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Commercial Microfinance in Egypt—The Case of the National Bank for Development

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Executive Summary

There is a large unmet demand for microfinance services among the entrepreneurial poor in Egypt. It is estimated that Egypt's microfinance industry currently reaches only about 5 percent of the more than 2 million potential borrowers. In this situation, commercial banks could play an important role since they have the advantage of both outreach capacity through their branch networks and fundraising capacity through their legal ability to accept savings deposits. Traditionally, commercial banks in Egypt, as in many other developing countries, have shied away from microfinance, perceiving it to be characterized by high risks and low rewards. The National Bank for Development (NBD) in Egypt, however, has had a different experience. A private commercial bank, NBD has successfully run a microlending program for over 16 years.

Microlending programs have existed in Egypt since the mid-1960s. Most microfinance services are delivered through government and nongovernmental organization (NGO) programs and some are conducted through business associations, development intermediaries, and public sector and special-purpose banks. Until recently, microfinance services in Egypt typically existed within broader human development and social safety net strategies. An important microfinance provider is the Egyptian Social Fund for Development (SFD), which channels sizable amounts of its funds through NGOs. There are also several national and international NGOs that have been more effective at addressing the credit needs of the poor; they lack the infrastructure and institutional setup to expand outreach beyond their local communities.

The NBD was the first commercial bank to start microfinance operations in Egypt. Realizing the twin potential of microlending for generating profits to the bank while helping to combat poverty in Egypt, the NBD, in collaboration with the U.S. Agency for International Development (USAID), established the Small and Microenterprise Division in 1987 with microlending operations in four of its branches. By 2003, microlending services were being delivered in 44 branches to 22,600 active borrowers with about $8.2 million in outstanding loans.

The NBD's approach to microfinance

In the Egyptian microfinance context, the NBD microlending program represents a unique operation. Modeled in part after the Grameen Bank, the NBD program combines the attitude of NGOs and the sound financial principles of banks, to make microenterprise lending a sustainable operation. This has translated into flexible lending procedures and client-oriented service delivery through well-trained and motivated bank staff. Together, these principles have shaped and guided the inception, progress, and expansion of the NBD microlending program over the past 15 years and have contributed to its profitability.

In the short run, the NBD's objective is to provide microenterprises access to credit to that would typically be denied by conventional banks. In the long run, its objective is to enable the transition of these borrowers into clients under more conventional banking standards. Underlying these two objectives are several other considerations, including improving the quality of life of small borrowers, promoting employment generation, preserving and expanding small enterprises, and fostering better business practices among the poor. The NBD targets small borrowers with existing enterprises that are neglected by traditional banking institutions.

NBD loans offered are typically small and with short maturities. Up until 2000, the maximum loan size was LE10,000 (approximately $3000). To further extend its outreach to the poor, the bank's management decided in 2000 to reduce the maximum loan size to LE3,000 (approximately $500 at the June 2003 prevailing exchange rate). Total bank charges are about 30 percent. No collateral is required and loan approval is based on the enterprise's viability and its cash flow cycle. The program is targeted to the poor: the average loan size is $480 while a typical poor household of six persons in Egypt has an average expenditure level of $1,358 per annum (2002 data). The NBD has made special efforts in recent years to reach female clients; as a result, the proportion of loans to women has risen from around 13.5 percent in 1998 to around 22 percent today. The program has been profitable for over 10 years. Indeed, at just under 18 percent, the profit rate of the microlending operations is higher than the rate received from the bank's other more conventional lending operations

A unique feature of the NBD outreach structure is its mobile banking units. While this brings additional costs, NBD has been able to recoup the costs since the poor are willing to pay for the convenience of having services at their doorstep.

Loan approval procedures are transparent and quick—the entire process generally taking less than two weeks. Close supervision, while costly, supports the viability of individual enterprises and ensures high repayment rates. Another program innovation is the provision of life insurance coverage to all its borrowers and a mandatory savings component to be held in an NBD interest-bearing account.

The possibility of repeat borrowing is also an important feature. In 1998, NBD statistics for a sample of branches showed about 76,700 repeat loans for a total value of $74.2 million, representing over 70 percent of the total value of loans disbursed and about 10 loan cycles.

Maintaining steady growth in its client base is one of the NBD's challenges. NBD managers emphasize that program growth is constrained by the high cost of reaching microfinance clients. NBD has chosen to service these clients through specially trained and remunerated officers rather than use its regular work force. This practice involves high administrative costs. Another challenge is to find a level of loan charges that maintains profitability but does not choke off program growth over time. Another continuing challenge for NBD will be balancing its targeting objective with that of helping clients get more benefits out of borrowing and/or maintaining steady program growth.

The NBD program's impact

Today 20 of NBD's 44 branches are donor-financed (17 by USAID and 3 by the Canadian International Development Agency, the United Nations Children's Fund, and the Ford Foundation) and 24 are self-funded. Program outreach also grew to about 22,600 borrowers, generating an $8.2 million loan portfolio. NBD's microfinance program achieved profitability reasonably quickly.

To date, no systematic and statistically-sound quantitative assessment has been conducted on the NBD's microcredit program's impact on the livelihoods of its beneficiaries. From a selected sample of repeat borrowers, however, NBD staff noted increases in the number of employees in their enterprises and that over 60 percent reported an increase in their incomes of more than 50 percent. Other studies in Egypt have found modest improvements in living standards of microcredit recipients, including a nutritional benefit. Some impact studies for Egypt suggest that microcredit programs may be less effective in reaching the vulnerable; this may be because the destitute poor are best served by direct assistance measures, while microfinance services are more effective when targeted at the entrepreneurial poor.

