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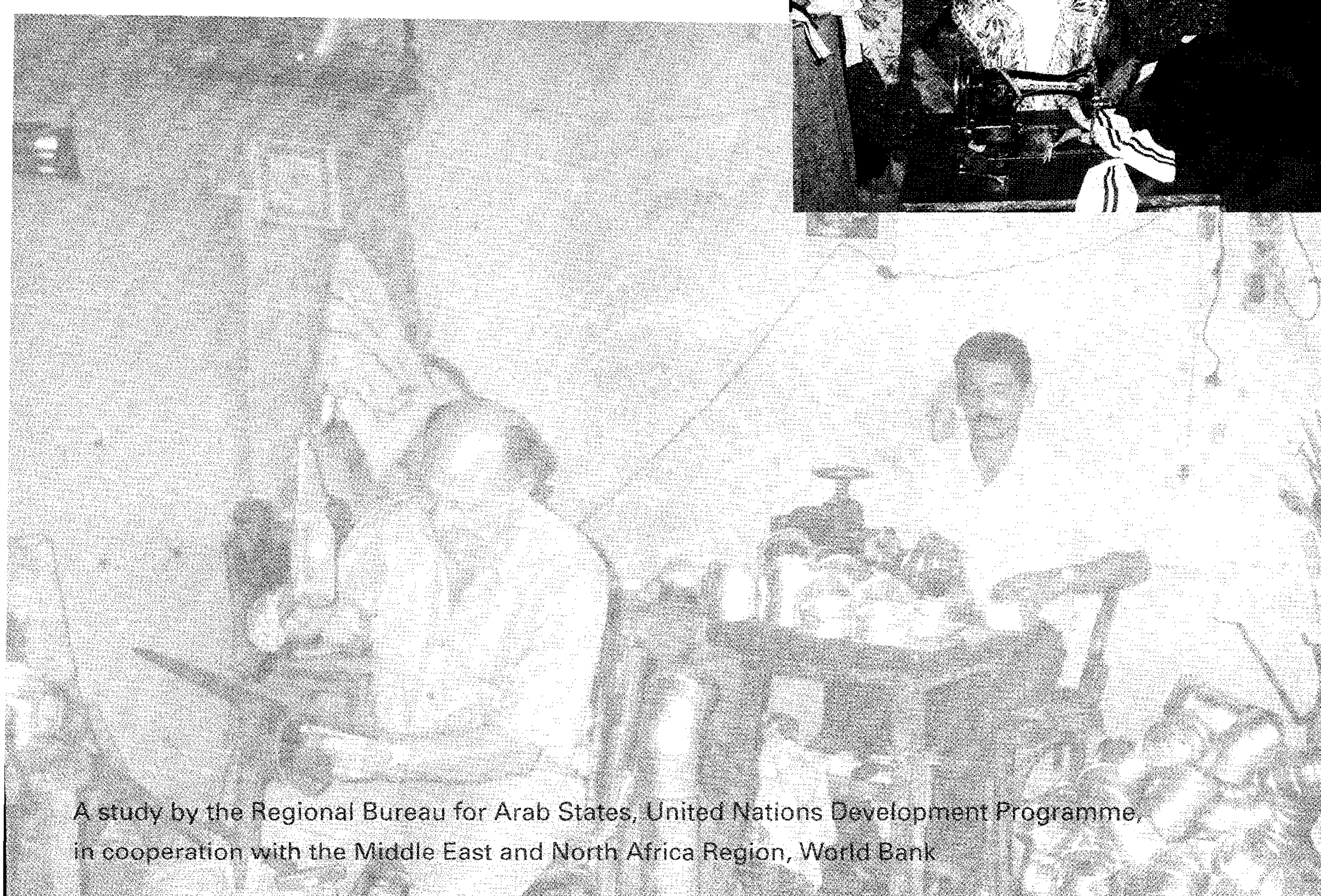
Case Study



A study by the Regional Bureau for Arab States, United Nations Development Programme, in cooperation with the Middle East and North Africa Region, World Bank

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Rahul Dhumale, Amela Sapcanin, and William Tucker

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The findings and recommendations expressed in this report are entirely those of the authors and should not be attributed in any manner to the United Nations Development Programme or the World Bank.

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The potential for commercial banks in microfinance

Commercial banks can profitably offer financial services to the growing number of microfinance clients

Microfinance institutions provide financial services—such as loans and savings services—to low-income populations (see Fruman and Goldberg 1997). Because this industry has only recently emerged in the Middle East and North Africa, practitioners are in a unique position to shape the field, set standards, and develop best practices that reflect the features of countries in the region. Presently, however, microentrepreneurs in the region have limited access to financial services—more than 95 percent of the potential demand for microfinance is not being met.

In Egypt a quarter of the population is considered poor by any standard, and another quarter lives on the edge of poverty (Asaad and Rouchdy 1998). Still, the country contains at least 1.5 million microenterprises, according to conservative estimates. Yet even though Egypt's microfinance programs provide far more loans than those of any other country in the region, just 5 percent of the potential demand for such resources is being met. Except for one commercial bank and one government program, all of Egypt's programs are run by nongovernmental organizations (NGOs).

The entrepreneurial poor in Egypt—and in the Middle East and North Africa in general—have limited options for financial services (USAID 1997). They tend to rely on self-financing or costly informal financing, such as rotating savings and credit schemes, supplier credits, and local moneylenders. In addition, government- and donor-subsidized programs cover some of the demand for microcredit. But the shortfall in credit available to microenterprises, which have great potential to boost economic growth and reduce poverty in Egypt, remains significant. This deficit of loan funds also impedes the government's stated goals of increasing economic growth, expanding exports, creating jobs, and lowering inflation. Commercial banks could help increase the supply of microcredit. Despite negative perceptions, experience has shown that commercial banks can profitably offer financial services to the growing number of microfinance clients.[1]

A recent survey of 206 microfinance intermediaries worldwide found that in many parts of the world—unlike in the Middle East and North Africa and contrary to perceived barriers—banks are becoming major players in microfinance (World Bank 1996). For a variety of reasons, banks appear well suited to lead this industry:

- Their branch networks give banks a large outreach capacity.
- Their well-designed loan delivery mechanisms and well-established operational procedures could easily be tailored to the needs of microentrepreneurs.
- They possess a readily accessible source of finance—their deposit base.
- Their capacity to offer diversified banking services (such as loans, deposits, savings, and other financial products) is, in principle, attractive to microfinance clients.

If they can modify their procedures in a way that enables them to manage large microfinance programs, commercial banks can be successful in the microfinance industry (Baydas, Graham, and Valenzuela 1997). They may also have to adapt certain banking practices and tailor their financial methodology to reach the poor. Microentrepreneurs need financial services that are delivered conveniently and quickly. As a result they are willing and able to pay a premium for continued and reliable access to these services. Thus, in order to encourage banks and other private actors to invest in this industry, it is necessary to demonstrate the profitability of microfinance and the existence of enormous market demand.

Microentrepreneurs need continued access to reliable microfinance services—services for which they are willing to pay a premium

This report describes the microfinance efforts of Egypt's National Bank for Development (NBD), the only commercial bank in the country that has established a separate unit to provide financing to the entrepreneurial poor. The NBD offers microloans ranging from $300 to $1,500 with maturities ranging from 3 to 11 months. Clients usually start with smaller loans, then become eligible for larger loans depending on their repayment history. The interest rate is a flat 16 percent, and a 3 percent transportation fee is charged. No collateral is required. The program has 18,800 active borrowers and $12.3 million in outstanding loans.

Most borrowers remain clients of NBD for a long time, indicating that microentrepreneurs need continued access to reliable microfinance services—services for which they are willing to pay a premium. This report reviews the microfinance industry in Egypt and analyzes the NBD's microfinance program. It shows that commercial banks can deliver financial services to the poor on a profitable—and hence, sustainable—basis. The main requirements for success are a staff incentive system, good client relations, and effective management and training.

