately 7 years. The Association was created almost only to implement microfinance activities.
- In the context of the USAID Cooperative Agreement, the Association received “ready-made kit” including branch opening plans, operations manuals, loan tracking software, and a standard chart of accounts. External assistance is now limited to occasional trainings.
- SBACD has relied exclusively on USAID funding to reach a 2.7 million USD portfolio.

Target clientele: Broad Other Activities: Yes

- SBACD is between the MBB Low-end (<20%) and Broad (20% to 120%) categories, as the average outstanding loan as a % of GNP per capita is 22.4% in March 2004. The individual (SME) loan clients qualify for the Broad category with an average loan outstanding of 30% of GNP per capita (1,600 EGP, 262 USD) whereas group loan clients are at the very low end of the market at 3% of GNP per capita (165 EGP, 27 USD).
- In addition to the group loan product targeted exclusively to women, predominantly poor, approximately 26% of loans disbursed to individual clients in the latest month were also for women.

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Acronyms

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

Microfinance Environment

Overview

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

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

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

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

Generally, banking sector not serving the microloan market

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

Legal and Regulatory Environment for Microfinance

NGO microfinance unregulated, limited MFI financing opportunities

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

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

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

Vast market with unmet demand

The Microfinance Market

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

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

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

Institutional Presentation

Mission SBACD's mission is to support community development broadly. To fulfill this mission, SBACD provides financial and business development services to small and micro enterprises as well as social economic services to the Sharkia community. A Special Project unit provides an exhibition facility for client products, houses a library and offers special trainings. SBACD also considers as part of its mission to contribute to the reduction of unemployment by creating jobs within the institution itself.

Legal form and supervision SBACD was registered in 1997 as a Non Governmental Organization (NGO) under the Ministry of Social Affairs. The Ministry may at any time inspect the NGO and in the event of unsatisfactory results of an inspection, the Ministry has the authority to change the Board and management. This has happened in 2004 to another Foundation in Cairo. The Ministry covers NGOs generally and does not have microfinance-specific knowledge to supervise the quality of these activities.

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

Ownership SBACD is governed by a General Assembly, composed of 48 members who elect a nine-member Board. The Board of Directors has a six-year mandate with one-third up for re-election every two years. The Board has no legal claims to income of the Association. In the event of liquidation by the government, the funds will become government property and may or may not be allocated to support other NGOs. The current Board is presided by Mr. Ahmed Ahmed Lakuz who has been president since inception. Other Board members include businessmen who have on average 6 years of experience on the Board.

Services Loan Product Features

	Individual Lending (SME)	Group Lending (Bashayer)
Minimum / Maximum loan amount	1,000 to 25,000 EGP	50 to 900 EGP
% of total outstanding portfolio	96.2%	3.8%
Nominal interest rate	16% p.a. flat	26% p.a. flat
Fees	1% of disbursed amount (for loans over 1,000 EGP) to have access to the Client Club services	None
Repayment frequency	Monthly	Weekly
Term (without grace period)	4 to 18 months	10 to 40 weeks
Grace period	None	None
Guarantees	Guarantee checks for the total amount of the loan and for each installment	Group solidarity
Effective interest rate	28%	46%

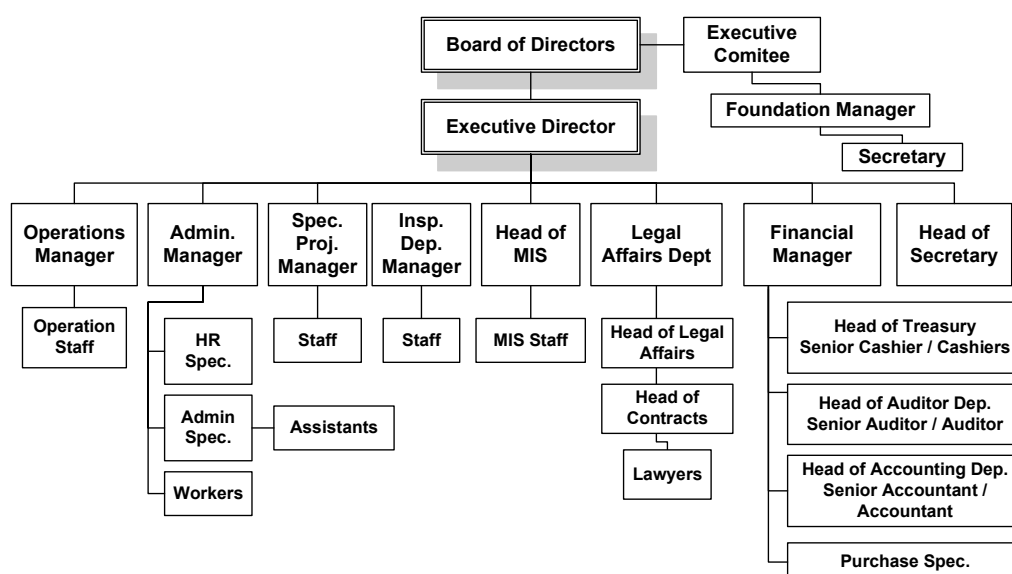
The Other Services

All the services mentioned below are operated within the same institutional structure as the microfinance activities.

Medical Project This program provides loans to medical doctors or pharmacists for the purchase of fixed assets. Loan amounts may go up to 200,000 EGP. The average outstanding loan is 40,000 EGP and loan terms are usually of 36 months. These loans are 100% guaranteed by the Credit Guarantee Corporation (CGC) and are financed by bank overdrafts backed by CGC's guarantee. In Dec. 2003, the Medical Program had an outstanding portfolio of 18 million EGP for 802 clients, a PAR31 of 2.5%, had a staff of 50 persons and generated a surplus of 56,000 EGP for the year 2003. **This program is not considered under the present rating and performance of this product is not taken into account in the quantitative factors of this evaluation. Risk related to unpaid loans are borne by the CGC The responsibility for coverage of accumulated operating losses, if any, is not clear.**

Special Projects "Special Projects" is the term used to cover SBACD's business development services. These initiatives include a library, an annual seasonal fair and a permanent space where clients may promote their products, and a small training center with classes in English, computers, and literacy. The Special Projects unit provided training sessions for 400 clients in 2003.

Human resources and branches SBACD has a headquarters (HQ) and four branch offices to cover all of the Sharkia governorate. Loan application evaluation is performed at the branch level and verified by HQ staff but loan approval and finalization of disbursement documents is centralized at headquarters. Disbursements are made in check during a one-day meeting held outside the branch under close control of HQ, and repayments are made through partner banks. Branches manage data entry for loan data only, and all accounting data except for loan repayments is centralized at HQ. Each branch has the following staff: a Manager, Accountant, MIS officer (with cashier and group loan money collectors), Lawyer, Deputy Branch Manager with supervisors and loan officers (LO) for the SME loan product and supervisors and loan coordinators for the Bashayer program. The HQ organizational chart is as follows:



Human resources	Dec. 2001	Dec. 2002	Dec. 2003	Mar. 2004
Number of branches	4	4	4	4
Number of personnel	274	295	342	335
% Loan officers	49.3%	46.4%	52.3%	51.3%
Turnover (exits/ period average number of personnel)	7.9%	29.2%	14.4%	n/a

External audits A local audit firm working with Egyptian auditing standards, Fathi Ghase, has been the MFI's external auditor since 1998. Each year the firm validates the financial statements through document verification, reconciliation of loan information with bank statements and a portfolio audit via letters to clients to confirm the outstanding loan amount. The firm has always certified SBACD's financial statements without reserve. The firm does not issue management letters that evaluate the internal control procedures.

Grant Thornton Mohammed Hilal, the auditor appointed by USAID, also audited the financial statements for the duration of the Cooperative Agreement (1997-2001) and also validated the financial statements without reserve but made recommendations to improve the internal control system. A special report was ordered in 2002 by USAID after client complaints. The results of this audit, based on a sample of 28.6% of the SME portfolio and 64.5% of the Bashayer portfolio, revealed frauds and several weaknesses in the internal control system. These weaknesses and the corrective measures taken are described in the Risk Management Section.

Governance and Decision Making

Decision-making

Board members susceptible to outside recommendations and policy exceptions

Decision-making process

As described in the Institutional Presentation, the governance of the Businessmen's Associations is not adapted to lending activities and is subject to political risk. In the case of SBACD, the Board is comprised of local businessmen, with no microfinance-specific experience, willing to help their community and dedicate a considerable amount of their time. They consider that, in addition to financial services, reducing local unemployment by creating jobs within the institution is part of SBACD mission. The Board members are willing to accept recommendations regarding loan clients and staff from within the Board or from external parties such as local politicians. This openness to policy exceptions, such as loans to relatives, and external influences has proven to the detriment of fiscally sound management of the financial services.

