

## **Ardian Fullani: Microfinance in Albania**

Speech by Mr Ardian Fullani, Governor of the Bank of Albania, at the Euro Mediterranean Conference on Micro Credit, Rome, 5-6 December 2005.

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Distinguished participants! I'm glad to participate in the Euro Mediterranean Conference on Micro Credit, an important event associated with the announcement of the Year 2005 as the "International year of micro credit" by the United Nations.

Authorities of a country usually aim at achieving sustainable economic growth in a non-inflationary environment. Ideally, in a free market, capital will go to those opportunities that represent the most efficient and profitable investments. But, in a developing country, markets have several imperfections and issues and capital could easily be misallocated. It could go in those investment opportunities that provide high but risky quick returns and on other low efficiency ventures that are nearly safe. This behavior could however be problematic for future economic growth of the country. Many sectors of enormous long term growth potential can be left unexploited. This means that some areas of the economy will be booming, while other areas will be considerably lagging behind leading to a very unbalanced economic development. Also, various groups of population, particularly low income groups, will most probably be excluded from financing opportunities increasing the odds of becoming poorer. As a result, social problems and issues may arise such as: job losses, loose population movements and illegal establishments, etc, which will stretch public facilities to cope with this situation. Therefore, it is important to find ways, to ensure more balanced development opportunities to all sectors of the economy and groups of population.

Albanian economy, by large relies, on micro-businesses. Nearly all enterprises in Albania fall into the category of small and medium enterprises SME-s. More than 90 percent of Albanian enterprises can be classified as small or medium-size according to our INSTAT data. The majority of these companies are engaged in trade and services, reflecting their micro business nature, and less in industry. As for employment, SME-s account for more than 40 % of total employment in the enterprise sector. There is a high concentration in the region of Tirana-Durres of private enterprises than other regions, while industry is concentrated mainly in Elbasan. This new private sector especially SME-s needs the financial support to grow. Until now banking sector has not been able to meet these needs. The situation is more problematic because SME-s do not have very developed financial sectors. Usually, these countries also have difficulties to access international financial markets.

I don't want you to get me wrong about the role of financial sector. Financial sector has made considerable steps in Albania. Today, our financial sector includes many banks and non-bank financial institutions, savings and loans associations and unions, insurance and reinsurance companies, pension funds. One should say though that the development of the financial sector institutions is more noticeable in the banking sector and the insurance sector. The banking system currently comprises 16 operating institutions, with total assets of around 53 per cent of the country's GDP. The system is well capitalized and liquid. Its intermediation role is increasing. The lending activity although small (accounting for around 23 percent of total banking assets and around 12 percent of GDP), is strongly picking up. Other financial institutions are trying hard to increase and modernize their activity. However, many problems primarily legal and property rights related which are outside financial sector are making it difficult for them to increase their credit lines.

Microfinance has proved to be a more effective way to deal with these problems. With its inventive formulas it makes financial resources become accessible to small and medium businesses that account for most of aggregate production during these development stages. These resources are often used to finance small projects in areas like agriculture, livestock or services like handicraft, small food stores etc.

The first microfinance institutions in Albania, were set up in 1994 as development projects co-financed by the Albanian Government and the World Bank. 13 donors cooperate with the Albanian government in supporting the development of SME-s in Albania. From 1992 a large share of funds has been allocated in Albania as donation, but only a portion has been spent. Most of these funds has been

given as soft loans for Albanian government. Aid represents around 30 % and only 5 % are direct commercial loans to co-finance the private investment. This sort of finance, called "Development Projects", is mainly used to finance SME-s' credit needs accompanied with technical assistance. The credit line funds are given from donors as soft loans and the government allocates them to banks to be used as commercial loans without harming the banking practice and the use of own bank capitals. As a consequence, a larger part of financial crediting sources is converted into commercial funds.

Today, the microfinance institutions are operating as self sustained institutions with an increasing customer base. In the last 5-7 years several other institutions have been focusing on microfinance. Currently we have 133 individual savings and loans associations organized under 2 Unions, which operate in rural areas. The number of their members is around 18 thousand and the stock of their outstanding loans is around 12 million euro. In addition, we have 7 microfinance institutions with total assets amounting to 50 million euros, and loans of 43 million euros. Banks are also getting more active in microfinance despite their little interest so far. This can be explained with tightening competitive conditions in the market and the need to explore new investment opportunities. Now we see an increasing amount of credit going to small businesses, which often helps them in the initial stages. Banks are particularly active for the microfinance in the urban areas. In fact, one of the banks has initially started to operate as a microfinance institution. It still holds a respectful position in this market segment, particularly in the urban areas. Lending to microfinance sector now counts for more than 10 per cent of the whole lending portfolio of the banking system.