Note

1. Commercial banks often perceive small entrepreneurs as being less attractive customers because of smaller profit potential, higher lending costs, and higher risk. In addition, dealing with a large number of widely dispersed enterprises is more demanding—both in terms of time and effort. Borrowers may not be easily accessible, and bank personnel tend to be separated from the clients by differences in language, literacy, and culture. Except for the National Bank for Development (NBD), Egyptian commercial banks shy away from microenterprise lending.

Egypt's recent strides—and remaining challenges

Since the early 1990s Egypt has made considerable progress in achieving macroeconomic stability. Between fiscal 1991 and 1997 inflation dropped from 21 percent to 6.2 percent (table 1), and the fiscal deficit dropped from 18 percent to 0.8 percent. Tight monetary conditions have been maintained, with both the current and capital accounts achieving surpluses. The balance of payments is in surplus as well.

To build on the success of stabilization measures, structural reforms have privatized various sectors, reformed the financial sector, deregulated various activities, improved tax and civil service procedures, and liberalized trade and the exchange system. As a result real GDP growth has reached 5 percent, the country has better access to international capital markets, private sector investment has increased, and local stock market activity has surged (El-Erian and Fennell 1997).

Despite fluctuations in oil prices and the uncertainties resulting from the Asian crisis, Egypt's economy has shown remarkable resilience. Yet the country faces several challenges. Savings and investment rates will have to rise from their current 18 percent to 23–25 percent in order to increase GDP growth to 6–7 percent—the level estimated as being required to reduce unemployment and address other pressing social problems for the country's nearly 60 million people (Economist Intelligence Unit country report). Given that official estimates of unemployment are about 10 percent—and unofficial estimates hover between 15 and 20 percent—Egypt will have to increase job and income opportunities to meet the rising expectations of its young and growing population.

Table 1. Economic and social indicators for Egypt, 1996–97

Indicator	*Amount*
Population (millions)	59.7
Annual growth rate (percent)	2.0
Labor force (millions)	17.3
Annual growth rate (percent)	2.7
GDP (billions of U.S. dollars)	50.9
Annual real growth rate (percent)	5.0
Unemployment (percent)	10–22
Inflation (percent)	6.2
Average exchange rate (LE/$)	3.39

Source: Central Bank of Egypt Annual Report 1996/1997; *Economic Review* 37(4); IMF staff estimates.

A range of measures is needed to narrow the wide gap between the rich and the poor. The living standards of the poor have deteriorated substantially since most subsidies were eliminated in 1991. In the mid-1990s estimates of the population living below the poverty line (the headcount ratio) ranged from 12 to 23 percent using a lower poverty line, and from 23 to 48 percent using a higher poverty line. Women and children are among the most vulnerable groups. In addition, poverty has a regional dimension: most of the poor are concentrated in the rural areas of five governorates in upper Egypt, and in the squatter and informal settlements of the largest metropolitan areas (Asaad and Rouchdy 1998). In rural areas the poor are either farmers with little or no land, or agricultural laborers. In urban areas poverty is associated with industrial employment and services, including a large number of government employees.

In this context microfinance could be a powerful development tool, contributing to private sector–led growth. The main functions of microenterprise—promoting productive investments that generate income for poor households—are closely correlated with one of the main objectives of microfinance—alleviating poverty by generating income and creating jobs. But can the country's financial sector adapt to the needs of microentrepreneurs?

An improving financial sector offers opportunities for microlending

In June 1997, 64 banks were registered with Egypt's Central Bank. Of these, 28 are commercial banks (4 of which are state-owned), 32 are business and investment banks (all of which are private), and 4 are specialized banks (all of which are state-owned). This system has the infrastructure and financing capacity to reach thousands of potential borrowers—together these 64 banks have 2,325 branches (table 2). In addition, the postal savings system has more than 2,900 outlets to reach the poor.

Substantial liberalization of the financial sector has been under way since 1991. Credit controls have been eliminated. Interest rates and foreign exchange regimes have been liberalized. Modern banking regulations and treasury bill auctions have been introduced. And the domestic stock market has been revitalized, placing Egypt among the top five emerging markets. Financial sector reforms have developed indirect instruments for controlling liquidity and management and have made domestic financial assets more attractive—efforts that could help diversify banking activities and expand microfinance as well.

Opportunities exist to further deregulate Egypt's banking sector. The state continues to play too large a role in Egypt's financial sector (table 3). Moreover, banks are forgoing potential profits by ignoring microenterprises and small enterprises, which generate a significant portion of the nation's value added and most of its employment.

Table 2. Egypt's banking system, June 1997

Type	*Ownership*	*Number of branches*
Commercial banks	4 public banks	883
	24 private and joint venture banks	298
Business and investment banks	11 private and joint venture banks	90
	21 offshore banks	42
Specialized banks	1 industrial development bank	14
	2 real estate banks	22
	1 principal bank for development and agricultural credit	976
Total	64 banks	2,325

Source: Central Bank of Egypt banking survey, 1996/97.

Table 3. Assets, deposits, and loans in Egypt's financial system, June 1997

Indicator	*Amount (millions of Egyptian pounds)*	*Public share of total (percent)*
Assets	261,118	61.8
Public commercial banks	146,650	56.0
Public specialized banks	15,303	5.8
Deposits	174,858	67.4
Public commercial banks	113,655	64.0
Public specialized banks	5,860	3.4
Loans	128,826	64.8
Public commercial banks	70,788	55.0
Public specialized banks	12,632	9.8

Source: Central Bank of Egypt banking survey, 1996/97.

Microenterprises and their enormous role in Egypt's economy

Microenterprises represent 93 percent of the private sector and account for 52 percent of private employment

A key distinction between microenterprises and small enterprises is the degree of interdependence between the household economy and the business activity. In microenterprises it is difficult to separate the household economy from the business activity. The economic decisions of the household play a major role in the economic decisions of the microenterprise, and the economic decisions of the microenterprise play a major role in the economic decisions of the household. In small enterprises the dividing line is more clear-cut. Thus microenterprises can be defined as productive activities that generate income for poor people and their households. Together with household activities, they are a means through which the poor subsist from year to year as well as a means to protect against unexpected economic shocks.

As noted, Egypt contains at least 1.5 million microenterprises, although this official estimate may fall far short of reality because it does not include underage employees or itinerant workers. The owners of these enterprises live near or below the poverty line. It is estimated that microenterprises and small enterprises account for more than 98 percent of the economy's private nonfarm establishments. Government estimates indicate that microenterprises represent 93 percent of the private sector and account for 52 percent of private employment (Ministry of Economy 1998).

Most of these enterprises are quite small and informal, in that they are either only partly or not at all licensed.[1] They generally provide work only for the owner and a few employees—usually family members. In most cases capital does not exceed LE 10,000 (about $3,000). The size of microenterprises in Egypt is a function of highly competitive local markets. Even if entrepreneurs were to receive intensive training and have adequate access to financial services, only a few might become dynamic, steadily growing businesses. Most of these enterprises need funds for working capital, whether to replace an existing (possibly expensive) informal source of capital

Ahmed is a young entrepreneur in his early 30s. He manufactures protective gloves and body suits. He has been borrowing from the NBD's microcredit program since April 1996, taking out four loans in the range of LE 1,000 to LE 5,000 ($300 to $1,500). The loans have been used to buy two new sewing machines, which have doubled his production capabilities; he is now able to supply four or five wholesalers instead of two. The loans are also used to buy raw materials and pay salaries; as a result his family-run business has grown from 5 to 10 workers. During discussions he spoke of expanding his two tiny rooms into three—the workshop next door caught his eye, and he has approached an NBD loan officer with his plans and received a preliminary approval. He makes a $0.15 profit on each pair of gloves and sells up to 4,000 pairs a month. He prefers to use his profits to restock inventory, rather than to keep "money as money."

or to enhance existing capital to expand operations. Most of the needed financing is short term, involving maturities of 6–12 months. However, borrowers tend to apply regularly for new loans, and so they build up a long-term relationship with the financial intermediary—as has been the case with microloans and small loans provided by the National Bank for Development, several business associations, and other microfinance programs.