Critical success factors

- *Senior management and staff commitment to the program*: This provided the impetus for program initiation and expansion and engendered the client-oriented attitude that is pervasive among the program staff, including branch managers.
- *An enabling public policy environment*. There are no government regulations forbidding commercial microfinance and no restrictions on many of the NBD's innovative techniques.
- *Its institutional innovations*: These included client-oriented service; a decentralized loan approval process; mobile banking units; female loan officers for female clients; a staff incentive scheme to reward performance; and a life insurance scheme in the array of the loan's financial services.
- *External catalysts*: Donor support was critical in the initial phases to cover higher start-up and administrative costs. USAID also encouraged the NBD to experiment with alternative procedures and adopt measures that proved useful in making the program successful. It is also possible that Egyptian microfinance institutions benefit from positive externalities among themselves. Egypt is reputed to have the best microfinance institutions in the region as a large fraction of them follow industry best practice, have good portfolios, high repayment rates, and loyal customers.
- *The ability to charge market determined interest rates and fees.* Microlending involves higher administrative and operational costs that must be recovered through various loan charges and fees.

The NBD's experience shows that the poor are willing to pay a premium to have continued access to simple, quick, and uncollateralized credit. Significant growth in the microfinance industry can come from having commercial banks enter this market niche. Public policy could help the industry grow by making it easier for microfinance-NGOs to borrow funds from regular banks for onlending and/or by making it easier for them to become banks themselves and accept deposits.

Introduction

The potential role of microfinance as an instrument for poverty alleviation is best appreciated by thinking of the poor as comprising at least two groups, the destitute who are unable to participate in the mainstream of an economy for various reasons (including physical disability, remote location, and individual family circumstances) and the "entrepreneurial" poor who participate actively in income-generating activities. The former group are best helped by direct social assistance measures but the latter may benefit as well from being provided access to modest amounts of credit (Brandsma and Chaouali, 1998). Recent evidence also shows that the impact of microfinance extends beyond the business loan: in addition to the direct impact on incomes of the borrowers there is an indirect impact on family health, nutrition and education as well, particularly if the funds are channeled through women borrowers (Pitt and Khandker, 1994; Littlefield, Morduch and Hashemi, 2003). This suggests a role for microfinance in helping achieve the broader Millennium Development Goals (MDGs) of improving education, health and gender equity.

The potential demand among the poor for microfinance services is huge in Egypt. A conservative estimate suggests that there were at least 1.5 million microenterprises in Egypt in 1996, the last year for which such data are available (Ministry of Foreign Trade, 2003). It is likely that the number of microenterprises has increased by at least 40 percent since 1996. This would put the current number of microenterprises at around 2.15 million units. Even this could be an underestimate since most official surveys miss a sizable fraction of the informal sector. While no formal aggregate estimates are available, it is generally believed that the outreach of the microfinance industry in Egypt is very limited and covers less than 5 percent of potential borrowers.

The large unmet demand for microfinance would signal a role for the private sector, especially commercial banks, to participate in the provision of such services. Banks have the combined advantage of considerable outreach, through their existing branch networks, and funds mobilization potential, through their ability to accept savings deposits. But they have traditionally shied away from serving micro-entrepreneurs because they perceive them as carrying higher risk—most of them operate in the informal sector and lack adequate collateral—and being unable to pay the high interest rates necessary to cover the higher administration costs of service delivery to them. The experience of the National Bank for Development (NBD) in Egypt suggests that these perceptions are not necessarily correct. This commercial, profit-oriented, bank started a microlending program in 1987. Since then it has increased the number of clients, the volume of loans and the diversity of the client base under its program, while maintaining healthy rates of profit. The experience of the NBD suggests that banking with the poor can be a commercially viable option under certain conditions.

This case study examines the experience of the NBD in extending microfinance in Egypt. In the process the following are highlighted: (a) the commitment of senior management to the objectives of microfinance; (b) the internal corporate procedures that were followed by the NBD to make this aspect of their business successful; (c) the public policy context in which the program has operated; (d) the manner in which the program has grown over time and (e) the social impact of the program.

The Microfinance Context in Egypt

Microlending programs have existed in Egypt since the mid 1960s. Most microfinance services are delivered through government and NGO programs and some are conducted through businessmen associations, development intermediaries and public sector and special-purpose banks. Microlending is delivered either as an independent service, as is the case with businessmen associations, or as part of an integrated package of social services that include literacy and health awareness programs, as is the case with several NGOs and development intermediaries (Assaad and Rouchdy, 1999).

Until recently, microfinance services in Egypt typically existed within broader human development and social safety net strategies. One of the earliest microcredit programs is the Productive Families Program (PFP), established in 1964 under the auspices of the Ministry of Social Affairs (MOSA), with the purpose of providing small loans to finance cottage industries and microenterprises and with a specific focus on women. Because it operates through MOSA's regional and local branches in the different governorates, the coverage of the PFP is nationwide . In 1998, it was estimated to have disbursed LE49 million ($14.4 million) and reached almost 39,000 beneficiaries in 25 governorates. Interest rates charged range between 7 and 14 percent and loan approval requires the availability of a salaried guarantor. Despite the potential for extensive outreach, the latter requirement excludes certain poverty and target groups. In addition, because the loan size is small and no effort is made to provide borrowers with entrepreneurial education, the benefits of the loan were found to expire with its duration (Kheir El-Din, El-Leithy and Tabbala, 1999). In 1971, MOSA also sponsored the establishment of Nasser Social Bank, with the purpose of administering zakat funds. These funds can be used either as grants or as interest-free loans to the needy. The bank itself also provides low-interest loans (at 6 percent per year) to specific target groups (Assaad and Rouchdy, 1999).