Board focused on operations, leaving less time for strategy

The decision-making process is extremely centralized with the Board being directly involved in the operations and in day-to-day management, approving all policy changes, loan disbursements, expenses, recruitments, monthly evaluation of employees, etc. The Board typically meets monthly and committees that handle specific issues, such as the credit committee and recruitment committee, meet on a weekly or monthly basis. The Board's high level of commitment in day-to-day operations leaves little room for more strategic issues in Board meetings or for initiative by the members of the management team.

Monthly up-to-date quantitative information

Management information

Monthly up-to-date financial and portfolio information is available to the Board members. Periodic reports provided to the USAID technical service provider offer a clear picture of SBACD's financial position for both microfinance activities and the "special projects". However, it is not clear that the Board uses this information to change in any way its business strategy.

Planning

Lack of business analysis more than lack of business plan the key problem

Relevance of the current strategy

SBACD does not have a formal business plan but the basic strategy has been straightforward, to extend SME loans and subsequently group loans to serve all of the Sharkia governorate through a network of four branches linked by a useful loan tracking system. The lack of a business plan did not initially prove problematic given the large market, absence of competition, structurally profitable business model, clear credit methodology, and sufficient initial funding. Rather, it is the lack of business analysis of current operations prior to decision making and the weakness of day-to-day control over financial performance that explains why SBACD is not yet profitable after 6 years of operations. Additionally, its expansion was limited by funding capacity in 2002 and 2003, although the EGP devaluation in 2003 increased funding capacity by approximately 35% to provide a temporary solution to funding shortages (See Section F).

SBACD management's goal to achieve sustainability in 2004, with the current branch infrastructure, is detailed in financial projections. These projections rely on the assumption that the LO productivity will rise to 120 clients per LO from the current 74 clients per LO.

This ambitious assumption has been a goal for a long time and the lack of an implementation plan reduces the likelihood that this goal will come to fruition. Therefore, it is difficult to evaluate the potential success of their efforts. SBACD did provide USAID with a couple of quantitative figures through 2006 for the outstanding loan amount, loans disbursed, and number of clients, but these are based only on general assumptions of growth. SBACD does not expect to use up excess funding capacity on existing overdrafts before December 2004. No major changes are expected in operating methods or MIS. SBACD has been willing since 1999 to open three more branches within the Sharkia governorate but needs subsidies for start-up costs and USAID has not accepted such funding requests given concerns about the Board.

Budgeting Process

Focus on “break-even”

Budgeting and planning is restricted to assumptions generated from LO caseload targets. The budget management is more “project” oriented than “institutional” as the Finance Manager focuses exclusively on reaching the USAID break-even point, which means covering cash expenses but not depreciation and loan loss provision expenses. The Finance Manager has few opportunities to reduce the budget as salaries represent more than 70% of non-financial expenses but he examines the cash situation each month and adjusts or postpones some administrative expenses or disbursements if necessary. Branch managers are not held responsible for the financial performance of their branches.

Management Team

Skills and experience of management team

Management serves more of an implementation than management role

Upon participation in the USAID Cooperative Agreement, SBACD was provided with a “ready-made kit” including product definition, core manuals, a loan tracking system, control systems, etc. SBACD management therefore was not required to innovate or create the systems and has not taken initiatives to adapt these models to their own experiences. Furthermore, the high level of Board involvement in day-to-day operations renders it more difficult for the management team to feel a sense of ownership for SBACD’s performance as they implement Board directives, preventing them from playing a full management role. This approach to management has resulted in poor institutional performance.

Staff would benefit from upgrades in technical skills that would allow them to go beyond field operations and think more strategically about their respective roles with planning, risk identification, financial analysis, product development, internal control and audit. At present there is no budget or plan for such technical upgrades and access to trainings has been restricted to in-country opportunities.

Minimal decision-making authority at the branch level

Branch managers have minimal decision-making power. All operational decisions are centralized at headquarters, such as loan approvals, recruitments, and the establishment of performance targets. Contrary to most MFIs, SBACD recruits branch managers from outside of the organization and does not promote field staff to this position. They therefore lack an intimate knowledge of operations when they begin.

Organization of the management team

Management team covers all key positions; some overlap reduces accountability

The core management team covers all the key positions, however there are some overlaps in the functions of the different departments. The team includes an Executive Director, Finance Manager, Operations Manager for SME, and Operations Manager for group lending. This core group is supported by a Lawyer, an MIS Manager and an Administrative Affairs Manager in charge of human resources. An Internal Inspection position was created in July 2001 in response to external audit reporting findings. Most of these managers have been with SBACD

since the beginning. However, the overlaps in duties reduce accountability for performance. For example, loan approval is done at HQ while branch managers are responsible for delinquency management and the Internal Inspection department is too involved in credit operations to guarantee its independence during audits (See section Risk Management).

Human Resource Management

Organization of human resource management

Board recruitment committee handles key HR issues; administrator at HQ

SBACD has centralized all human resource management at HQ with an administrative Personnel Manager who ensures an efficient personnel administration. The Recruitment Committee of the Board along with the ED cover the core human resource issues, such as recruitment, salary scales, incentive schemes, staff evaluations and training plans.

Skills management and performance evaluation

HR policies not sufficient to solve problems of low productivity and staff motivation

SBACD could improve the professionalism of its recruitment, training, and staff evaluation to address the current problems of low staff productivity and motivation. Like other Egyptian Foundations, SBACD has difficulty retaining young women as the group loan coordinators and thus has high staff turnover in this program.

- ❑ Staff recruitment requests are approved by the Board but not necessarily based on the institution's needs as a significant number of staff are below performance targets. Positions are advertised first informally and if no candidates are found they then make public advertisements. The Chairman makes final hiring decisions after pre-screening by the Recruitment Committee and key managers. As is common in many institutions in Egypt, hiring is often influenced by personal relationships.
- ❑ SBACD performs monthly all-staff evaluations but a strong subjective element limits the true incentive impact of the resulting bonuses. All branch staff, including administrative staff, participates in a classic incentive scheme that is based on their quantitative results for number of loans disbursed and repayment rates. All staff are also evaluated on a monthly basis by their direct supervisor on qualitative items such as cooperation with colleagues, respect for senior staff. The Board reviews these evaluations and might change some of the grades based on their own appreciation of performance. The scores on these evaluations have an impact on the calculation of each person's bonus.
- ❑ Internal promotion of field staff is possible but limited to the deputy branch manager position since Board members consider that higher positions (branch managers, HQ management team) have to be filled by much older people with many years of business experience outside the institution.
- ❑ The Board determines each employee's salary, even if there is an informal definition of the range of salaries per position. The many exceptions to this informal grid and the absence of documentation of the salary policies make the process rather subjective.
- ❑ Policies to address poor performance, such as sanctions and warnings, are not clear. The remedies after the fraud discovered in 2001 appeared to be stricter for lower level staff, including firings, than higher-level staff.
- ❑ Initial training of SME and group loan officers is provided during the first week after recruitment by the USAID technical service provider upon request from SBACD. Recruitments might be postponed or rushed to adapt to the training schedule and are rarely done outside of this schedule. The institution usually recruits 30-35 LOs every four months, however approximately 80% of them leave after the week-long basic training. On-going training is not considered a priority by management, except for the MIS department.

Information Management Systems

Management Information System (MIS) and Equipment

Description of the MIS

Infrastructure	<ul style="list-style-type: none">• The HQ and branches are linked through leased lines for the loan tracking system that allows for input and consultation based on predetermined access rights.• Computers are in sufficient number (approx. 2 per branch and 21 in HQ) and of appropriate quality to run the operations efficiently.
Accounting	<ul style="list-style-type: none">• Software: El Mohassib (local standard), Excel, paper books• Branch accountants prepare all paper documents (journal vouchers with justifications) that are entered in the software and in accounting books by HQ accountants.• Branches each have their own account numbers within the accounting system, facilitating analytic accounting.• Accountants reconcile data with banks statements on a daily basis and financial internal auditors reconcile it with portfolio information on a monthly basis.• Financial statements are issued every month and include calculations for depreciation and loan loss provision expenses.
Activity information	<ul style="list-style-type: none">• Software: El Mohassil (developed by EQI)• The HQ MIS officer inputs client information and disbursement data and prints out all disbursement documents (guarantee checks, disbursement checks).• Repayment information is sent daily by banks in a manual paper format and is input in the software by the branch MIS specialist and validated by the accountant.• Data is reconciled at the end of the month with computerized bank statements.• Up-to-date information is available each day for the day before and monthly summary reports are available in the system.