Note

1. This study defines microenterprises as establishments with fewer than 10 employees and requesting loans of LE 500 to LE 19,000 ($150 to $5,600).

Who provides microfinance in the region?

Several models are used to provide financial resources to the entrepreneurial poor

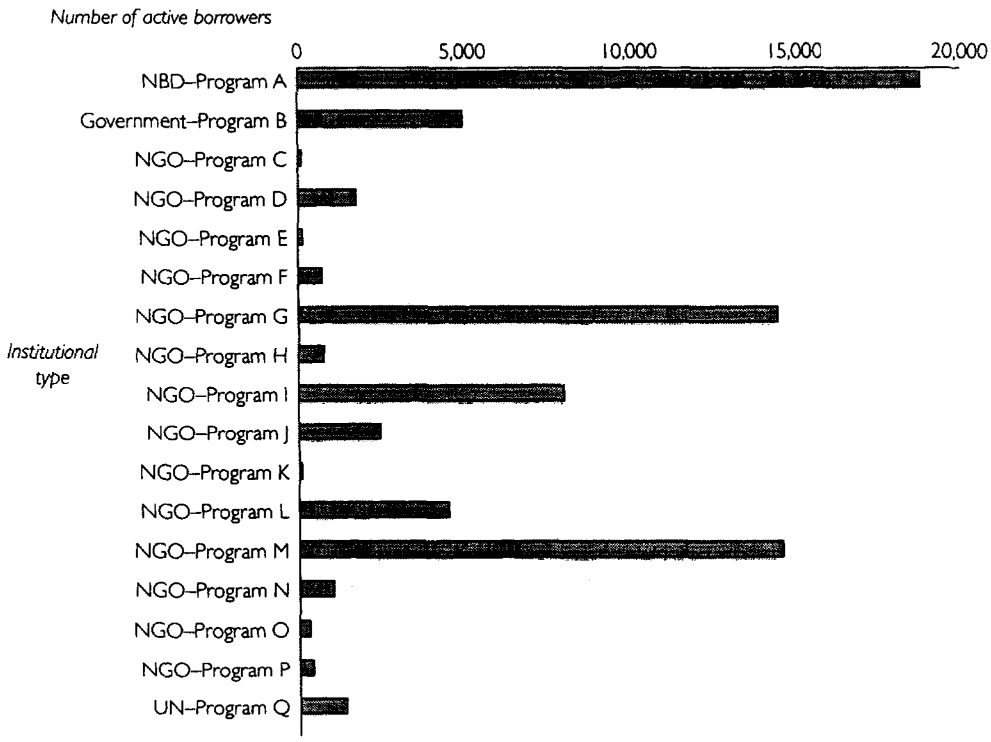
Egypt's microfinance providers serve nearly 75,000 borrowers and have about $55 million in outstanding loans (Brandsma and Chaouali 1998). Still, 95 percent of potential microfinance borrowers are not being served. The average loan ranges from $200 to $1,500.

Several models are used to provide financial resources to the entrepreneurial poor. NGOs, the predominant source of microfinance, offer an alternative to commercial banks, especially for loans to microenterprises and small enterprises (figure 1). NGOs receive financial support from a number of international donors and private foundations.

Government-subsidized interest rates are used for loans granted by the Social Development Fund, which is supported primarily by the World Bank and the European Union. Public banks account for more than 87 percent of the fund's use. Because the fund is focused on creating new small enterprises, average loans are somewhat higher and for longer periods than under other programs.

Finally, microfinance units of commercial banks—such as the National Bank for

Figure 1. Microfinance industry in Egypt, 1998



Source: Brandsma and Chaouali 1998.

Development—have received support from the U.S. Agency for International Development, though the NBD is now financing program growth with its own resources. The NBD's operation ("program A" in figure 1) has the largest number of active borrowers. Although several NGOs in Egypt manage their loan portfolios in cooperation with local banks, the NBD is the only commercial bank with a microlending unit. Moreover, it relies on microfinance best practice techniques.

The average outstanding loan of the NBD's microfinance program is slightly lower than the average for all microfinance providers in Egypt. Still, the NBD's average outstanding balance is at least three times the poverty line of $200—despite the fact that the program operates in areas that are overwhelmingly poor (such as the upper and lower Egyptian governorates and the squatter areas of greater Cairo). Initial average loans to first-time borrowers are closer to the poverty line, however.

The National Bank for Development's microfinance program—a model for the region

The NBD recognized that microfinance could not only generate profits, but also alleviate poverty

The NBD was incorporated in 1980 as an Egyptian joint stock company with capital of $15 million. By the end of 1997 the bank's assets had risen to $1.7 billion and its capital base was $71 million (4 percent of total assets; table 4). In December 1997 the bank had almost $950 million in outstanding loans (net of provisions). The NBD has about 20,000 shareholders, including individuals, companies, and other organizations. As a full-service commercial bank, the NBD provides a range of services through its 66 branches, which are spread throughout Egypt's governorates. Over the years the bank has established nearly 65 joint stock companies operating in various sectors of the economy, including food, tourism, financial services, and housing. Today these companies are worth $195 million.

In 1987 the NBD began to recognize the potential role of microenterprises and small enterprises in the Egyptian economy. The bank realized that providing loans to these borrowers would not only combat poverty but also create jobs in this frequently overlooked segment of the population. Moreover, similar microlending programs elsewhere had recorded high levels of repayment. Senior management realized that the bank could not only generate profits from microfinance—though on a smaller scale than in its conventional commercial operations—but also help alleviate poverty in Egypt.

Working with the U.S. Agency for International Development (USAID), the NBD established a Small and Microenterprise Division and started microlending in four of its branches in 1987. In 1993 USAID and the NBD increased to 13 the number of branches engaged in microlending in the greater Cairo area. USAID agreed to cover the administrative costs and operating expenses of this program, and capitalized a revolving credit fund of $11 million. Once it broke even on its expenses, the

Table 4. Balance sheet of the National Bank for Development, 1997
(millions of U.S. dollars unless otherwise noted)

Indicator	*Amount*
Assets	1,765
Capital	71
Deposits	990
Outstanding loans (net)	946
Investment securities	323
Return on equity (percent)	5

Source: NBD balance sheet, June 1998.

Rabbia first applied for an NBD loan of LE 1,500 ($450). Since then he has taken 12 loans to reach the maximum amount granted under the NBD's microcredit program (LE 10,000). Rabbia's microenterprise fashions tin sheets into air conditioning vents and covers; his main clients are hospitals and movie houses. Of the eight employees in his workshop, four are family members. Rabbia used his first loan to buy raw material: sheets of tin metal. Subsequent loans were used to buy $5,000 metal-turning machines. Future loans will continue to finance the purchase of raw materials and be used to expand Rabbia's second workshop.

NBD contributed LE 10 million ($3 million) of its own funds to the microcredit fund.

Objectives

The NBD's microcredit program has diverse and ambitious objectives. In the short run it hopes to provide access to credit to microenterprises and small enterprises that would otherwise be ignored by conventional banks. In the long run it hopes not only to create jobs by extending credit but also to help these small borrowers become clients under more conventional banking standards.