The quality of the microfinance loans has been satisfactory. On average, the portfolio at risk is between 1.5-2 percent, according to their reports. This is not only because of their small size (usually under 1.5 thousand euros each), but also because of the diversity of the projects, ensuring diversification of the loan portfolio. One should also say that the experience gained by the microfinance institutions in this area, have also played an important role for this good quality.

The legal framework on microfinance was completed in 1996, with the approval of a special law that defined the principles upon which such institutions could be found and operate. Such principles for the specialized institutions included free will, reciprocal cooperation, capitalization of the profit and reinvestment in the community etc. Later developments made it necessary for the Law to change. Hence, a new Law "On Savings and Loans Associations and their Unions" was approved in Parliament on May of 2001. Several changes supported this new law. Besides the principles that were restated, the Law has defined the legal personality of the microfinance institutions, their permitted activities, the rights and the obligations of the members of the association, the managing structures of the associations and their functions, other important supervisory financial requirements and ratios, the role of the Unions and that of the Bank of Albania as the regulatory and the supervisory authority. Mandated with this role, the Bank of Albania has approved several regulations focusing on microfinance institutions and development. This regulatory framework, comprises the supervisory requirements to start and operate a Saving and Loan association, the indicators that enable their reporting and their financial analysis, and the principles based on which the on-site examination of such institutions occurs.

The regulation of the Bank of Albania "On licensing the Savings and Loans Associations and their Unions", is the first document issued by the Bank of Albania in this area, representing a big step forward into the formalization of these institutions. It defines the documentation requirements for the license application, the deadlines and the authority that should grant the license. These requirements are directed to the single associations, to the Union, and to the Union member association. It has been recognized the role of representing Union proposed member associations in the licensing process, meant also as an important tool to induce single SLA to become Union members. The number of the Unions is certainly not limited. The other important regulation is that of "The Supervision of Savings and Loan Associations and their Unions". In this regulation, the Bank of Albania has defined supervisory indicators for certain typologies of risk that are characteristic of current stage of development of the microfinance institutions in Albania. Counterparty risk is assessed through the requirements for a consistent process of loan portfolio analysis. These includes the ways the loans are classified, their provisioning requirements, their potential individual or group guarantees, the supervisory norms of the loan quality etc.. In addition, the counterparty risk is indirectly controlled by the requirements in capital adequacy of the institution. There are also other risks that are considered in the regulation, for which certain requirements have been defined. For the liquidity risk, there have been set up various norms for maintaining sufficient liquid assets and limiting the duration of the loans. For the concentration risk, the regulation requirements focus on the lending activity, and set out the norms for the net exposure in relation to the total assets of the institution. This regulatory framework is

meant to be actively orienting the activity of the microfinance institutions, and as such, will be revised as the developments may require. Besides these two regulations, the examinations manual of these institutions has been prepared. It is based on the CAMELS system we use for banks, and is aiming at assessing the adequacy of the internal policies and procedures, the quality of the management and the identification, assessment and monitoring of risks. The Accounting Manual is also prepared and is based on the national accounting standards, adjusted for the microfinance activity. We retain current regulatory framework, after some expected changes and approval, is adequately monitoring microfinance activity in Albania while not becoming an impediment for its development.

While acknowledging the role of the microfinance as an important tool for ensuring development opportunities to small businesses that otherwise may never access financial resources, one should keep in mind that microfinance is sound if it is provided by sound institutions. There is not much benefit if such institutions fail because of lenience of their internal rules and procedures, and/or because the supervisory authority has closed an eye on them because of their social role. This will also make other institutions become hesitant in engaging in microfinance.

The relationship between the microfinance institutions and the banking sector regarding their interaction in the economy financing, is a delicate issue. Their coexistence is certainly "peaceful" at the early development stage of at least one of these groups of institutions, but as the economy grows and competition increases, they tend to move toward each-other. At that stage, it is important to pay special attention for ensuring clear "rules of the game" for their activity and to provide adequate policies that allow for structural reforms of these institutions and of their market influence.

In conclusion, microfinance is a very important mean to achieve a balanced economic growth, by providing financial support to small and medium businesses which are vital for the medium and long term economic growth. Compared to some other countries in the region, microfinance in Albania have shown higher growth rates with good quality. However, there is ample room for enhancing it further. Maintaining a stable macroeconomic environment, and the improvement of the level for a better law and order, and land and property rights, fair competition, are very important factors that will improve business financing in Albania. As supervisory authority we will try hard for microfinance future growth to be sound. The credit bureau project that our bank is undertaking shortly is also expected to boost credit through ameliorating information problems.

Thank you for your kind attention.