Another important provider of microfinance is the Egyptian Social Fund for Development (SFD), which channels sizable amounts of its funds through NGOs. This is in addition to several national and international NGOs, including UNICEF, CIDA and CARITAS, among others. While these NGOs have been more effective at addressing the credit needs of the poor, they lack the infrastructure and institutional setup to expand outreach beyond their local communities. Their microlending activities also remain largely donor-dependent because they charge subsidized interest rates and their operations are not based on cost-recovery. And while banks appear to be potentially well-placed to take over microlending activities because of their extended network of branches, experience through the SFD's Enterprise Development Program (which provides credit to small and medium enterprises through several public and private banks) showed that bank staff were usually uncooperative with small borrowers and often requested multiple collaterals, casting doubt on whether commercial banks are the appropriate channel for small and medium enterprise lending (Kheir El-Din, El-Leithy and Tabbala, 1999).

The NBD was the first commercial bank to start microfinance operations in Egypt. Realizing the twin potential of microlending for generating profits to the bank while helping to combat poverty in Egypt, the NBD, in collaboration with the United States Agency for International Development (USAID), established the Small and Microenterprise Division in 1987 with microlending operations in four of its branches. By 2003, microlending services were delivered in 44 branches. Loans offered by the NBD are typically small and with short maturities (3 to 11 months). Up until 2000, the maximum loan size was LE10,000 (approximately $3000). To further extend its outreach to the poor, the bank's management decided in 2000 to reduce the maximum loan size to LE3,000 (approximately $500 at the exchange rate prevailing in June 2003). The bank charges a flat interest rate of 16 percent plus a number of administrative and insurance fees which take the total charges up to around 30 percent. No collateral is required or sought and loan approval is based on the viability of the enterprise and its cash flow cycle. As of 2003, the program had 22,600 active borrowers and $8.2 million in outstanding loans.

The NBD's Approach to Microfinance[1]

Within the Egyptian microfinance context, the NBD microlending program represents a unique operation. Modeled in part after the Grameen Bank, the NBD program combines the attitude of NGOs and the sound financial principles of banks, in order to make microenterprise lending a sustainable operation. This was translated into flexible lending procedures and client-oriented service delivery through properly trained and motivated bank staff. Together, these principles have shaped and guided the inception, progress and expansion of the NBD microlending program over the past fifteen years and have contributed to its profitability.

The NBD has an ambitious but focused objective for its microlending program. In the short run, the objective is to provide access to credit to microenterprises that would typically be denied by conventional banks. In the long run, the objective is to enable the transition of these borrowers into clients under more conventional banking standards. Underlying these two objectives are several other considerations, including improving the quality of life of small borrowers, promoting employment generation, preserving and expanding small enterprises, and fostering better business practices among the poor.

The NBD targets small borrowers with existing enterprises that are neglected by traditional banking institutions. These include artisans in various sectors as well as informal groups and enterprises without proof of registration. Funding is provided to clients in a range of activities in trading, productive and service sectors, such as blacksmiths, electricians, bakers, spice retailers, potters, tailors, metal painters and shoemakers. Activities mostly consist of light manufacturing and assembly, maintenance, transport, storage and distribution and agricultural product processing and marketing.

[1] This section draws on Dhumale, Sapcanin and Tucker (1998).

A unique feature of the NBD outreach structure is its mobile banking units. To reach individuals in remote areas without access to conventional banking, the NBD operates minivans (with the driver also serving as a security guard) which transport loan officers to areas (mostly in Cairo) where the bank has no branches. These mobile branches perform all the transactions conducted in a regular branch, such as collection of repayments and application review. By bringing banking services directly to where the poor live, the NBD takes on additional costs. However, it has been able to recoup these costs since the poor are willing to pay for the convenience of having the services delivered to their doorstep. For many of the poor, the alternative would be to close shop, forego daily profits, and incur transportation costs in order to conduct their banking business (such as the weekly repayment installment) at a distant bank branch.

Loan approval procedures are transparent and quick—the entire process generally taking less than two weeks. No bankable collateral is required and lending is based on cash-flow criteria as opposed to more conventional asset-based ones. Monitoring and supervision start with the disbursal of the loan, as well as periodic collection of installments. Borrowers are initially visited once a week. These visits provide the opportunity for loan officers to educate borrowers about sound financial and accounting practices and serve as an early detector of troubled enterprises. Close supervision, while costly, is important in supporting the viability of individual enterprises and ensuring high repayment rates. An innovation of the program is the provision of life insurance coverage to all its borrowers, whereby in case of unforeseen events, such as the death of the borrower, the debt is taken over by the bank and the borrower's family is provided with a $120 contribution towards funeral and burial expenses. Finally, the transaction also includes a mandatory savings component. Savings equal to 10 percent of the loan are collected once the loan is approved and are deposited into an interest bearing account at NBD.

Important loan features include small loan sizes and the possibility for repeat borrowing. Until 2000, loan values under the program ranged from a low of LE 500 to a maximum of LE 10,000. Since then, the maximum loan size has been set at LE 3,000. These loans are an important source of liquidity for working capital and running costs of these enterprises. Between 60-80 percent of enterprise profits is reinvested; the balance is used to support household needs and savings. Continued access to microfinance is an important feature of this program. In 1998, NBD statistics for a sample of branches showed about 76,700 repeat loans for a total value of $74.2 million, representing over 70 percent of the total value of loans disbursed and about 10 loan cycles (Dhumale, Sapcanin and Tucker, 1998).