Zaynab and her husband do not have children, but they are raising the children of her deceased brother. Before taking an NDB microloan, Zaynab was well known in her neighborhood for the skillful sewing she did at home, but she could not take on larger orders because she could not afford the fabric. Her first loan of LE 500 ($150) came in November 1995. Her most recent loan, the seventh from the NBD's microcredit program, was LE 4,000 ($1,200). Today Zaynab sews dresses and hems sports and other active wear. She began by herself and now employs one other seamstress. Her raw materials consist of rolls of fabric and stripes, as well as other fashionable fabric for dresses. She can produce up to 150 pieces a day and earns $0.60 to $0.90 a piece. Zaynab is not interested in having a workshop outside her home, but she would like to increase her productivity by buying hemming machines and employing several of her neighbors on a type of lease arrangement. She has discussed her plans with her loan officer and has received a positive response. Zaynab emphasizes that none of her achievements would have been possible if she had not been given the opportunity to borrow. She is constantly encouraged by the demand for her product, and feels that the program has greatly improved the quality of her family's lives and increased economic security.

Unlike routine bank loans, the NBD's microcredit program has several social objectives. In many cases, for example, the income from a microenterprise represents a household's total income. Thus sudden physical calamities to any member of the household may be more relevant than usual when considering a new repayment schedule. The ultimate aim of the NBD program is to improve the quality of life of small borrowers while teaching them how to increase control over their financial resources. The program promotes employment generation, self-employment, the preservation and expansion of existing activities (particularly in the crafts industry), and better accounting, bookkeeping, and credit management.

The NBD's microcredit program has diverse and ambitious objectives

The NBD's program is one of the few microcredit programs in the Middle East and North Africa that is conducted through a commercial bank. The program's success may encourage other commercial banks in the region to pursue similar endeavors (table 5; see also the annex).

In December 1997 the NBD's microcredit program had $12 million in outstanding loans—less than 1.3 percent of the bank's overall outstanding loan portfolio and similar to the amount that USAID established

Table 5. Basic data on the National Bank for Development's microcredit program, June 1998

Indicator	*Amount*
Total number of disbursed loans	188,000
Total amount of disbursed loans	$131 million
Repayment rate on disbursed loans (percent)	99.2
Number of loans disbursed to women	13,522
Share of women in total loans (percent)	13.5
Number of current active borrowers	18,800
Current outstanding loan portfolio	$12.3 million
Average loan size	$896
Average outstanding loan balance	$654
Revolving of loan fund	2.4 times a year
Sectoral distribution of loans (percent)	
Production	22
Services	17
Commercial	37
Investment	24
Total number of savers	16,564
Total savings	$1.76 million

Source: NBD balance sheet, June 1998.

The NBD's main comparative advantage is its potential for expanding the breadth and depth of its outreach

as a revolving credit fund with the bank in 1989. As can be deduced from these amounts, the NBD has managed to actively participate in lending to microenterprises without investing too much of its own capital. And, as is shown later, the program is highly profitable. In hindsight, USAID may have invested too much, not only in loan funds but also in the costs of operations and institutional development until the NBD broke even. But this investment was probably an essential "ice breaker" for the microfinance industry in the Middle East.[1] And as noted, the NBD is now using its own deposit base to finance the growth of the microcredit program.

The program has nearly 19,000 borrowers and an average outstanding balance per borrower of $654, with an average loan term of five to seven months.[2] The small size of loans and their brief maturity indicate that the NBD's program is reaching microenterprises. Moreover, data for the NBD's program are comparable to those for microcredit programs in other countries.

The NBD's main comparative advantage is its potential for expanding the breadth and depth of its outreach through its extensive branch network and adaptive approach to clients. The bank has 66 branches, of which 33 have implemented the microlending program. One of the NBD's unique features is its mobile banking services. Minivans—with a driver (who also serves as a security guard), tellers, and loan officers—visit areas in Cairo where the bank does not have branches. These mobile branches collect repayments, disburse new loans, review applications, and conduct all other business normally carried on in their regular branch offices. Mobile branches enable the bank to get to know its clients while combining the discipline of commercial banks with the outreach of NGOs.

The loan officers interviewed often cited their clients' initial surprise and disbelief in learning that the bank had come to them, rather than vice versa. At first promoting the project and selling it to potential clients was a large part of the daily work of the loan officers. This is a good example of how the NBD has tried to provide credit to those normally excluded by conventional banking channels.

Target groups

The NBD's program aims to address the credit needs of small borrowers, artisans, and other entrepreneurs neglected by conventional banks. The NBD also extends credit to informal groups and enterprises without proof of registration. The most important factors in the loan decision are the economic viability of the enterprise and the integrity of the borrower. Bankable collateral is not required. Borrowers do, however, have to sign a promissory note obliging them to repay the loan. And, as noted, the program stresses the importance of timely repayment.

The NBD focuses on financing income-generating activities undertaken by individual entrepreneurs from the informal sector. Loans are provided to owners of existing enterprises that, in the words of one of the loan officers interviewed, have an "outstanding reputation." Following program guidelines, no loans are provided to start up new microenterprises. Clients come from a range of activities in trading, productive, and service sectors. Microenterprise owners include blacksmiths, electricians, bakers, spice retailers, potters, tailors, metal painters, and shoemakers. Activities generally include light manufacturing and assembly, maintenance, transport, storage and distribution, and agricultural product processing and marketing.

NBD statistics for a sample of branches show 76,660 repeat loans for a total of LE 251,572,974 ($74.2 million). This represents 71 percent of the total value of loans disbursed within the program and about 10 loan cycles.[3] All the clients interviewed for this report were repeat borrowers, having obtained between 2 and 12 loans. As noted, continued access to microfinance is essential and sought after.

Salah-a-Din, who has a family of 10, owns a small workshop that plates metal and oxidizes door and window handles. He heard of the NBD microcredit program after several of his neighbors applied for loans. In August 1993 he took his first loan, for LE 1,000 ($300), and after nine loans reached LE 5,000 ($1,500). Salah-a-Din is a good example of "learning by doing," as he taught himself his trade. Before joining the program he had no electricity and had to perform some tasks manually; with the NBD's first loan he was able to buy a generator. Today he owns two generators and has increased his revenues by 60 percent. Moreover, he now has five employees and his goods are being exported through wholesale distributors. Salah-a-Din stresses that the loans gave him the liquidity he needed for his business. He has doubled his existing capital, and in the past few months his average profits have reached almost 100 percent. He plans to expand, because the demand for his products is high, and he intends to apply for new loans.

Most of the borrowers interviewed are in the informal sector, and businesses are usually conducted from their homes. In our sample only one borrower had more than one workshop, although in almost every case owners were looking to expand. Loan values range from $150 to $3,000, which is the limit under the NBD's microfinance program. Many borrowers' relationships with the bank stretched over several years, starting from those who joined the program in 1993. All clients look forward to larger loans in order to be able to produce more and hire more workers. Employees in the enterprises visited typically included extended or close family members and a few outside workers, with the total number of employees ranging from 2 to 12. Despite high competition, most borrowers believed there was sufficient demand for their services to warrant expansion to at least another workshop.

Most borrowers continue borrowing because the loans provide them with the liquidity needed to keep their businesses running. Moreover, most borrowers reinvest 60–80 percent of enterprise profits. The rest is used for household needs and savings. In summary, NBD clients, who otherwise would not be considered bankable in commercial terms, depend on the program for initial and continued access to finance.

NBD clients depend on the program for initial and continued access to finance

Credit methodology

Loan approval

After the loan officer and the client agree on the maturity and repayment schedule of the proposed credit—interest rate, fees, and savings requirements—various documents are sent to the branch supervisor or manager for final approval. If the loan is approved, the loan officer contacts the borrower and arranges to collect the mandatory savings deposit. In addition, the borrower must sign a promissory note before the final disbursement occurs. If the loan application is rejected, the loan officer contacts the applicant and explains why. Overall, the entire process takes less than two weeks.