Security

Adequate security system with passwords, regular back-ups and secure document storage

SBACD has an adequate security system. Passwords are needed to enter computers and key databases, even if no minimum number of digits has been set thereby minimizing the effectiveness of the password protection. These passwords determine the access-rights of each individual in the organization to allow data entry and data consultation as appropriate. Regular backups of all data are made in the branches and at headquarters although the backups are not currently stored in a fireproof location. Valuable documents such as the guarantee checks are adequately kept in safes or in the bank and are inventoried, but are not always returned to the clients after the closing of the loan creating storage problems.

Ease of system use

Efficient MIS structure even if excessive controls and manual bookkeeping reduces efficiency

The computer stock and software allows for a clear flow of information that is easy for users at HQ and in the branches and allows quality financial and portfolio information. The infrastructure of leased lines that links the branches to headquarters ensures that all relevant actors have immediate access to up-to-date information. The loan tracking software facilitates

an efficient loan handling processes and provides rich information for branch managers and loan officers. Data consolidation for all branches is automated on a daily and weekly basis with extensive and flexible reporting tools for management analysis programmed into the software. In addition, SBACD has programmed in a separate software additional reports for loan data analysis. The accounting software provides all needed information and the centralization of data input ensures easy consolidation.

This well conceived information flow is somehow rendered less efficient by SBACD procedures. The production and validation process for portfolio information is signature-intensive and despite the fact that loan contracts and repayment schedules may be printed from the loan tracking system, SBACD prefers to prepare these manually. SBACD also keeps manual accounting books for supervisory bodies. This results in three parallel systems for bookkeeping: paper books, the accounting software, and excel spreadsheets to reconcile the two other systems.

MIS plan and future improvements

Given already strong MIS, no improvements planned in the near future

There is no long-term MIS plan related to hardware or software but this does not appear necessary in the near future given the high quality of the current system. Improvements are nevertheless regularly added to the software by EQI, the provider, based on its own observations or requests from clients. The SBACD MIS Manager improves the reporting modules he developed upon management request.

Skills of MIS managers

MIS manager with appropriate skills given current duties

The MIS manager has the requisite skills to oversee the current MIS needs of SBACD, which include maintenance of the computer base and network as well as the development of reporting tools. If the contract with the software provider were ever terminated, the MIS manager would need further training on specific software development techniques.

Information on Activities

Information quality

Rich and reliable information but only partially used

Given a useful loan tracking system and common database across the network of offices, SBACD has regular, rich and reliable portfolio information in addition to key client information. However, SBACD management does not take full advantage of this information. Although there are numerous useful reports or indicator calculations already developed in the MIS, SBACD focuses on the number of loans disbursed and the repayment rate. This data provides only a partial picture of SBACD's performance. Branch and operations managers are accustomed to certain basic reports and are not aware of the richness of the information available in the system. Additionally, client business data is not currently tracked in the MIS. Given the vast market potential, SBACD does not collect information about market changes. Staff members individually have impressions of market changes, but the information is not collected formally for product development or marketing purposes.

Information dissemination

Easily accessible information

Information may be accessed by all those who need it according to pre-specified access rights.

Financial and Accounting Information

Information quality and financial analysis

Accurate and complete financial information SBACD has accurate monthly accounting information by branch, product and consolidated with frequent bank reconciliations. Full financial statements are produced every month by branch and consolidated. It is to be noted that SBACD financial statements differ somewhat from international accounting standards. They show the loan loss reserve as a positive item in the liabilities and “interest under collection” for the total amount of all interest revenues to be collected over the term of the loans.

Financial analysis underdeveloped On a monthly basis, SBACD also fills out internal spreadsheets developed by the technical service provider that calculate several profitability ratios by branch and consolidated, and includes an allocation of HQ costs proportional to each branch’s revenues. The institution’s financial analysis focuses on a "break even" calculation that does not include loan loss provision, depreciation or allocation of HQ costs, rather than on the net result that is also displayed in the spreadsheets. SBACD management does not efficiently use nor analyze this information to improve the financial performance in the future. Branch managers do not receive this information on a regular basis and are not accountable for the profitability of their branches.

Skills of finance department

Further training would be useful The Finance department manages the accounting work but would benefit from further training on financial analysis and business planning.

Risk Management

Procedures and Internal Controls

Internal Controls

Measures to address 2001 audit findings but system still too discretionary

SBACD has made improvements to the internal control system after weaknesses were identified in a 2001 external audit, however the resulting system still has several weaknesses. The findings included a 100,000 EGP fraud by group loan officers not returning cash collected, LO's collecting bribes from clients, an insufficient internal audit department, poor client documentation, and a lack of legal action for delinquent loans. Additional policy violations included loans to Board relatives and employees, that were not always reimbursed, and loan approvals based on Board recommendations and not on a business analysis.

Good internal controls at the field level but excessive controls and discretionary decisions minimize effectiveness of the system

To address this concerns, SBACD added additional layers of control but did not remove the discretionary nature in decision-making and the inspection department is too involved in daily operations to serve as a true audit. The chain of internal controls nevertheless has several positive aspects such as the separation of tasks and the availability of information.

- ❑ SBACD procedure manuals for the SME/Bashayer program were developed by EQI and not updated according to all changes in procedures. Staff is aware of their respective procedures but the lack of clear documentation leads to misunderstandings about the role of other positions, such as the role of internal inspection in delinquency management.
- ❑ The separation of tasks for client selection, approval, cash collection, and transaction records was effective in the system designed by EQI and was improved to separate cash collection from group loan coordinators based on fraud experiences.
- ❑ Several control steps have been added since 2001, with a primary focus on limiting fraud at the field level. This results in excessive controls with up to ten persons reviewing each loan application.² This system, in addition to being labor intensive without necessarily an added value at each step, also removes accountability for loan performance from the lower level field staff.
- ❑ Given the availability of financial and portfolio data, SBACD can easily identify under-performance. Monthly LO productivity reports indicate caseload, repayment rate, and number of new clients. SBACD does not use the full potential of its data, notably efficiency indicators, to better monitor performance and implement the appropriate remedies.
- ❑ The active role of the Board in operational decisions limits the ability of the top layer of control from being a true monitor of performance, representing a risk for SBACD. They exercise too many discretionary decisions that deviate from policy. These risks are not sufficiently mitigated by the regular availability of financial information and the participation in the USAID Cooperative agreement, which includes reporting and oversight by USAID and the program administrator's EQI.

² Those reviewing the loan application include: loan officer, loan supervisor, deputy branch manager, branch manager, internal control, finance department, executive director, and Board credit committee.

Mix of partner banks, strong procedures and insurance mitigate cash handling risks

Liquidity security

Insurance for cash handling and transport, a clear separation of collection and recording duties, and use of partner banks mitigate cash handling risk. For the SME program, SBACD relies on partner banks for disbursements and repayments. Some clients may choose to make repayments at the branch where appropriate security measures and control procedures are applied. "Membership fees" are collected in cash in public facilities and these transactions could be better protected from fraud or theft. To better secure cash handling in the group loan program, SBACD created the position of collector to separate duties from the group loan coordinator.

Internal Audit

Operational risks discussed but other risks underestimated

Risk identification

SBACD does not have a clear approach to risk identification. Management focuses on operational matters and short-term credit risks such as repayment rate. The internal inspection department verifies compliance with existing procedures but does not formally analyze risks per se. The Board and management underestimate risks such as lack of funding, increasing competition, slow growth, the macroeconomic environment, and challenges with expansion while still operating at a deficit. Field and inspection managers, being hired without prior field experience, need capacity building trainings to best identify risks related to their work.

Operational role of Inspection Department creates inherent conflict of interest

Internal audit quality

SBACD has an Inspection Department that serves more as an additional layer of hierarchical control than a true audit department. The role of the Inspection Department of 14 employees, added in 2002, has an inherent conflict of interest, as it cannot monitor operations in which it played an active role. The team's work nevertheless limits the risks of fictitious clients and frauds by Loan Officers since they systematically validate all loan applications, visit clients before loan approval (a sample of clients under 5,000 EGP and all clients over this amount), participate in disbursement days, and follow up on delinquent clients. The team has the authority to propose new procedures when necessary, but the approach to internal control problems is to increase the number of hierarchical controls without clear added value. The more traditional duties of an internal audit department, such as surprise visits and portfolio audits, are not performed.