Continuing Challenges

Among the continuing challenges of NBD's microfinance program are those of maintaining steady growth in its client base.[2] NBD managers emphasize that program growth is constrained

[2] This appears to be an industry-wide challenge in Egypt. Observers note that Egypt is characterized by successful but small microfinance programs. Program growth and market penetration have been low even though there exist several successful programs (Brandsma and Hart, 2000, p30).

by the high cost of reaching microfinance clients. NBD has chosen to service these clients through specially-trained and remunerated officers rather than use its regular work force. While this has been responsible for low staff turnover and overall program success, it does involve high administrative costs. While case loads are reasonable and case officers generally well utilized, managers are always mindful of the high costs involved in expanding their branch and case officer networks.

It is possible that the growth of the client base may be constrained in part by the loan charges that are applied by NBD. When all charges and fees are added up, recipients end up paying just under 30 percent on their loans from NDB (compared to about 16 percent paid currently by large blue-chip borrowers). This rate may be too high for some potential clients. On the other hand, it is considered acceptable by NBD borrowers whose alternative sources are usually money lenders charging even higher interest rates. Furthermore, as a commercial bank, NBD has to ensure that its microlending operations are profitable, and market-based loan charges are consistent with this objective. The challenge, therefore, is to find a level of loan charges that maintains profitability but does not choke off program growth over time.

It is also possible that it is the maximum loan size (of LE3,000) rather than interest charges that are the main constraint on more rapid growth of the client base. Borrowers who need a larger loan have to migrate to other lenders whose loan sizes are more flexible. When the decision was taken to reduce the maximum loan size in 2000, NBD's microlending client base shrank to around 17,000 before being rebuilt to its present level of just over 22,600. Furthermore, the opportunity for existing borrowers to grow out of poverty might be constrained by the smaller size of projects they can take on with the present loan limit. One of the reasons why the maximum loan size was reduced was to ensure that NBD's microfinance funds were better targeted to poor households. Balancing the targeting objective with that of helping clients get more benefits out of borrowing and/or maintaining steady program growth will continue to be an important challenge for NBD.

In the near future, the NBD intends to experiment with financing start-up microenterprises. These projects are typically risky because start-up operators may lack the business and entrepreneurial acumen present (to varying degrees) in borrowers with existing activities. Nevertheless, this idea is currently being assessed and the financial procedures necessary for its viability to the bank are being examined. It is thought that such a scheme would help combat the high unemployment that has been a feature of Egypt's economy for the last decade or so.[3]

[3] It is generally felt that microfinance should not be used to solve unemployment problems except indirectly through the solving of financial intermediation constraints for the poor (Brandsma and Hart, 2000; p14).

Impact of NBD Program

Program Growth

The first four branches set up by NBD with the financial support of the USAID proved successful. Expansion plans were drawn up and by 1993 the number of branches engaged in microlending was increased by 13 in the Greater Cairo area to reach 20 nationwide, covering seven governorates (see Table 1). By 1998, the microlending program was implemented in 38 out of the 66 NBD branches, covering poor areas in greater Cairo as well as Upper and Lower Egypt, generating a microcredit portfolio of almost $12.3 million and reaching close to 19,000 small borrowers. Expansion has continued into 2003, with the total number of branches with microcredit lending increasing to 44 in 16 governorates, of which 26 are specialized branches and 18 operate microcredit windows. Of the 44 branches, 20 are donor financed (17 by USAID and 3 by the Canadian International Development Agency (CIDA), UNICEF and the Ford Foundation) and 24 are own-funded. Outreach of the program also grew to about 22,600 outstanding borrowers, generating a loan portfolio of $8.2 million.[4]

Table 1: Program Growth, 1993-2003

Indicator	1993	1998	2003
Number of branches engaged in microlending	20	38	44
Number of governorates covered	7	10	16
Number of clients/borrowers	10,464	18,947	22,600
Total value of loans disbursed (US$ million)	12	149.1	144.6

Source: NBD Staff calculations.

As already noted, a decision was taken by NBD management in 2000 to reach poorer clients with smaller loans. Among the outcomes of this decision were: (a) a decrease in average loan size to around $480; (b) an increase in rural outreach, as the number of branches operating in rural areas rose to six; (c) an increase in gender orientation, as the share of loans disbursed to women rose from 13.5 percent to 22 percent;[5] and (d) a shift towards commercial and services projects, both sectors typically containing a higher proportion of poor individuals. This policy switch came at a cost: both profits and the number of active clients declined in 2000/01 before recovering over the next two years.

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[4] Note that the dollar value of outstanding loans declined between 1998 and 2003. However, this was due largely to the decline in the average loan size brought about by policy in 2000 and to the depreciation of the Egyptian pound from 3.14 to 6.13 units to the dollar between 1998 and 2003. In local currency terms, the value of the portfolio increased from roughly LE 42 million to LE 52 million over this period.

[5] This was largely due to the implementation of two programs in Upper Egypt, funded by CIDA, with a specific focus on women. In general, the gender orientation of NBD's portfolio is not much different from the average for Egypt which is around 25 percent. The gender orientation of microfinance programs in several other MENA countries is much higher, going up to as much as 70 percent in Morocco and 95 percent in West Bank-Gaza (Brandsma and Hart, 1998; p23.)

Table 2: Basic Program Data, 1998 and 2003

Indicator	Amount	
	1998	2003
Total number of disbursed loans	188,000	337,452
Total amount of disbursed loans	$149.1 million	$144.6 million
Repayment rate on disbursed loans (percent)	99.2	99.5
Number of loans disbursed to women	13,522	74,038
Share of women in total loans (percent)	13.5	21.9
Number of current active borrowers	18,947	22,600
Current outstanding loan portfolio	$12.3 million	$8.2 million
Average loan size	$896	$480
Average outstanding balance per borrower	$654	$375
Revolving of loan fund	2.4 times per year	2.4 times per year
Sectoral distribution of loans (percent):		
Production	22	18
Services	17	21
Commercial	37	42
Investment	24	19

Note: Exchange rate is US$1=LE 3.4 in 1998 and US$1=LE 6.13 in 2003.