Savings accounts

Savings are mandatory because the NBD aims to encourage its borrowers to adopt better methods of managing financial resources. As a precondition to loan approval, applicants must deposit an amount equivalent to 10 percent of the value of the loan requested into an interest-bearing savings account at the NBD. This gesture, in both symbolic and practical terms, demonstrates to the NBD that borrowers are willing to commit to the goals of the program. Moreover, the bank believes that it makes borrowers better educated about important financial practices, which is consistent with the program's goals. Borrowers

Close supervision of repayments enables the NBD to identify delinquent borrowers without delay

earn up to 8 percent on these deposits and, after their loan is settled, they are free to choose how to use their savings. Finally, because borrowers often do not have bankable collateral, mandatory deposits reduce the NBD's risk exposure. Since the program began, microborrowers have deposited nearly $2 million in savings.

Best practice microfinance, however, suggests that mandatory savings may not be the most effective way to educate borrowers. By definition, borrowers have limited cash, which is why they are requesting a loan. And although there is significant demand for savings products in the areas where microenterprises operate, this demand generally comes from households who simply want a safe and convenient place to deposit excess liquidity. Finally, mandatory savings mechanisms generally capture less savings than the outstanding microloan portfolio—as has been the experience of the NBD. By contrast, voluntary savings captured by microfinance institutions often exceed the outstanding microloan portfolio—as has also been the experience of the NBD (table 6).

Loan monitoring

Once a loan has been disbursed, loan officers begin monitoring and collecting the periodic installments. Loan officers initially visit borrowers every week. The purpose of these visits is not solely to collect repayments: the NBD sees the weekly visits as part of an ongoing exchange of information. Borrowers can learn about banking and saving and obtain advice on how to make their business more efficient. This approach demonstrates the NBD's commitment to borrowers' needs and its desire to promote financial discipline. Close supervision of repayments enables the NBD to identify delinquent borrowers without delay. Traditional collection procedures are used to recover loans—including, when necessary, legal action.

Table 6. National Bank for Development deposits and loans, 1996–97
(millions of Egyptian pounds)

Indicator	*1996*	*1997*
Customer deposits	3,367.3	4,096.6
Loans to clients	2,608.8	3,158.1

Source: NBD balance sheet, June 1998.

Financial results

At the behest of the U.S. Agency for International Development and as part of a project assessment, a financial analysis of the NBD's microcredit portfolio was carried out in the first quarter of 1996 (Tucker 1996). At that time the NBD had just changed the senior management of the small enterprise and microenterprise program, and its operations were going through a period of assessment and adjustment. The analysis made two important conclusions about the NBD's microcredit operations:

- *Scale of operations.* The bank had demonstrated impressive institutional capability, generating a microcredit portfolio of about $10 million in a short period. This outcome was achieved primarily by implementing the program in 13 bank branches in the greater Cairo area. During 1995, however, growth in the loan portfolio halted then declined slightly as the bank adjusted operational requirements for meeting the credit needs of thousands of small borrowers. Such a slowdown is not unusual given the adjustment that the program experienced.
- *Profitability.* The bank's operations reached the break-even point relatively quickly. Of the 13 branches managing microloan portfolios, many had not yet reached the break-even point. But the few larger and more successful branches were generating enough profit to cover the operating losses of the slower-growing branches. Although operations were breaking even, the overall profitability of the program was stagnant in 1995, with a profit margin (net result divided by income) of 3 percent. Still,

compared with the pretax profit of banks in other countries—0.49 percent in the United Kingdom, 0.99 percent in Lebanon, 1.29 percent in the United States, 1.39 percent in Greece, 3.56 percent in Turkey (OECD 1994)—this figure is quite acceptable. At the time the profit margin of the NBD as a whole was 5 percent.

According to NBD data, the situation has improved considerably since this analysis. For example, the outstanding loan portfolio of the 13 branches analyzed in 1996 has grown considerably (figure 2).

An analysis of a microcredit program's sustainability within a commercial bank may require different approaches than those usually applied to nonprofit microfinance institutions. Full financial sustainability, for example, must take into account the institution's equity. As the following material shows, bankers can and often do analyze their operations in different ways. As with the assessment carried out in 1996, this report has assessed the financial results of the microcredit program in terms of its contribution to the overall profitability of the NBD. Specifically, satisfactory performance could be defined as a profit margin greater than or equal to the bank's overall profit margin. If the microlending operation generates a higher profit margin than that reported by the bank in its audited financial statements, the program may be deemed a financial success. This orientation limits the assessment to the income statement of the program. It is worth noting, however, that the microcredit program has been successful enough for the bank's chairman to expand it throughout the bank's network of 66 branches.

The following analysis assesses the profitability of the NBD's microcredit program by itself but also compares it with the bank's other activities. Revenues and costs are used to determine profitability. Revenues include interest and fee income. Costs include cost of funds (including equity), operating expenses (including depreciation), staff compensation and incentives, loan loss provisions, and overhead.

Revenue

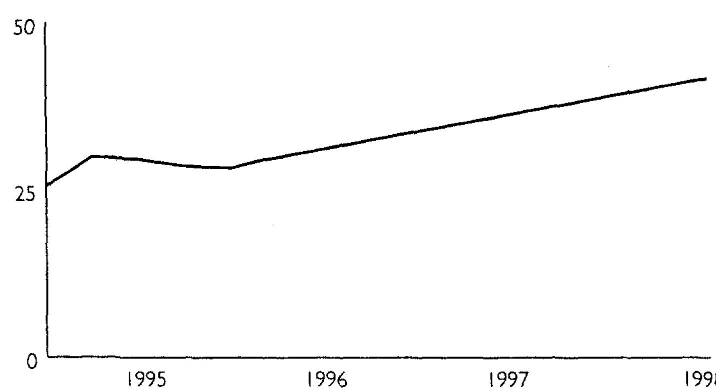
Total revenue for the NBD's microlending program is determined by direct and indirect sources.[4] The two main sources of direct revenue are a flat 16 percent annual interest rate and a flat 3 percent annual transportation fee.[5] The transportation fee covers part of the cost of mobilizing loan officers. For a six-month loan the equivalent annual percentage rate of these two fees is 31.88 percent. Payments for interest and fees are spread equally over the time to maturity and then paid weekly. Principal installments are paid according to the activity of the borrower. The spread between the cost of funds for the NBD and the price at which the bank markets these loans covers the risk inherent in lending as well as the direct and indirect administrative costs encountered by the NBD.

The NBD's program is being extended throughout its network of 66 branches

The three main sources of indirect revenue are a life insurance fee, a penalty fee, and prepayment.[6] The NBD provides life insurance coverage to all microborrowers, to protect them from unforeseen risks or unexpected adverse conditions that might threaten their business and cause a loan default. In case of a calamity, the NBD takes over the borrower's loan and provides the beneficiaries with up to $120 for funeral and bur-

Figure 2. Outstanding loan portfolio at 13 NBD branches in Cairo, 1995–98

Millions of Egyptian pounds



Source: NBD balance sheet, June 1998.

ial expenses. The life insurance fee is a flat 4.75 percent a year of the principal amount. As with other fees, payments are calculated into the weekly interest installments.

The penalty fee is 0.5 percent a month (6 percent a year) of the principal amount. As with other fees, this payment is calculated into the weekly interest installments. After borrowers make their final payment, they receive a refund of the penalty fees paid—unless they missed a payment and incurred a penalty charge. In that case the penalty charge is subtracted from the penalty fees paid and the balance is refunded.

Revenue should reach $3.5 million in 1998

If a borrower prepays any installment, the NBD refunds or recalculates overpaid interest (equal to 65 percent of the amount remaining to be paid during the maturity period).