Activities: products and services

Marketing and competition

Competition from Banque du Caire not yet a threat SBACD's potential market is vast with a population of more than five million in its current service area. SBACD has experienced increasing competition on the SME product since 2002 from the Banque de Caire, but does not consider this a threat and has not discussed competitive advantages or strategies that it could use in the face of new market players. BdC has a very similar SME product at the same interest rate, 16% flat, and was also provided with technical assistance from EQI. BdC has a more limited scope on SME lending with a focus on loans between 3,000 and 10,000 EGP whereas SBACD serves SME clients from 1,000 to 25,000 EGP. However, BdC has the advantage of disbursing loans within two days, as opposed to seven to 15 days for SBACD depending on the timing of the loan request during the month. The group loan product has virtually no competition. SBACD is the market leader on this product in the governorate and there is room for exponential growth.

Portfolio Management

Lending methodology

Loan products provided by technical assistance; no major changes EQI has provided SBACD with appropriate loan methodologies for both SME and group lending products that respond adequately to the target market segments and client base. The strong MIS facilitates portfolio management. The products were designed to limit the credit risks and help develop a reimbursement culture among clients with adequate, albeit not very sophisticated, business analysis. SBACD has limits in loan amounts according to maturity of client or business, guarantees and regular follow up encouraged by a strict incentive scheme.

Appropriate borrower selection procedures but numerous exceptions Borrower selection procedures include all necessary steps: evaluation of the client business, reputation checks in the local community, and cross-evaluation by a second person. In the case of the SME product, the client repayment capacity is not sufficiently analyzed to reduce the risk of over-indebtedness. The evaluation of the client file by the inspection department that was added to the process results in a lengthier and less transparent process without adding significant value. Frequent exceptions are still made to the rules to satisfy client requests such as giving a first loan above the defined limit, increasing loan amounts for late clients, and rescheduling or refinancing of loans for clients even though they would have had resources to pay back.

Improved delinquency management procedures now appropriate Delinquency management has improved over the past two years and is now appropriate, with greater pressure on loan officers for swift client visits and repayment collection in the case of delinquency. Group loans are collected every week at the clients' home by an SBACD collector, which results in very frequent client contact. The delinquency management process now also includes visits by the inspection department to clients that are more than 30 days late. After 60 days, delinquent client files are transferred to the legal department that files legal suits, which was not the case before 2001.

Loan Officers skills

Adequate basic skills but low motivation LOs are dedicated either to SME or group lending and receive an initial training provided by the USAID technical service provider to obtain an adequate skill base and good knowledge of the loan methodologies and the procedures. They perform the basic credit analysis during the

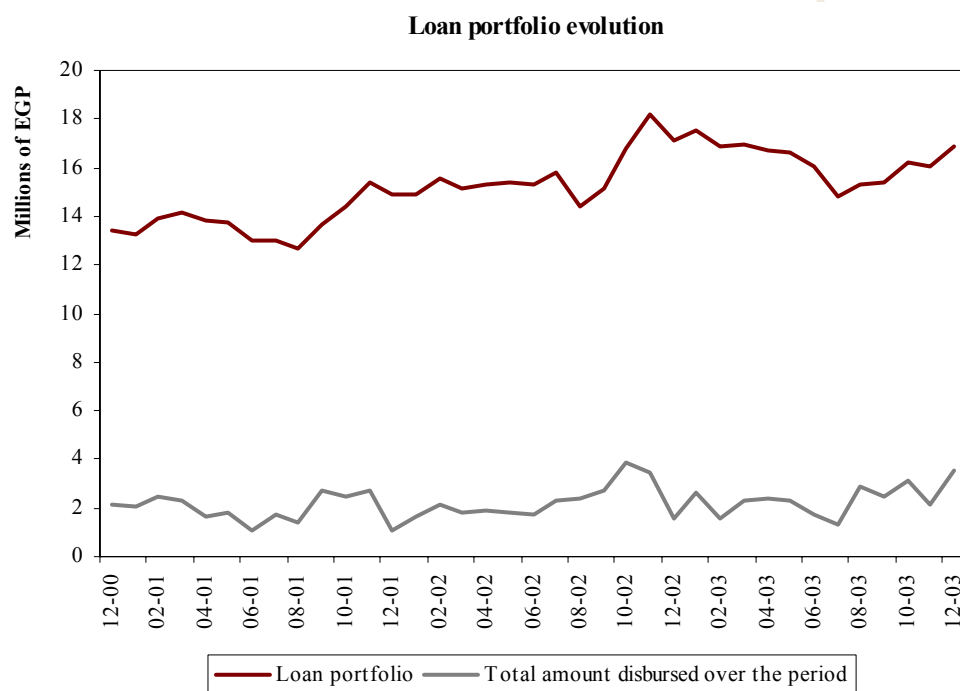
loan application process but do not all have a full appreciation of business analysis and risk assessment. The numerous levels of control during the loan application process, the very strict incentive schemes, and the lack of advanced training for LOs contributes to the low motivation of field staff.

Global portfolio management rules

There are no specific rules for portfolio diversification. However, the MIS may produce statistics on the portfolio by product, region, and business type.

Portfolio at risk (PAR)

Write-off ratio



Portfolio growth slowed in 2003

SBACD portfolio growth of over 10% per year experienced an abrupt slowdown in growth in 2003. This change is attributable to a lack of funding after reaching capacity on overdraft agreements (See Section F) as well as macroeconomic conditions resulting from the 2003 EGP devaluation and possible competition from Banque du Caire starting in 2003. The outstanding portfolio typically dips during the year to reach a high at the end of the year as disbursements pick up after the summer until just before the end-of-year holidays.

Difficult start for group loan product

The group lending product experienced a very difficult start-up phase with high turnover of group loan coordinators and cases of fraud by coordinators discovered in 2001 and 2002 that represented half of the portfolio. The group lending portfolio thus declined in 2001 and 2002 and only recovered in early 2004 to its 2001 levels. This product represents almost 25% of the total active clients but its share in terms of outstanding loan amount remains very modest (3.8% in March 2004) because of its very small average loan size (186 EGP compared to 1,659 EGP for the SME loans).

USD, unless otherwise stated	Dec. 2001	Dec. 2002	Dec. 2003	March 2004
Loan portfolio	3,215,595	3,719,644	2,724,718	2,857,720
Loan portfolio (EGP)	14,791,738	17,296,347	16,847,202	17,824,170
Evolution	10.1%	16.9%	(2.6%)	5.8%
Average outstanding loan	2,998,576	3,422,432	2,680,619	2,779,402
Number of active borrowers	12,729	10,856	13,226	13,987
Evolution	(7.7%)	(14.7%)	21.8%	5.8%
Average outstanding loan per client	302	343	206	204
% of GDP per capita	26.8%	29.4%	22.4%	22.4%
Average amount disbursed	462	466	269	496
% of GDP per capita	41.0%	40.0%	29.3%	54.4%
PAR 31-365	26.6%	12.5%	6.7%	5.3%
PAR > 365	0.0%	0.0%	3.2%	2.0%
Write-off ratio	0.0%	13.6%	6.0%	1.5%

Performance by product (in EGP)	Dec. 2001	Dec. 2002	Dec. 2003	March 2004
SME				
Loan portfolio	14,458,452	16,925,495	16,317,222	17,146,743
% of evolution	13.1%	17.1%	(3.6%)	5.1%
Number of active borrowers	9,685	9,421	10,086	10,337
PAR 31-365	25.4%	12.5%	6.8%	5.4%
PAR > 365	0.0%	0.0%	3.3%	2.1%
Write-off ratio	0.0%	12.4%	6.1%	1.5%
Bashayer				
Loan portfolio	331,201	212,424	517,041	677,428
% of evolution	(48.5%)	(35.9%)	143.4%	31.0%
Number of active borrowers	3,044	1,435	3,140	3,650
PAR 31-365	77.2%	8.9%	3.0%	2.3%
PAR > 365	0.0%	0.0%	0.0%	0.0%
Write-off ratio	0.0%	77.5%	0.0%	0.0%

PAR figures to be interpreted carefully

The PAR statistics must be interpreted carefully as there are two factors that impact their calculation. First, the aging of late loans may be slightly overestimated because MIS officers apply late repayments to the installment of the month of repayment and not the month of the late installment. This unfortunately leaves some loans with very old installments overdue when in fact the loan may be only one installment overdue. On the other hand, the PAR is somewhat underestimated due to the “Client Club” to which all clients of loans exceeding 1,000 EGP apply upon loan disbursement. The fees are used to build a guarantee fund that can repay loans on behalf of the clients in the event that they experience serious problems such as death, sickness, or natural catastrophe. Loans are then taken out of the PAR and are due by the client to the “Client Club”. The procedure to select clients that may benefit from this fund is not clear and subjective. Debtors of the “Client Club” are followed, unsystematically, by the Head of Special Projects Department. This fund totals approximately 21,000 EGP but only 8,000 EGP are currently being used by clients.