Source: Dhumale, Sapcanin and Tucker (1998) for 1998 and NBD staff calculations for 2003.

Program Profitability

The microfinance program of NBD achieved profitability reasonably quickly. Overall operations were breaking even and generated an overall profit of 3 percent in 1995, which grew to 15-17 percent in 1997 and almost 18 percent in 2003 (see Table 3). It is clear from the evolution of costs and profits of the program between 1997 and 2003 that operating expenses have risen as a proportion of total income. This probably reflects the "cost" of the decision in 2000 to reduce the maximum loan size. However, the cost has been absorbed adequately in the sense that profitability has risen modestly (following an initial drop in 2000/01).

Table 3 also allows for a comparison of the microlending program with the overall performance of the NBD in 1997 and 2002. Three aspects of this comparison are worth noting here. First, as expected, the operating expenses ratio is higher for the microfinance program than for the bank as a whole. Second, despite the higher operating expenses ratio, the profit rate is higher for the microfinance program than for the bank as a whole. Indeed, interviews with NBD staff suggest that the microfinance program, while it accounts for only 5 percent of the portfolio (by value), generates almost 30 percent of the overall profits. Third, this may be due in part to the fact that the cost of funds for the microlending component is lower than that for the bank as a whole, since some of the funds that the NBD still recycles were made available to it as a grant from donors.

Table 3: Profitability of the NBD and its Microcredit Program, 1997 and 2002

Indicator	1997		2002	
	Entire Bank	Microlending Program	Entire Bank	Microlending Program
Income	100.0	100.0	100.0	100.0
Cost of funds (estimated)	66.6	34.8	72.2	18.7
Operating expenses	17.5	28.5	12.8	44.5
Loan loss provisions	8.6	10.0	6.5	17.2
Overhead (estimated) *	--	10.0-12.0	--	--
Pretax profit	7.3	14.7-16.7	8.5	19.6

* For 2002, overhead expenses are included in operating expenses.

Source: For 1997, Dhumale, Sapcanin and Tucker (1998). For 2002, data provided by NBD staff.

Poverty Targeting of Program

NBD's stated aim is to target small borrowers with existing enterprises and no access to formal credit. Because the majority of these enterprises are informal, and given that a large fraction of informal enterprises are operated by poor individuals and households, by targeting the entrepreneurial poor the NBD can contribute to poverty alleviation in Egypt. In order to assess the overlap between the client base of the NDB and the poverty population in Egypt, we compare the average loan size given by NDB with the average expenditure needs of the poor. This is a fairly common practice in lieu of more detailed information (Brandsma and Chaouali, 1998). The most recent analysis of poverty in Egypt suggests a "lower" poverty line of LE 1116 per person per annum and an "upper" poverty line of LE 1,574 per person per annum in 2002 (UNDP, 2003).[6] For a typical family with two adults and four children, the relevant poverty markers are LE 6,112 and LE 8,416 per household per annum, or US$1358 and $1870 (at the mid-2002 exchange rate of LE 4.5 to the dollar). If we compare the average loan size of US$480 in 2003 with these levels of household expenditures, it is clear that NBD's loans are likely to be going to poor households. This impression is further strengthened if we consider that the initial loans to first-time borrowers range between $100 and $300 only.

Other Assessment Data

Program effectiveness with respect to poverty alleviation is, of course, best measured by the extent to which access to microfinance directly improves the welfare of poor recipients. To date, no systematic and statistically sound quantitative assessment of the impact of the NBD's microcredit program on the livelihoods of its beneficiaries has been conducted. Some indicative

[6] The "upper" poverty line is set at the level of total expenditures characterizing families who spend as much on food as required to achieve basic nutrition requirements. There are other, poorer, families whose entire expenditures (on food and nonfood items) is equal to the food poverty line. For these families, a "lower" poverty line is derived as the food poverty line augmented by a non-food allowance. The lines vary by household size and location.

evidence is available, however, from data gathered from a selected sample of repeat borrowers at the time they took their last loan. NBD staff report that in this sample of borrowers, 30 percent reported having increased the number of permanent employees in their enterprises and 20 percent having increased their temporary employees. In terms of income changes, over 60 percent reported that their incomes had increased by more than 50 percent (since the last loan), 11 percent by less than 50 percent and 24 percent reported no change. About 9 percent reported that they had bought their own shops and 5 percent that they had increased the size of their shop.

Inferences can also be made about the likely impact of the NBD's program from studies that have assessed the outcomes of other microcredit programs in Egypt (Barsoum and Shaban, 1999; Kheir El-Din, EL-Leithy and Tabbala, 1999). These studies generally find positive but modest improvements in living standards of microcredit recipients (see Box 1).

Box 1: Impact of Microcredit on Livelihoods of the Poor in Egypt

A study to assess the qualitative impact of a number of microcredit programs on living standards of recipient households was conducted in Egypt in 1999. A total of 63 beneficiaries in Cairo, Assiut and Minia were interviewed. These were the recipients of microcredit services from six microcredit providers in Egypt: UNICEF in Assiut, Save the Children in Cairo and Menia, Association for Children and Development in Assiut, Egypt Youth Association in Menia, Upper Egypt Association in Minia and Caritas in Menia and Cairo.

The analysis focused on the role of microcredit in increasing household income by looking at changes in living patterns resulting from microcredit and that would not have occurred without microcredit. Since interdependency between the household economy and the business activity is very high in microenterprises, the study also focused on separating expenditure for the enterprise from that for daily consumption and the establishment of assets (both physical and human) for the household.