Revenue for the first seven months of 1998 was about LE 7,011,000 ($2,062,000). Assuming comparable results for the rest of this year, annual revenue will reach $3.5 million. Although the microlending program represents only 1.3 percent of the NBD's total loan portfolio, revenue from the program may account for more than 3 percent of the bank's total interest and fee income this year—one indication of the program's profitability.

Cost of funds

As was the case in 1996, the bank's microlending operation does not monitor its cost of funds. The 1996 profit margin of 3 percent was calculated from an internal transfer-price cost of funds for each branch, which at that time was defined by the NBD as 11 percent. This cost of funds was applied to the resources that had been transferred to the branches that were implementing the microlending program. This transfer price may be considered high. World Bank data show that in 1996 the average cost of funds (including the cost of equity) of private banks ranged from 7.29 to 7.51 percent. The average costs of funds (including equity) of public banks ranged from 8.36 to 9.33 percent. The treasury bill rate was about 9 percent.

A similar, though less precise, approach was used for this analysis. Specifically, the NBD's overall commercial cost of funds was applied to the outstanding microloan balance. The bank indicated that its cost of funds had declined slightly, to 10 percent. And as noted, its outstanding loan balance is about LE 41.8 million ($12.3 million). Thus the estimated annual expense is LE 4.18 million. For the first seven months of 1998, then, the annual expense was LE 2.44 million. This represents 34.8 percent of all revenues. Put another way, it means that for every LE 100 that the microlending program generates in revenue, it must set aside LE 34.8 to cover the cost of the funds it uses.

Khadra took over her husband's cosmetics workshop after he died. She took her first loan from the NBD's microcredit program in 1995 for LE 2,000, and followed it with four others. Khadra used her deceased husband's "secret formula" to expand into an entire line of cosmetics; today she produces nail polish, hair gels, lotions, lipsticks, and facial creams. One of the main expenses in her production process is the cost of containers, such as nail polish bottles and lipstick tubes, which she uses her NBD loans to buy. She recently managed to purchase her raw materials locally, which greatly reduced her costs. Her revenues are seasonal because most of her products are popular with students, who can only wear such products during holidays and special occasions. Khadra earns an average of 5 cents per bottle, and during the high season she can sell up to 1,200 bottles. She now employs four to six workers and is hoping to renew her factory with new loans. She has even been approached by the largest local producer of cosmetics to start a new product line. She wants much larger loans, as she believes she could expand her work much faster than with the smaller loans available under the NBD's program.

Operating expenses

On 31 December 1997 the NBD had 2,818 employees, with total salaries of LE 18 million (NBD Annual Report 1997). The microlending program has 390 staff members, or 14 percent of the bank's staff. This includes almost 160 loan officers—99 of whom work in the 13 donor-supported branches and handle an average of 107 outstanding loans, with an average outstanding portfolio of LE 325,930 ($95,862) per officer and an average of 14 new loans each month. Some 118 members of the microlending unit are women, but few work as loan officers. This is explained by the intensity of work, which demands long working hours and conflicts with family obligations that female officers find difficult to overcome. In the branches that target women, however, a majority of loan officers are women. Given that 14 percent of the NBD's staff manages just 1.3 percent of the bank's outstanding loan portfolio, microfinance is clearly a labor-intensive activity for the banking sector.

Abdel is a carpenter who enjoys a good reputation in Zawiyya, a neighborhood in greater Cairo famous for its carpentry industry. He applied for his first microloan from the NBD in May 1995, for LE 5,000 (about $1,500). He quickly reached the maximum LE 10,000 (about $3,000) available under this program with six additional loans, which he used for working capital. Abdel's business has grown 70 percent since he joined the program: he has opened two new workshops, is about to open a third, and now acts as a distributor. He has "graduated" to become a regular bank customer and is now applying for a regular NBD loan for LE 250,000 (about $73,700) to support his partnership in a large wire factory in an industrial Cairo suburb. This new financial status will bring much larger loans and lower interest rates. Abdel emphasizes that the main reason he has managed to enter into this partnership is the fact that he was able to receive microfinance loans.

In the past loan officers were hired on short-term, temporary contracts. Now all the officers have been converted to bank staff, with the benefits that come with permanent positions. Some NBD managers believe that the former approach to employment was preferable because it made it easier to handle the problems that may occur with loan officers.

Most loan officers are university graduates with a degree in commercial studies, accounting, or computer science. The NBD recruits young graduates to be loan officers because of the demands that this work poses. It is a very laborious activity, requiring staff to learn how to deal with different types of clients and to manage loans on a cash-flow basis. In the branch visited in Cairo, however, most of the loan officers had been with the program since it was created in 1993, indicating low turnover.

In contrast, in branches where the NBD has invested its own onlending funds, staff has assumed responsibility for microfinance activities. These loan officers are paid on a performance-based reward system and usually work on the microlending program after official hours. Like other loan officers, they review applications at borrowers' homes, issue credits, and collect repayments. Initial results are encouraging.

Staff compensation and incentives

Salaries, including incentives, for loan officers range from LE 300 to LE 600 ($88 to $177). On average, half of this income is base salary; the other half is earned incentives. Given the intensity of the work, the base salary may not be fully commensurate with loan officers' efforts. But according to NBD management, none of the loan officers has chosen to work in activities outside the microfinance program. Despite the hardships of the work, the possibility of earning extra pay motivates many officers. Incentives are based on the rate of loan collection and loan disbursement, in equal proportion. The target disbursement rate is about 10 new loans per month. Extra benefits are offered if loan officers collect old loans or go beyond the target. While managers emphasize that loan officers are devoted and key to the success of the program, Mona Mubarak, deputy manager of the microfinance unit, notes that the "incentive system is the basis for the microfinance program." Management indicated that incentives and staff costs represent the unit's main operating costs. To expand microfinance in the NBD's remaining 33 branches, as is planned, most of the funds will need to be allocated to start-up and operational costs, including hiring new staff and providing incentives.

Loan officers described the microcredit program as being very successful in reaching clients in inaccessible areas

Box 1. Branch Sawah—Reaching the poor quickly and effectively

Branch Sawah, in greater Cairo, is one of the largest branches in the NBD's microcredit program. Since 1993 its loan officers have disbursed LE 51 million across 15,000 loans. Current outstanding loans are LE 4 million. Clients usually have no collateral, and 10 percent of clients are illiterate. Loans range from LE 300 to LE 10,000. The branch employs 20 staff members: 1 manager, 2 deputies, 10 loan extension officers, 4 computer and control officers, 1 legal and follow-up officer, and 2 office support staff, including a driver. All the loan officers are men. There used to be a female loan officer who stayed on the job for two years and who disbursed nearly LE 2.6 million in 950 loans. But because some clients have trouble accepting female loan officers, bank management has preferred to hire male loan officers. The work is difficult: loan officers are dropped off in their areas of operation and often have to spend all day walking while visiting 30–40 clients. The officers interviewed for this report are all between the ages of 25 and 35 and show tremendous dedication and commitment to this type of work.