Significant improvement in portfolio quality

The overall portfolio quality improved greatly during the past three years from an extremely high PAR31-365 of 25% in 2001 to a more manageable 5.3% as of March 2004. This situation was caused by frauds and a generalized laxness in the application of procedures, such as poor business analysis leading to client over indebtedness and irregular client follow-up and delinquency management. These problems have been corrected to a significant extent by the reinforcement of the internal control system and stricter application of procedures and should

now be prevented. The PAR31 (PAR>365 added to PAR 31-365) nevertheless remains relatively high at 7.3%, illustrating that the initial loan analysis is not sufficiently reliable.

Write-off policy starting in 2002 Massive “write-offs”³ of bad loans for more than 3 million EGP (more than 500,000 USD) were necessary to clean up the portfolio and thus far only 200,000 EGP have been recovered. SBACD only began writing-off loans in 2002 upon discovery of fraud.

Credit risk coverage

	Dec. 2001	Dec. 2002	Dec. 2003
Risk coverage ratio	77.4%	87.5%	96.6%
PAR 31 net of loan loss provision / Equity	3.8%	3.8%	1.2%

Coverage by provisions

SBACD applies a standard provisioning methodology that provides sufficient risk coverage for overdue loans. Details on the provisioning methodology may be found in the appendix.

Coverage by guarantees

Guarantee checks main incentive for client repayment Guarantee checks are the main incentive for clients to repay given that checks not honored can entail jail sentence or civil action. This system of post-dated guarantee checks includes one for the total loan amount of principal and interest, as well as one check per installment that is supposed to be returned to the client upon installment repayment, although SBACD does not always return the checks unless the client comes to claim them. These checks are required for both SME and group loan clients. SBACD also requires for the individual loan product a guarantor that is a first-degree relative, preferably living in the same household, but not necessarily with a stable income. A new law restricting the use of these checks, already postponed three times, is expected to be implemented in 2006. SBACD management has not yet identified alternative guarantees.

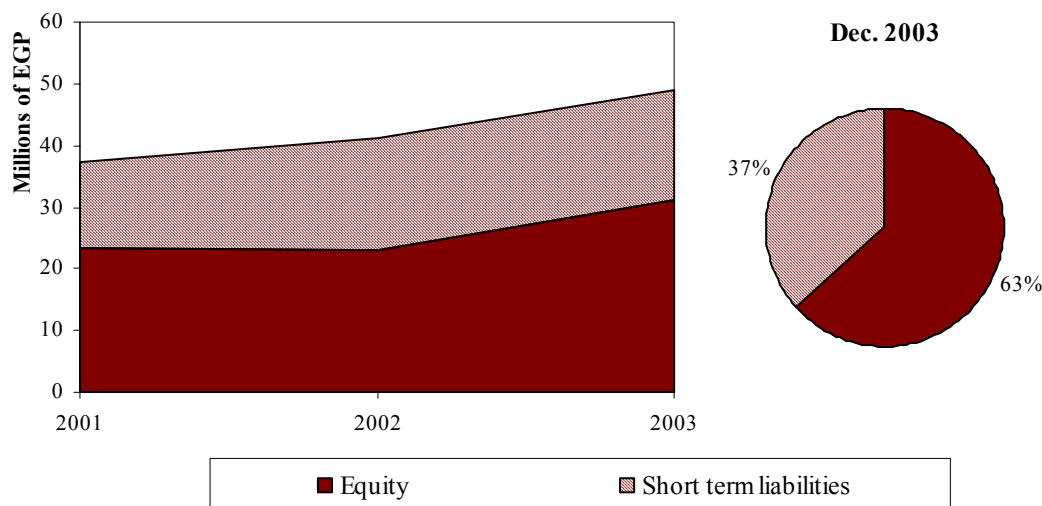
³ Loans are written off from the loan loss reserve and the loans outstanding upon Board approval. This is a very rare occurrence given the reticence to formally write-off loans. Instead, SBACD will place loans in suspense as an intermediate step one year after the original term date of the loan. These loans are already provisioned at 100% after 120 days since the last payment. Loans in suspense are not displayed anymore in the outstanding loan amounts in the loan tracking software but are classified a specific category. In order to provide a better idea of the performance of the institution (use of a better indicators for all the performance ratios), we have deducted these loans in suspense from the reserve and the loans outstanding in the balance sheet, as if they had been written-off.

Financing and liquidity

Financing Strategy

Description of the funding structure

Funding structure



Donated equity from USAID with overdrafts backed by deposits

SBACD is funded almost exclusively by equity, in the form of USAID subsidies for operating expenses and collateral deposits to finance the portfolio, and bank overdraft facilities obtained using these collateral deposits. Interest earnings on the collateral deposits are below 1% and per the Cooperative Agreement must be capitalized in these deposits. Several successive years of deficit have accumulated negative retained earnings for 5.5 million EGP (887,000 USD).

Balance sheet inflated by fixed deposits

It is to be noted that the amount of equity and thus the amount of total assets is larger than it would ordinarily be given that the USD deposits, that, per the Cooperative Agreement, can exclusively be used to guarantee the overdrafts and are not the property of the foundation, are included in the balance sheet rather than being off balance sheet items. Without these deposits, the capital structure of SBACD would display a lot more fragile picture with a thin equity of 480,000 EGP (75,000 USD), total assets of 18.3 million EGP (instead of 49 million EGP) composed of -30% retained earnings, 32% donations, and 98% bank overdrafts (instead of -11% retained earnings, 75% donations, and 36% bank overdrafts).

Asset & Liability Management Procedures

No formal procedures, ALM based on Cooperative Agreement

SBACD does not have any formal ALM policies but per the Cooperative Agreement must finance the portfolio funded by USAID with the bank overdrafts:

- ❑ **Interest rate level:** The interest rates are between 10% and 11% per annum in addition to interest earnings on the collateral deposits below 1%.
- ❑ **Overdraft leverage:** Leverage on USD backed overdrafts is 95% of the fixed deposit amount. Another Association has reached as high as 150%, and it might be possible for SBACD to reach a better leverage in the future.
- ❑ **Exchange rate:** The exchange rate applied to USD collateral deposits has been renegotiated after the devaluation to reach 5.5 EGP per USD whereas other institutions have obtained rates above 6 EGP per USD.

- ❑ **Excess overdraft capacity:** As of March 31, 2004, the excess capacity on both deposits is approximately 11 million EGP but it is expected that this cushion will be used up by mid-2005.
- ❑ **Foreign exchange risk exposure:** In the event that the EGP gains strength with respect to the dollar, SBACD is at risk for having its overdraft limits lowered but has a security margin given that its exchange rate for the USD is currently 10% lower than the current market exchange rate. All borrowings and loans to clients are denominated in EGP.
- ❑ **Maturity matching:** Daily overdrafts are used to finance the portfolio of loans ranging from a few months to up to 18 or 24 months, the long-term part of loans being nil at year end 2003. However it is unlikely that the banks would revoke these agreements given the collateral backing.
- ❑ **Interest rate type:** Although both borrowings and loans to clients are fixed rate, the bank may change the overdraft rates without prior approval in some cases.

Financing Strategy

Funding shortages addressed in short-term by devaluation

SBACD has thus far been able to meet its financing needs through overdraft facilities obtained through the USAID Cooperative Agreement, with the exception of end 2002 when the excess capacity of overdrafts dropped to only one month's disbursements. This problem led to some minor delays in loan disbursement at the time. The January 2003 EGP devaluation allowed SBACD to renegotiate its overdraft contracts and increase capacity by 35%, delaying the need for seeking alternative financing sources until mid-2005 according to SBACD portfolio growth targets.