The general finding from the interviews is that income from credit-financed projects is limited and is used for everyday expenses. When beneficiaries were asked directly about the impact of microcredit, the general first answer was that nothing much had changed in their lives; whatever they got they spent. However, as the interview progressed, casual reference was made to a latrine that was added to a house that had none, to an extra room constructed, to how expensive private tutoring was, or to the goat the family acquired. Most households indicated that the income they got from the enterprise was spent on food and transportation, followed by private tutoring, daughters' trousseau and treatment of a sick household member.

Microenterprises are therefore a source of income, albeit limited, to an otherwise economically constrained household. This income helps improve the livelihoods of the members of those households. For instance, the complaint that private tutoring is costly suggests a role for microcredit in building human capital in terms of supporting the education of children. Additional income that is spent on food contributes to the improvement of the nutritional level of the household members, especially the younger ones. The increase in income also allows households to consume meat or chicken on a more frequent basis, thereby reducing deficiency of animal proteins among poor Egyptian households. These changes constitute a significant impact on the livelihood of poor households.

The study also revealed the existence of a high demand for microcredit. Most beneficiaries interviewed expressed their desire for subsequent, and sometimes larger, loans. Enterprises that were most successful were in households with a larger number of able and productive individuals. This might suggest that microcredit is a mechanical exclusion of the poorest of the poor who are usually the disabled, the old and those unable to work. These groups, however, are best addressed through direct assistance rather than indirect assistance by providing microcredit.

Source: Barsoum, Ghada and Adel Shaban (1999). Beyond Credit: An Impact Assessment of Microcredit Programs on the Livelihood of Poor Households in Egypt.

Beneficiaries typically reported increases in incomes due to the microenterprise, although these were small and irregular (Kheir El-Din, El-Leithy and Tabbala, 1999). Increases in household income typically supported household expenses, especially child education and improved access to health services. Additional income was also used to improve the nutritional content of the poor's diet, by enabling them to acquire high-protein content food on a more frequent basis. This is consistent with evidence from microcredit programs in other countries also. For instance, a longitudinal study of microcredit clients in Bangladesh showed fewer members to suffer from malnutrition, compared to the control group, and that the extent of malnutrition decreased with longer membership in the microcredit program (Littlefield, Morduch and Hashemi, 2003). All these elements contribute to an improvement in the human capital base of the poor and increase in their control over resources.

Some qualitative evidence was also gathered for this case study through informal interviews of 10 borrowers in Boulak, a low-income section of Cairo, in October 2003 (see Box 2). Most of the borrowers had been clients with the NBD for several years and had taken several loans. Initial loans sizes ranged between LE 500 and LE 1000. For most, these loans provided an important source of liquidity to finance working capital and running expenses. Loans are mostly used to sustain operations of the microenterprise; in the more successful cases, they also contribute to expanding the activity.

With one exception, all borrowers reported increases in incomes from credit-supported activities. Part of this income is used to finance household expenses, but most of it is reinvested in the enterprise. Although it was not possible to gain further insight as to the internal allocation of income on household expenses (between education and health for instance) and on how the microenterprise may affect the dynamics of gender equity in the household (the interviews were conducted in public venues and without much opportunity for detailed conversations), all microentrepreneurs visited had children who were either in school or had completed the equivalent of at least 12 years of schooling. Those with children in school noted that they were likely to continue to keep their children in school. This suggests that access to microfinance might help provide a sustainable source of income that allows households to make "longer term" investments in human capital rather than exhaust their resources entirely on "short term" subsistence needs.

Some impact studies for Egypt suggest that microcredit programs may be less effective in reaching the vulnerable, such as people who are disabled, old and unable to work (Barsoum and Shaban, 1999). This is found in other contexts as well. For example, impact results for microfinance programs in Bangladesh showed these to be less successful in reaching those groups most prone to destitution (Amin, Ria and Topa, 2003). What these results suggest is not the ineffectiveness of microfinance as an anti-poverty instrument but its relative ineffectiveness in helping some groups among the poor. The poor are not a homogenous group and some among them, namely the destitute poor, are best served by direct assistance measures. Microfinance services are more effective when targeted at the entrepreneurial poor.

Box 2: The Value of Microcredit: NBD Borrowers' Perspective

Mona has a shop that sells plastic home supplies and slippers. She is a second-year client with the bank and is into her third loan. Her first loan was for LE 500 and the following two were for LE 3000 each. Before the loan, Mona was selling women capes (*abaya*, a traditional long dress worn by women) from her home. The NBD loan allowed her to take her business to the market place and to change her activity. Loans were used to purchase supplies and build up inventory. Increases in income from the enterprise are mostly reinvested into the project. Mona has four children, all of school age and all in school.

Manal has a small shop selling household detergents and cleaning products. She has been a client with the NBD for one year and has taken two loans, each for LE 500. Her story is one of the less fortunate ones. Income from her business is not enough to cover her expenses, including the rent for the shop, and she sometimes has trouble making enough money for the installment. Manal is not considering applying for another loan.

Sayed is a fishmonger. He has been with the bank for four years and is into his eighth loan. His first loan was for LE 1000; successive loans amounted to LE 3000. He started with one shop where he sells fish; his business did well and with his third loan he as was able to expand to an adjacent shop, where he sells different kinds of cured fish. With income from his microenterprise, he was able to move his family (currently of six people) into a bigger apartment. Sayed has six children; two have completed their technical education (equivalent to 12 years of schooling) and are already working (not as fishmongers though), while four are still of school-age and attending school.