- Amr was a recent graduate when he read about the NBD's microcredit program in a newspaper. He finds the work in the mobile microfinance unit to be very different from that in the regular branch where he used to work. Today he oversees 150 loans, with borrowers in income-generating activities such as carpentry, sewing, shoemaking, and metal painting. He visits 30–40 clients each week to collect and disburse loans and research new applications. Clients initially thought he was a tax officer, and would often close their shops and avoid him. Once the program became better known in the community, however, Amr established good relationships with his clients, who today hold the program in high regard. The rewards of his job—in terms of financial incentives as well as the success of his clients and the change he feels he makes in the community—keep Amr's enthusiasm for the job very high. He has no plans to return to regular branch work.
- Abdel Hamid joined the program in the same way as Amr, and also has established excellent relations with his clients. He visits businesses, talks to the owners to promote the microcredit program, and identifies potential applicants. At first clients were reluctant to deal with him, as they did not expect a bank to deliver services to them. Among his early experiences with clients, he recounted an encounter with an owner of a butcher shop who thought he was a thief and was about to physically attack him. The presentation of bank cards and some quick convincing saved him from the angry butcher. Today this client has taken several loans and enjoys a trusting relation with Abdel.
- Fatma handles loan documentation in the branch, having spent time in the field as a loan officer in a few governorates. In one day she sometimes handles more than 500 loan receipts. Although field work is difficult, she misses it—particularly the good relationships she had with her clients, who were mainly women. She found it rewarding to see her clients develop their business from a one-person operation at home to a small workshop with a few additional female employees, be it in sewing, cosmetics production, or grocery stores.

All the branch's loan officers described the microcredit program as being very successful in reaching clients in inaccessible areas. They believe that their work has made a difference in moving many clients from total poverty to some economic security. Finally, they indicate that the demand is huge and that they could disburse many more loans if there were more staff.

According to NBD management, operating expenses for the microcredit program for the first seven months of 1998 totaled LE 2.2 million ($650,000). The NBD, however, includes in this figure the interest paid on clients' savings accounts. Thus operating expenses should be adjusted downward slightly, to about LE 2 million ($588,000). What this means is that for every LE 100 generated by this lending operation, the NBD must spend LE 28.5 to cover operating costs. This is comparable to other microlending operations in Egypt.

Loan loss provisions

In 1996 the NBD adopted a target repayment rate to indirectly monitor the quality of its loan portfolios, and loan loss provisions were determined each year based on managers' assessment of overall credit risk.[7] Analyses of each branch's portfolio quality, combined with a prudent loan loss reserves policy based on the portfolio at risk, allowed the NBD to allocate a cost of loan loss reserves for each branch.

The NBD now uses two repayment rates to monitor portfolio quality. In June 1998 the figure for outstanding loans was 95 percent; the figure for disbursed loans was 99.2 percent. Loan loss reserves are determined quarterly by bank management. The degree of risk is determined by analyzing the outstanding balance of each overdue loan, less the savings balance of that client and the amount held as a penalty fee, plus the amount generated by the insurance fee. The remainder is considered at risk and is the amount used to determine loan loss reserves.[8]

The microfinance industry encourages the use of specific formulas to determine required loan loss provisions. For example, a portfolio at risk for 1–30 days could have a loan loss provision of 0 percent; for 31–60 days, 25 percent; for 61–90 days, 50 percent; and for more than 90 days, 100 percent. Appropriate loan loss reserves are generally determined through discussions and analyses carried out by the bank and its regulator. Many factors can influence the "ideal" level of reserves.

Loan loss provision expenses in the NBD, expressed as a percentage of total revenue, were 9.3 percent in 1996 and 8.6 percent in 1997. No data are available on the appropriateness of this level of reserves. But given that many microfinance programs generate a reserves expense closer to 5 percent, it might be possible to assess the overall profitability of the NBD's microlending operation by applying a conservative assumption for this expense. Moreover, the bank has indicated that the microcredit portfolio is of a higher quality than the rest of the bank's portfolio. Thus this report assumes that 10 percent of the revenue generated by the microcredit program is applied to a loan loss reserve. The justification for this high percentage, relative to other successful microfinance programs in Egypt, is the indirect nature in which repayment rates measure portfolio quality: the risk to the NBD could be higher than indicated. Since available data do not allow for a precise determination of risk, a higher than normal expense will be applied to this line item.

The microcredit portfolio is of a higher quality than the rest of the bank's portfolio

Overhead

The data for operating expenses provided by the NBD may not have included overhead expenses such as the cost of office space and its depreciation. As noted, the bank manages the finances of its microcredit program in a discreet manner and does not distribute information for each branch barring explicit authorization from the bank's chairman. Thus the results below on the overall profitability of the microcredit program, above and beyond the caveats already mentioned, may be inflated. A conservative estimate of the cost of overhead would be 10–12 percent. Even in this case, however, it appears that the resulting profit margin of the microcredit operation could absorb any further adjustments in total expenses and continue to appeal to the bank's board of directors.

Profitability

As noted, the sustainability of the NBD's microcredit operations can be assessed through an analysis of its profit margin. Table 7 compares the income statement of the microcredit program, adjusted as described above, with that of the entire bank.

The pretax profit of the microlending program is at least twice that of the bank's

This comparison brings to light significant differences:

- The cost of funds is much higher for the NBD than for the microcredit program. This is a direct result of interest rate policy: the yield on microloans is substantially higher than on the bank's corporate loans. Since the cost of funds remains constant in monetary terms, the portion of revenue that must be used to cover this cost is lower for microlending. This generates a higher financial margin with which to cover operating expenses.
- As noted, 14 percent of the NBD's staff works in the microlending operation, yet this program accounts for just 1.3 percent of the bank's loan portfolio. This disparity is reflected in the microcredit program's higher operating expenses.
- Loan loss provisions are assumed to be higher for the microcredit program, although for most high-quality microlending operations the actual figure is often lower. As indicated, the assumption in the table is conservative.
- The pretax profit of the microlending program is at least twice that of the bank's. Profits could be even higher with increased efficiency. A large number of staff do not operate directly in lending (of 390 staff, 160 work in lending operations), resulting in a very high overhead.

Before the new management assumed responsibility for the microcredit program, the profit margin was stable, at around 3 percent. After this new team made adjustments, the profit margin surged to 14.7–16.7 percent in June 1998 (figure 3). These impressive results affirm the NBD chairman's decision to expand the bank's microlending operation throughout its network of 66 branches.

Leadership

Senior management has been crucial to the success of the NBD's microfinance program. Their vision, drive, and awareness that commercial banks can help alleviate poverty served as a catalyst for the initiation of the program. Senior managers also recognized an intriguing business opportunity in responding to potentially significant market demand for the bank's services. Similar comments can be made for branch managers, who are usually recruited from the bank's career echelon. Branch managers and their deputies are intimately involved in

Figure 3. Profit margins in the NBD's microlending program, 1995–98

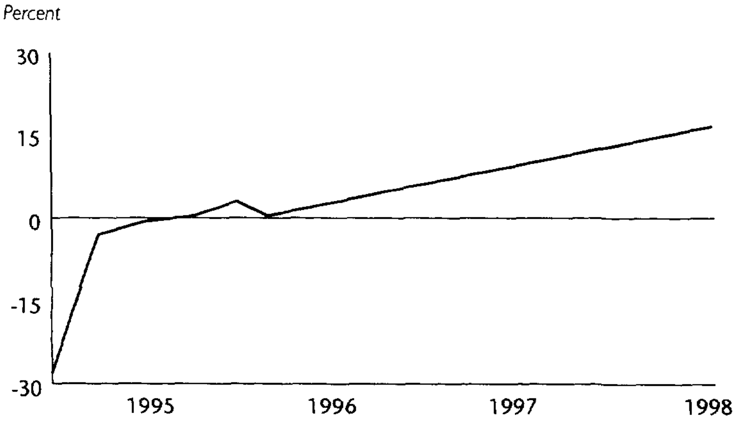


Table 7. Profitability of the National Bank for Development and its microcredit program, 1997
(percentage of total revenue)

Indicator	*Entire bank*	*Small and Micro-enterprise Department*
Income	100.0	100.0
Cost of funds	66.6	34.8
Operating expenses	17.5	28.5
Loan loss provisions	8.6	10.0
Overhead (estimated)	—	10.0–12.0
Pretax profit	7.3	14.7–16.7

Source: Authors' calculations based on NBD data.

making decisions on credit at different stages of loan application and client review. Managers often get personally involved in client cases—particularly when it comes to potential risks of default.