Lack of financing plan highly problematic

The lack of a clear financing plan for the future is highly problematic. SBACD has limited funding options since retained earnings are negative and additional subsidies from USAID are unlikely, unless certain internal weaknesses are addressed. The other USAID-funded Foundations have nevertheless obtained better conditions on their overdrafts (in terms of interest rate, exchange rate, leverage) showing that SBACD has not been very dynamic during its negotiations with banks and that there is room for a better use of the existing funding sources.

Liquidity Management

Cash-flow projections

Cash-flow planning will need to be more precise in future as funding becomes scarce

SBACD does not perform any cash-flow projections, in large part because there has usually been ample capacity on the overdrafts and because there is not a formal institution-wide planning process to generate precise data. The MIS could provide detailed information once disbursements enter the validation process. The Finance Manager only checks that funds are sufficient before issuing disbursement checks. SBACD will clearly need to implement a more rigorous planning as funding sources become scarce.

Resources optimization

Given the reliance on bank overdrafts as the main funding, SBACD maintains very little cash on hand and has no additional investments beyond bank collateral.

Efficiency and Profitability

Profitability analysis	Dec. 2001	Dec. 2002	Dec. 2003
ROE	(6.1%)	(3.9%)	0.05%
Liabilities / Equity	60.9%	78.1%	57.7%
ROA	(3.7%)	(2.3%)	0.03%
Profit generation			
Operational self-sufficiency	70.9%	80.3%	100.3%
Portfolio Yield	22.9%	23.3%	27.9%
Operating expense ratio	15.8%	14.7%	16.0%
Staff productivity	39	37	39
Loan officer productivity	79	79	74
Average outstanding loan per client (USD)	302	343	206
Funding expense ratio	9.7%	10.0%	10.9%
Cost of liabilities	10.0%	9.9%	10.2%
Loan Loss Provision expense ratio	6.8%	4.5%	1.1%
PAR 31-365	26.6%	12.5%	6.7%
Write-off ratio	0.0%	13.0%	6.1%
Asset management			
Outstanding Loan Portfolio / Assets	31.4%	37.4%	32.2%
Non-portfolio income / Total revenue	0.0%	0.2%	0.1%
Adjusted ratios			
Adjustment expense ratio	0.7%	0.6%	0.6%
AROE	(6.5%)	(4.4%)	(0.3%)
AROA	(4.0%)	(2.6%)	(0.2%)
Financial self-sufficiency	69.3%	78.6%	98.2%

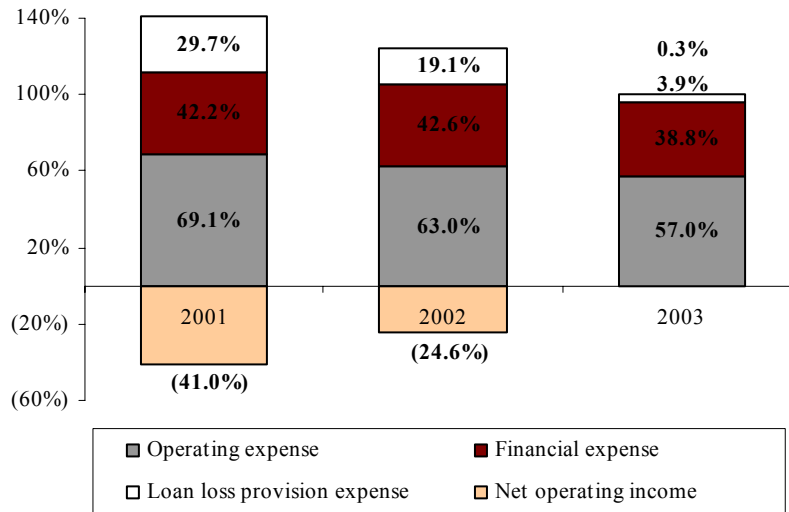
Regional peers for the Benchmarking Arab Microfinance Bulletin produced by the MIX Market in December 2003 (2002 data) include: Alexandria Business Associate (ABA), Dakahlyia Businessmen's Association for Community Development (DBACD), and the Regional Association for the Development of Enterprises of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

Overview of the profitability

Operating costs covered for the first time in 2003

SBACD was able to cover its operating costs for the first time in 2003. Steady improvement over the past 3 years of the ROE and ROA resulting in an increase from (6.1%) and (3.7%) in 2001 to 0.05% and 0.03% in 2003 respectively. Operational self-sufficiency followed the same trend, and rose from 70% in 2001 to 100% in 2003 as portfolio quality improved. These results are significantly lower than that of SBACD regional peers, which have an operational self-sufficiency average of 113%. Leverage increased from 61% to 78% between 2001 and 2002 due to the combined effect of stable equity and an increase in use of credit facilities to finance the portfolio. In 2003, the trend changed as the 2003 devaluation of the EGP resulted in a 34% increase in equity and a subsequent decrease in the leverage ratio down to 57.7%. Leverage is limited in Egypt as banks usually require matching collateral to provide loans to MFIs.

Cost structure in % of financial income



Portfolio yield increasing with improvements in portfolio quality

Portfolio yield and effective interest rate

The portfolio yield significantly increased over the period going from approximately 23% in 2001 and 2002 to 27.9% in 2003 due to important improvements of the portfolio quality. This latter figure is much closer to the theoretical portfolio yield of approximately 28%. SBACD did not change its interest rates, 16% flat or 28% declining for the individual loan product since inception in 1998 and 26% or 46% declining for the group loan since inception in 2001. The rates were set in conjunction with USAID at the beginning and have simply never been changed. SBACD's interest rates are similar to those charged by its main competitor, Banque du Caire, and other similar MFIs in Egypt. These rates are significantly lower than its regional peers at 40%.

Operating expense ratio

Operating expenses as a percent of the outstanding portfolio remained relatively stable at approximately 15% to 16% throughout the period. This ratio is significantly less than the MBB peer group at 38.4% given the lower salary levels in Egypt relative to other countries in the region.

Productivity ratios considerably lower than peers

Staff and loan officer productivity also remained stable, with respective ratios of 39 and 79 in 2001 and 39 and 74 in 2003, and very low proportion of LOs around 50% of total staff. These productivity ratios are significantly lower than regional peers (133 and 213 respectively) reporting to the MBB, and even lower than some in-country peers. Given the population density in the region, expectations for productivity ratios could be much higher for both the group and individual loan products. The labor-intensive and very administrative loan approval process (information is checked 12 times by 10 different persons before a loan can be issued) and the lack of clear guidelines for hiring new staff contribute to this poor performance. Most procedures could be streamlined for more efficiency of the structure.

Personnel and depreciation account for almost 90% of expenses

Personnel expenses as a percent of operating expenses have increased from 60% to 70% between 2001 and 2003 since SBACD increased its portfolio size and number of staff and, at the same time, cut its administrative expenses in absolute values. The latter only represent 9% of operating expenses, which leaves little room for more non-personnel cost cutting. With SBACD being the owner of all its premises, depreciation has consistently been a high expense, and 17% of operating expenses in 2003.

Funding expense increased as operating deficits were financed by overdrafts

Funding expense ratio

SBACD finances its portfolio entirely with overdraft facilities from local banks backed by USD deposits. The funding expense ratio slightly increased from 9.7% in 2001 to 10.9% in 2003. This is due to the fact that, as operating deficits accumulate, an increasing part of the portfolio is financed by the overdraft rather than by equity. Interest rates on the overdraft facilities remained stable over the period at 10% or 11% depending on the partner bank, which is within the range of interest rates obtained by similar institutions in Egypt although on the high end.

Loan loss provision expense ratio (cost of risk)

The loan loss provision expense ratio decreased from a high 6.8% in 2001 to a reasonable 1.1% in 2003, following the dramatic improvement in portfolio quality.

Movements in the loan loss reserve could not be reconciled for 2001 based on the information provided by SBACD. The loan loss provision expense for that year might thus be underestimated.

Asset management

Portfolio represents 85% of unrestricted assets

SBACD low ratio of productive assets, with a portfolio only representing on average a third of total assets, is biased by the fact that assets include the USD deposits provided by USAID and that can only be used as a collateral for the overdraft facilities negotiated with the banks. The portfolio in fact represents a more reasonable 85% of the unrestricted assets and this proportion has increased over the years as fixed assets are being amortized. Fixed assets account for a high 13% of these unrestricted assets since it has been a strategy of many Egyptian Foundations to purchase their premises with the important USAID initial funding.