Mohamed has a shoe repair workshop. He has been with the bank for eight years and is into his ninth loan. His first loan was for LE 2000 and his current is for LE 3000. The loans were used for capital investments. Mohamed started with one machine; he now has four machines in the workshop, two big and two small ones. Income from his activity was used to finance household expenses, including the purchase of durables such as TV and a fridge and also to support household expenses, especially education. Mohamed has nine children: four males and five females. All adult males and females have the equivalent of at least 12 years of schooling, with two of the males now assisting their father in the workshop. Two of the girls are still attending school. When asked whether he intended for them to continue education, he said: "Until university, if they want to…." .

Hussein has a small candy and grocery store. He is handicapped and cannot make use of both his arms. He too has been with the bank for eight years and has taken over ten loans. His first loan was for LE 1000 and his current is for LE 2500. Prior to the NBD, Hussein took a loan from the Giza Businessmen Association. However, because he had to go to their office to make periodic payment of installments, his disability made this trip quite a burden. The fact that the NBD loan officer goes all the way to his store to collect payments and conduct transactions has been an important factor in maintaining his relationship with the bank. Hussein has six children and the store is his only source of income.

Microcredit and the MDGs

The qualitative information about the impact of the NBD program, as well as that of other microfinance programs in Egypt, is consistent with the literature suggesting that microfinance can help achieve some broader social and economic objectives that are enshrined in the Millennium Development Goals (see Littlefield, Murdoch and Hashemi, 2003). For instance, for the first goal, eradication of extreme poverty and hunger, it is observed that income from microenterprises is used for consumption of high protein containing food items, thereby contributing to the reduction of child malnourishment. Income from microenterprises is also used to support education of children in the household, thereby contributing to improved outcomes in net primary enrolment and completion rates, which is the second goal. In addition, by creating employment opportunities for family and non-family members, microenterprises contribute to the alleviation the problem of youth unemployment in Egypt—goal number eight.

Critical Success Factors

Commitment of Management

It is widely acknowledged in the microfinance industry in Egypt that the development of the NBD's microfinance program owes a lot to the commitment, vision and drive of its senior management, especially the Chairman, Mr. Mohamed Zaki El-Oraby, and to the dedication of the staff in the microlending program. Senior management believe in the potential role of microfinance as an instrument of economic and social change. Their commitment to the program provided the impetus for program initiation and expansion and in engendering the client-oriented attitude that is pervasive among the program staff, including branch managers. The NBD recognized that successful service delivery depends crucially on the personnel working in direct contact with the borrowers—the case officers. This is why the microlending program relies on intensive training of its staff and on an appropriate reward system. Case officers receive an initial six-month training program, including theoretical training on the basic principles of microfinance followed by on-site training in one of the branches, and unlike conventional NBD staff, are rewarded on a performance-based incentive scheme. Financial incentives proved an important factor in stimulating staff performance (Dhumale, Sapcanin and Tucker, 2000).

Public Policy Environment

The success of the microlending program to date has also been enabled by a generally supportive public policy context. There are no government regulations explicitly encouraging commercial microfinance, but there are none against it either. For instance, there are no interest rate ceilings: this has allowed the NBD to charge higher interest rates to recoup its costs. There are no restrictions on incentive-based salary schemes such as those present in Egyptian state-owned banks. Unlike the case, for example, in Lebanon, there are no obstacles to granting legal status for mobile branches. Finally, there are no restrictions on the ability to engage in financial transactions with non-registered (informal) enterprises. All these factors have indirectly contributed to the overall success of NBD operations.[7]

Institutional Innovation

The whole NBD approach to microlending represents an institutional innovation in Egypt. Some of the more salient features of this approach include: a client oriented attitude in service delivery and a decentralized loan approval process; the use of mobile banking units to further and deepen outreach to small informal borrowers; the use of a staff incentive scheme to reward performance

[7] There are other aspects of the public policy environment in Egypt that pose challenges for microfinance institutions. For example, it is not easy for NGOs to become microfinance banks given that the minimum capital required to get a banking license is high at around $30 million. Also, in their current legal form, NGOs find it difficult to borrow from banks for onlending since they are thought to lack transparency and accountability (Brandsma and Hart, 2000).

in the microlending unit; and the introduction of a life insurance scheme in the array of financial services that are part of the loan..

To succeed in microfinance, the NBD recognized that it had to change its approach and the way it did business. New and flexible lending techniques had to be adopted in order to manage risks and lower costs associated with microlending. This was reflected in a more client oriented and demand driven approach to service delivery. Thus the NBD adopted the practice of getting its specially-trained loan officers to go to the clients at their shops (or homes if necessary) to conduct transactions and solve business-related problems rather than have them come to the branch offices. This is important for many small borrowers who are unable to travel to bank premises due to disability or are unable to leave their enterprises unattended during working hours. Periodic visits by the loan officers to the microenterprises also serve to cement relationships with their clients and facilitate their monitoring and follow-up. Another feature of the flexibility of service delivery in the NBD program is the use of female loan officers in branches with programs that explicitly target women and in more culturally conservative areas in Upper Egypt. This approach has been effective in soliciting a higher proportion of women to apply for microloans, as evinced by the shares of women in total loans in poorer governorates in Upper Egypt.

The loan approval process and loan features are tailored to the needs of small borrowers. The NBD program relies on a decentralized loan approval process to the branch level. Once the economic viability of the project is asserted and the terms of the proposed loan have been agreed to by the loan officer and the microentrepreneur, the credit committee at the branch level is authorized to approve the loan. This devolution of loan approval authority has allowed the quick and timely disbursal of loans (usually less than two weeks), which is another important feature of the NBD program. Other bank-operated enterprise lending programs, such as the SFD's Enterprise Development Program (SFD/EDP), feature longer loan approval and disbursal periods of 9 to 12 weeks (Kheir El-Din, El-Leithy and Tabbala, 1999). Loan sizes are also small to better suit the needs of microenterprises. These loans provide an important source of liquidity without imposing excessive debt burdens on the borrowers (potentially the case with bigger loans). Because many of these microactivities cannot achieve sustainability with just one loan, the possibility for repeat loans is allowed and encouraged under this program.