Bank managers appear to be true believers in microfinance, often cited as the key factor for getting commercial banks involved in microlending. For example, the new general manager of the NBD's microfinance unit, Mr. Bassiouni, was transferred to his current position from a previously held post of managing "ordinary" and Islamic bank branches. He was initially bewildered by the large number of staff in the unit, as well as by its administrative costs. But he was quickly convinced of the business's profitability and impressed by the rate of repayment (an average of 99.2 percent, the highest of all NBD lending operations). Today Mr. Bassiouni is the driving force behind the NBD's plans to expand microlending in the remaining 33 branches using the bank's own loan funds. Management in general now believes that microlending should be carried out by banks. Banks have the know-how, qualifications, and methodology to conduct this type of lending. In addition, commercial banks have the branch networks needed to reach low-income populations in both urban and rural areas. These banks' desire to diversify their banking services and offer microlending can be corroborated by the huge market demand by the entrepreneurial poor. The most frequently cited obstacle, however, has been the high start-up cost of hiring additional staff and providing incentives, as well as limited understanding of the microfinance business. The profitability of microfinance, however, warrants that such programs continue beyond initial donor support.

Career development and training

NBD management places emphasis on increasing the efficiency and productivity of human resources within the bank and has provided training at different levels throughout the bank. Staff have had the opportunity to attend seminars, conferences, and training courses by specialized institutions inside and outside Egypt. These courses are designed to enable staff members to enhance their skills, keep them up to date with developments in the industry, and achieve the bank's goal of offering clients the best banking services (NBD Annual Report 1996).

Loan officers in the microcredit program go through several months of training. This consists of initial placement for two months at a rural branch in any of the governorates, coupled with theoretical training on the basic tenets of microfinance. Loan officers are taught how to select and follow up on microenterprise clients, as well as how to conduct client research and analysis, issue loans, and deal with clients.

The NBD plans to build a major training center to provide courses in microfinance and other subjects

Moving beyond the daily operational training needs of its staff, the NBD plans to build a major training center to provide courses in microfinance and other subjects tailored to the needs of clients. The center will be open to other Egyptian microfinance institutions and to institutions from other developing countries. The center is expected to offer high-level business and accommodation services and will be a focal point for exchanging international experience, with instructors from Egyptian institutions as well as foreign experts and practitioners. The goal is to achieve a fully self-sustainable institute within 5 to 10 years. Funds are still lacking to complete this institution, however. More analysis of this initiative is needed to judge whether it is justified by the actual demand for such services, the center's mission and goals, and the substance of training.

Notes

1. USAID's current policy is to fund only a minor part of a microfinance program's loan capital, and it requires banks to use their own deposit base.

2. An interesting development, as shown in the annex, is that the average loan sizes in the new, NBD-funded branches are considerably higher than in the branches that were, or continue to be, donor supported. This trend will be worth

watching as the NBD continues to extend its operations into the small enterprise and microenterprise sector.

3. These statistics, however, exclude self-funded branches, for which data were not provided by the NBD.

4. In 1996 the financial assessment of the NBD's microlending program obtained information on each of 13 bank branches. At present, NBD personnel are not authorized to share these data with nonbank personnel. As such, the data in this report refer to the entire program. For comparative purposes, the bank provided consolidated information for the 13 branches that were analyzed in 1996.

5. "Flat" interest rates are applied to the amount disbursed rather than to the outstanding (and declining) loan balance. For example, flat interest on a 12-month loan of LE 1,000 would be LE 160 (1,000 * 16 percent = 160). The total debt would be LE 1,160, divided into 12 monthly payments of 96.67.

6. Although the life insurance fee is put in a contingency account upon receipt, in the long run it can be considered income from a financial service. As for the penalty fee and prepayment, since most borrowers are repeat clients, these fees can be rolled over and so can be considered income as well.

7. The repayment rate compares installments that should have been paid in a particular time period with installments that were actually paid. The time periods may be cumulative from a program's beginning or can be yearly, quarterly, or monthly; techniques vary. The portfolio at risk (the outstanding balance of loans in arrears divided by the outstanding balance of all loans) monitors portfolio quality more precisely.

8. For example, in the United States the Internal Revenue Service determines the policy for loan loss provisions in banks. This is because of the effect these provisions can have on net profit, and hence the level of taxes to be paid to the government.

Making the move to microfinance

The NBD is the only private commercial bank in Egypt that manages its own explicit microlending operation. Although other banks in Egypt may provide microlending, none has a dedicated department such as that located in the NBD.

There is tremendous demand for financial services, particularly loans, among poor households in Egypt. Yet even though the outstanding loan portfolio of Egyptian microfinance providers is by far the largest of all the countries in the region, only 5 percent of the potential demand for such resources is being met.

Banks appear to be a natural conduit for microlending. They have an existing infrastructure (their branch network) from which to offer financial services, and they manage the country's savings. Internal savings are a sustainable alternative to the funds provided by international donors for microenterprise development. Many banks, however, perceive microlending to be extremely costly and risky.

While it is true that microlending is costlier than corporate lending, the NBD has shown that microlending can be highly profitable. Microcredit borrowers are willing to pay higher costs—in terms of both interest rates and fees—for convenient and timely services. Moreover, a properly managed microloan portfolio may be of higher quality than traditional corporate loans in Egypt. Finally, microlending involves the development of long-term relationships. When quality services are offered, clients often return for additional, larger loans. Since the cost of managing repeat loans decreases, microcredit may become more profitable over time.

Banks appear to be a natural conduit for microlending, which can be highly profitable

Annex Loans by the National Bank for Development's Small and Microenterprise Program

Table A.1 Number and value of donor-funded loans

Branch	*Number of loans disbursed*	*Share of number of loans disbursed to women (percent)*	*Value of loans disbursed (millions of U.S. dollars)*	*Share of value of loans disbursed to women (percent)*	*Average loan size (U.S. dollars)*
Greater Cairo					
Giza	8,076	17	7.53	15	933
Helwan	10,132	14	7.79	11	770
Sawah	15,338	18	15.19	15	990
Shobra El Khima	7,318	14	6.05	12	828
M. El Gedidah comm.	8,734	16	6.29	13	720
M. El Gedidah Islamic	7,183	15	6.31	13	878
Garden City	8,746	13	8.10	10	927
Zamalek	9,079	15	7.44	12	819
Bab El Louk	8,768	14	8.75	13	1,016
Azhur	7,030	6	6.32	4	899
Kasr El Nil	9,148	8	8.74	6	956
Borsa	7,786	12	7.84	9	1,007
Opera	8,301	8	8.94	15	1,077
Sharkia					
Belbis	14,596	22	5.36	19	367
Kafr Sakr	11,492	20	3.98	17	346
Dumiatta (RSSE)					
Dumiatta	10,160	6	4.27	6	420
Faraskore	13,755	17	4.28	14	311
Menia	8,584	28	2.94	26	343
Qena	4,527	69	1.47	56	324
Luxor	9,470	91	3.47	86	367

Note: As of June 30, 1998.

Table A.2 Number and value of self-funded loans

Branch	*Number of loans disbursed*	*Value of loans disbursed (U.S. dollars)*	*Average loan size (U.S. dollars)*
el-Zakazeek	122	308,473	2,528
San El-Hagar	59	99,550	1,687
Ismaelia	84	211,377	2,516
Tanta	264	722,305	2,736
Mahal El Hobra	2	4491	2,245
Banha	17	48,203	2,835
Biela	97	228,143	2,351
Shbin El-Kom	29	65,419	2,255
Abu El-Matamir	159	368,413	2,317
El-Fayoum	97	240,119	2,475
Assiut	64	170,808	2,668
Sohag	276	664,970	2,409
Aswan	52	126,047	2,423

Note: As of June 30, 1998.

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