Adjusted performance

Details concerning the specific adjustments are included in the annexes.

SBACD barely achieved operational self-sufficiency in 2003 and thus did not yet achieve financial self-sufficiency, even though the adjustment expense ratio remains minimal over the period at less than 1%.

Evolution of profitability

Productivity ratios considerably lower than peers

SBACD has set operational self-sufficiency goals of 108% in 2004, 123% in 2005 and 127% in 2006. These goals are ambitious when compared to SBACD's past performances. The existing infrastructure and assets should allow SBACD to reach these targets and to strengthen profitability, but the fact that most decisions are so far been taken without a careful analysis of financial performances and consequences provides no certainty in that matter.

- SBACD could greatly improve its productivity, since it is for now half that of similar institutions in Egypt, and could hereby lower its operating expense ratio; the set targets of 120 active loans per loan officers are very realistic (it is the average among the SBACD MBB peers) but were not in line with the recruitment plans in the branches.
- If SBACD really manages to increase its profitability while maintaining the portfolio quality at its current level, the funding expense ratio is only likely to decline since SBACD was granted slightly higher interest rates than the other MFIs in Egypt.

Appendices

Financial statements and notes

General notes to financial statements per CGAP Disclosure Guidelines

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

1. The Financial Statements presented include a balance sheet, income statement, and accompanying notes.
2. The financial statements provided include 3 years of data.
3. Segment Reporting for Multiservice Microfinance Institutions: The non-financial services provided through the “Special Projects” are listed as non-operating income in the income statement per Note 13. A breakout of the balance sheet by program would not change materially the information presented.
4. Portfolio reporting
 - (1) Loan loss provision expense: expenses related to actual or anticipated loan losses are shown separately from other expenses in the income statement (“loan loss expense”).
 - (2) The loan loss reserve is shown as a negative asset in the balance sheet. It is calculated every month by the finance department according to the methodology described in the table.

Provisioning Methodology SME program

Aging	Provision (% outstanding balance)
Rescheduled	50%
<30 days	0%
31-60 days	10%
61-90 days	25%
91-120 days	50%
>120 days	100%
Write off	Upon Board approval.

- (3) Loans are written off from the loan loss reserve and the loans outstanding upon Board approval. This is a very rare occurrence given the reticence to formally write-off loans. Instead, SBACD will place loans in suspense as an intermediate step one year after the original term date of the loan. Loans in suspense are not displayed anymore in the outstanding loan amounts in the loan tracking software, but are classified a specific category. These loans are already provisioned at 100% after 120 days since the last payment. In order to provide a better idea of the performance of the institution (use of a better indicators for all the performance ratios), we have deducted these loans in suspense from the reserve and the loans outstanding, as if they had been written-off.

- (4) **We were not able to reconcile the movements in the loan loss reserve for 2001. The table below summarizes the information that was provided to us:**

	2001	2002	2003
Loan Loss reserve, beginning of year	1,793,035	3,039,941	3,819,602
Loan Loss expense during the year	1,048,599	779,661	231,897
Recovered amounts on provisioned loans			
Unjustified provision expense	198,307		
Loan Loss reserve, before loans in suspense	2,841,634	3,819,602	4,051,499
New loans in suspense		(1,951,702)	(1,007,996)
Loan Loss reserve, loans in suspense deducted		1,867,901	1,091,802

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

5. Portfolio quality

- (1) Indicators: Portfolio quality and the calculations of such are displayed in the tables in Section A. 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) Renegotiation of loans: SBACD allows rescheduling. This process requires headquarters approval and the loans are tracked separately and provisioned at the rates above.
- (3) Insider loans: the MFI does not allow employees to borrow funds.

6. Donations

- (1) Revenue from donations is shown separately from income generated by operations in the income statement.
- (2) Current period donations: SBACD has received donations from USAID in the context of a Cooperative Agreement totaling approximately 5.6 million USD, over the last several years, the majority of which was destined exclusively for fixed deposits to back overdraft facilities.
- (3) Donations accounting methodology: Grants for operations to be used in the current operating period are recorded in the balance sheet. Grants for fixed assets were recorded directly in the balance sheet with amortization of such assets passing through the income statement. Grants for loan funds are recorded directly in the balance sheet.
- (4) In-kind donations: Please refer to the Appendix on Adjustments for details on in-kind donations that Planet Rating has identified.
- (5) Cumulative amount of all prior period donations: Please refer to note on current period donations.

7. Details of liabilities

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

Loan Provider	Overdraft capacity	Amount used EGP	Interest Rate	Currency	Guarantee
Bank of Alexandria	17,880,825	8,255,326	11%	EGP	USD Collateral Fund
Banque du Caire	11,184,091	9,277,509	10%	EGP	USD Collateral Fund
Total	29,064,517	17,532,835			

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

8. Other significant Accounting Policies

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

Asset Class	Useful Life	Depreciation Rate
Building and real estate	50	2%
Fixtures, photocopiers, fixed tools, and equipment and stationery	5	20%
Furniture	10	10%
Computer software	3	33%

- (3) Inflation accounting: none
- (4) Currency mismatch: please refer to the F area. Note that all transactions are done in EGP except for the fixed deposits backing overdraft facilities.
- (5) Accounting treatment of unrealized gains or losses due to foreign currency fluctuations: All transactions are recorded in EGP. Foreign transactions are recorded based on the exchange rate in the free market and re-evaluated at year-end based on the declared exchange rate at the date of preparing the financial statements. The differences, if any, are capitalized in equity.

Specific notes to the financial statements

Balance Sheet

1. Mainly USD denominated deposits part of the USAID Cooperative Agreement used as collateral for local currency loans. EGP denominated deposits account for 0.5% of the total.
2. This amount includes all loans, regardless of final term date. SBACD grants loans of up to 24 months. The amount of principal falling due beyond 12 months is nil.
3. Interest is only recognized when collected.
4. Interest on deposits. Per the Cooperative Agreement with USAID, interest on the USD fixed deposits is capitalized and therefore SBACD may not withdraw these interest earnings and recognize it as income.
5. In 2001, this amount includes payments for the medical program for 219,953 EGP. Other significant amounts are inventories.
6. Short-term overdraft facilities.
7. Interest on the borrowings is payable daily so there is no accrued interest.
8. This includes accrued expenses for 36,693 EGP in 2001, 80,396 EGP in 2002, 155,394 EGP in 2003.
9. Includes grants from USAID for operating expenses, USD deposits to serve as loan collateral, and interest earned on these USD deposits. Grant from SBACD association to the microfinance project account for 150,000 EGP.

Income Statement

10. Per Cooperative Agreement with USAID, all interest earned on dollar deposits related to the grant must be capitalized directly and not recognized as revenue, these are only interest earned on EGP deposits.
11. SBACD rarely writes off loans, however it does put loans "in suspense" one year after their due date with a 100% provision. This revenue represents principal collected on loans put "in suspense."
12. This amount includes legal fees.
13. Revenue and expenses related to the Special Projects managed by the Association.