Another institutional innovation of the program is the use of mobile banking units, to bring microfinance services to locations where the bank has no branches and where lack of infrastructure constrains the establishment of formal financial services in general. These mobile units are authorized to conduct all financial and business transactions normally done at the regular branch office. This is another service delivery feature that is lacking in other commercial banks. For instance, SFD/EDP borrowers complained about the unavailability of bank branches in their community (usually remote rural areas) and the duration of the trip to the nearest bank branch to conduct their periodic transactions (Kheir El-Din, El-Leithy and Tabbala, 1999).

Critical to the success of the NBD microlending program is the existence of motivated and qualified staff and loan officers. Most loan officers are recruited from among young university graduates with degrees in accounting and commercial studies and receive an intensive training consisting of a two-week theoretical training and a twenty-two-week field training in different branches. However, given the labor intensity and modality of service delivery in the microlending program, the NBD recognized the importance of financial incentives in determining performance. The NBD therefore developed a separate reward system with performance-based incentives for its staff in the microlending program. Staff and loan officers in the program receive a base salary, augmented by incentives based on performance with respect to certain targets. Each loan officer in the program handles an average of 110-150 loans. The target disbursement rate is about 10 new loans per month and loan officers receive additional benefits if they collect old loans or go beyond the target (Dhumale, Sapcanin and Tucker, 1998). Despite the labor intensity, the NBD microfinance operations are quite efficient by regional and international standards. For instance, Brandsma and Chaouali (1998) estimate that an efficient and productive loan officer in MENA can manage at least 100 individual loans or 200 group loans.

To mitigate the risks both to the borrower and the bank in the case of unforeseen events, the NBD program introduced a life insurance scheme as part of the package of financial services it offers to its clients. This reduces the financial burden on the borrower's family in the face of calamities and serves to educate borrowers about the importance of proper risk assessment and financial planning.

External Catalysts

The experience of the NBD shows that it is possible to create a market for formal/commercial microenterprise lending. This, however, requires donor support in the initial phases to cover higher startup and administrative costs inherent to lending to small borrowers until operations break even and become sustainable. The role of the USAID has been critical to the support and expansion of the initial pilot projects on a broader geographic scale, thereby enabling the NBD program to achieve sustainability associated with scale economies in microlending. Over the years, the success and profitability of the microenterprise program has not only prompted the NBD to contribute its own funds, it has also encouraged other banks, such as Banque du Caire, to participate in the microcredit market, with the assistance of donor funds.[8] The role of external catalysts is not limited to finance, of course. By arranging for technical assistance and by exposing NBD management and staff to international best practice in microfinance, USAID was able to encourage them to experiment with alternative procedures and adopt measures that proved useful in making the program a success.[9]

[8] USAID has also been instrumental in replicating various microfinance models around the country through different businessmen associations, such as the Alexandria Businessmen Association (Assaad and Rouchdy, 1999).

[9] It is also possible that Egyptian microfinance institutions benefit from positive externalities among themselves. Egypt is reputed to have the best microfinance institutions in the region in the sense that a large fraction of them follow industry best practice, have good portfolios, high repayment rates and loyal customers (Brandsma and Hart, 2000). There is likely to be a degree of institutional knowledge-sharing among them which benefits them all.

Lessons Learned

As the only commercial bank in Egypt with a long-running microlending program, the NBD has demonstrated the viability of commercial microfinance as a means of meeting the credit needs of the poor. When managed with a business orientation, banking with the poor can be profitable and sustainable.

The experience of the NBD suggests that several factors are key to success. These include:

- The commitment of senior management to take a risk on developing a program focused on a target group that is not typically covered by traditional commercial banking operations.
- The ability to change bank staff and management attitudes so as to combine a client oriented approach and sound financial practices in service delivery.
- The ability to change loan booking and processing procedures so as to respond to the special needs of micro-enterprise clients. This includes devolution of greater loan granting authority to branch officials, the use of female loan officers to cover female clients, the deployment of mobile banking units to access areas where no bank branches exist, and the practice of going to the client to collect payments rather than having the client come to the branch office.
- An incentive system for staff that is compatible with the special needs of microlending: Because microfinance is a labor intensive activity by banking standards and requires the loan officer to seek out the entrepreneur and assess his integrity and the viability of his project, he must be rewarded on a performance basis. This is to encourage loan officers to achieve greater and deeper outreach.
- The ability to charge market determined interest rates and fees. Microlending involves higher administrative and operational costs that have to be recovered through various loan charges and fees. The experience of the NBD has shown that the poor are willing to pay a premium to have continued access to simple, quick and uncollateralized credit. Furthermore, significant growth in the microfinance industry can only come from having commercial banks in this market niche and commercial banks are only likely to remain in this niche if they can recoup their costs from lending charges.
- Public policy could help the industry grow by making it easier for microfinance- NGOs to borrow funds from regular banks for onlending and/or by making it easier for them to become banks themselves and accept deposits. This, in turn, may require modification of banking laws and supervision procedures to achieve both prudence and low transaction costs in the monitoring of microfinance institutions.
- The availability of low-cost donor funds to kickstart the process. While NBD has been able to run its microlending program in recent years without additional funds from donors, the initial availability of such funds is widely acknowledged to have been critical.

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