SBACD Egypt		EGP			USD			Evolution	
Balance sheet	Notes	Dec. 2001	Dec. 2002	Dec. 2003	Dec. 2001	Dec. 2002	Dec. 2003	2002/2001	2003/2002
ASSETS		37,397,844	41,267,043	49,000,792	8,129,966	8,874,633	7,924,955	10.3%	18.7%
Short Term Assets		33,963,296	38,353,909	46,594,160	7,383,325	8,248,152	7,535,728	12.9%	21.5%
Cash and Due from Banks		61,230	127,838	44,035	13,311	27,492	7,122	108.8%	(65.6%)
Short Term Investments	1	21,838,990	22,768,001	30,737,193	4,747,607	4,896,344	4,971,162	4.3%	35.0%
Short Term Net Loan Portfolio		11,751,797	15,428,446	15,755,400	2,554,738	3,317,945	2,548,139	31.3%	2.1%
Short Term Gross Loan Portfolio	2	14,791,738	17,296,347	16,847,202	3,215,595	3,719,644	2,724,718	16.9%	(2.6%)
(Loan Loss Reserve)		3,039,941	1,867,901	1,091,802	660,857	401,699	176,578	(38.6%)	(41.5%)
Interest Receivable		0	0	0	0	0	0	-	-
On loan portfolio	3	0	0	0	0	0	0	-	-
On investments	4	0	0	0	0	0	0	-	-
Accounts receivable and other assets	5	311,279	29,624	57,532	67,669	6,371	9,305	(90.5%)	94.2%
Long term assets		3,434,548	2,913,134	2,406,632	746,641	626,480	389,227	(15.2%)	(17.4%)
Long Term Net Investments								-	-
Long Term Gross Loan Portfolio		0	0	0	0	0	0	-	-
Net Fixed Assets		3,434,548	2,913,134	2,406,632	746,641	626,480	389,227	(15.2%)	(17.4%)
Other Long Term Assets		0	0	0	0	0	0	-	-
LIABILITIES AND EQUITY		37,397,844	41,267,043	49,000,792	8,129,966	8,874,633	7,924,955	10.3%	18.7%
Liabilities		14,149,762	18,090,670	17,923,332	3,076,035	3,890,467	2,898,761	27.9%	(0.9%)
Short term liabilities		14,149,762	18,090,670	17,923,332	3,076,035	3,890,467	2,898,761	27.9%	(0.9%)
Short Term Borrowings	6	14,038,853	17,839,542	17,532,835	3,051,925	3,836,461	2,835,606	27.1%	(1.7%)
Interest payable	7	0	0	0					
Accounts Payable and Other Short Term Liabilities	8	110,909	251,128	390,497	24,111	54,006	63,156	126.4%	55.5%
Long term liabilities		0	0	0	0	0	0	-	-
Long Term Borrowings		0	0	0	0	0	0	-	-
Other Long Term Liabilities		0	0	0	0	0	0	-	-
Equity		23,248,082	23,176,373	31,077,460	5,053,931	4,984,166	5,026,194	(0.3%)	34.1%
Paid-In Capital								-	-
Donated equity	9	27,733,904	28,649,284	36,608,232	6,029,110	6,161,136	5,920,692	3.3%	27.8%
Retained earnings without donations and reserves		(4,485,822)	(5,472,911)	(5,530,772)	(975,179)	(1,176,970)	(894,498)	22.0%	1.1%
Current year		(1,326,923)	(987,089)	(57,862)	(288,461)	(212,277)	(9,358)	(25.6%)	(94.1%)
Other equity accounts		0	0	0	0	0	0	-	-

SBACD Income Statement	Notes	EGP			USD			Evolution	
		Dec. 2001	Dec. 2002	Dec. 2003	Dec. 2001	Dec. 2002	Dec. 2003	2002/2001	2003/2002
Financial Revenue (a)		3,159,765	3,723,140	4,638,446	686,905	800,675	750,181	18%	24.6%
Financial Revenue from Loan Portfolio		3,155,839	3,706,585	4,622,467	686,052	797,115	747,597	17.5%	24.7%
Interest on Loan Portfolio		3,136,893	3,513,996	4,339,599	681,933	755,698	701,848	12.0%	23.5%
Fees and Commissions on Loan Portfolio		0	0	0	0	0	0	-	-
Penalty Revenue on Loan Portfolio		18,946	192,589	282,868	4,119	41,417	45,749	916.5%	46.9%
Financial Revenue from Investments	10	0	8,972	6,079	0	1,930	983	-	(32.3%)
Other Operating Revenue		3,926	7,583	9,900	853	1,631	1,601	93.2%	30.6%
Financial Expense (b)		1,334,750	1,584,709	1,799,685	290,163	340,798	291,065	18.7%	13.6%
Interest paid on borrowings		1,334,010	1,583,777	1,799,582	290,002	340,597	291,049	18.7%	13.6%
Interest paid on deposits		0	0	0	0	0	0	-	-
Net Inflation Adjustment Expense		0	0	0	0	0	0	-	-
Other Financial Expenses		740	932	103	161	200	17	25.9%	(88.9%)
Financial income [c=a-b]		1,825,015	2,138,431	2,838,761	396,742	459,878	459,116	17.2%	32.7%
Net Loan Loss provision expense (d)		939,760	710,351	179,659	204,296	152,764	29,056	(24.4%)	(74.7%)
Loan loss provision expense and write off		1,048,599	779,661	231,897	227,956	167,669	37,505	(25.6%)	(70.3%)
Recovery from Loans written off	11	108,839	69,310	52,238	23,661	14,905	8,449	(36.3%)	(24.6%)
Operating expense (e)		2,182,211	2,344,104	2,646,001	474,394	504,108	427,941	7.4%	12.9%
Personnel Expense (includes fringe)		1,339,551	1,574,034	1,886,426	291,207	338,502	305,094	17.5%	19.8%
Administrative Expense (non-staff operating expenses)		842,660	770,071	759,575	183,187	165,607	122,847	(8.6%)	(1.4%)
Depreciation and amortization		551,896	468,615	451,949	119,977	100,777	73,094	(15.1%)	(3.6%)
Consulting fees	12	16,716	121,632	54,523	3,634	26,157	8,818	627.6%	(55.2%)
Others		274,048	179,824	253,103	59,576	38,672	40,935	(34.4%)	40.8%
Net Operating Income Before Taxes and Donations [f=c-d-e]		(1,296,956)	(916,024)	13,101	(281,947)	(196,994)	2,119	(29.4%)	(101.4%)
Income Taxes (g)								-	-
Net Operating Income Before Donations [h=f-g]		(1,296,956)	(916,024)	13,101	(281,947)	(196,994)	2,119	(29.4%)	(101.4%)
Non Operating Revenue (i)	13	240,106	230,494	264,993	52,197	49,569	42,858	(4.0%)	15.0%
Non Operating Expense (including related taxes) (j)	13	270,072	301,559	335,955	58,711	64,851	54,334	11.7%	11.4%
Net Income Before Donations [k=h+i-j]		(1,326,923)	(987,089)	(57,862)	(288,461)	(212,277)	(9,358)	(25.6%)	(94.1%)
Donations (l)		0	0	0	0	0	0	-	-
Net Income (after Taxes and Donations) [m=k+l]		(1,326,923)	(987,089)	(57,862)	(288,461)	(212,277)	(9,358)	(25.6%)	(94.1%)

Adjustments

The following adjustments were applied:

- ❑ **Adjustment for inflation** is performed to account for the effect of inflation on equity and fixed assets. In this case, the equity is composed of operating subsidies as well as fixed USD deposits provided by USAID for the sole purpose of guaranteeing bank overdrafts used to finance the portfolio. Therefore, this adjustment excludes the amount of equity attributable to such collateral deposits that in other cases could be considered an off-balance sheet item.
- ❑ **Adjustment for cost of funds** is performed to estimate the cost that the institution would pay if using commercial financing. This adjustment accounts for the cost savings received from donated funds or concessional loans. In this case, the portfolio is financed entirely from overdrafts offered by banks so no adjustment was performed.
- ❑ **Adjustments for in-kind donations** are performed to account for services that ordinarily would be a cost to the institution but are not reflected in the financial statements. In this case, SBACD benefited from trainings offered by the USAID technical service provider, EQI. Planet Rating estimated the value of these trainings to be the equivalent of 5,000 USD per 5-day training session (SBACD reported an average of 3 training sessions per year, for 30 to 35 persons each).
- ❑ **Adjustment for loan loss provisions** are performed to account for the cost of risk related to the portfolio if the institution's policy is not sufficient and to better compare performance across MFIs. In this case, the institution's loan loss policy was sufficiently conservative that no adjustment was made.

Data in EGP unless otherwise stated	Dec. 2001	Dec. 2002	Dec. 2003
Adjustment for the cost of funds = (a*b-c)	0	0	0
a. Average amount of borrowings	13,314,067	15,939,198	17,686,189
b. Shadow price of borrowings	n/a	n/a	n/a
c. Interest expense on borrowings	1,334,010	1,583,777	1,799,582
Adjustment for inflation = (a -b) * c	0	0	0
a. Avg. Equity (1)	(322,337)	1,034,638	512,163
b. Average fixed assets	3,696,535	3,173,841	2,659,883
c. Inflation rate	2.4%	2.5%	3.4%
Adjustment for in-kind donations	100,000	100,000	100,000
a. Staff and technical assistance	100,000	100,000	100,000
b. Other	0	0	0
Adjustments for provisions	0	0	0
Loan losses	0	0	0
Other risks	0	0	0
Other adjustments	0	0	0
Total adjustments	100,000	100,000	100,000
Net income before donations	(1,296,956)	(916,024)	13,101
Adjusted net income before donations	(1,396,956)	(1,016,024)	(86,899)
Adjusted net income before donations (USD)	(303,686)	(218,500)	(14,054)

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