Impact of the financial crisis on the Romanian microfinance sector - Results from a case study

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Abstract
The microfinance sector has grown significantly in the last years in Romania, despite the lack of coherent legal and regulatory framework. Therefore in the first part of this article we focus on defining microfinance in general and presenting important Microfinance institutions from Romania. The second part underlines findings from a financial institution we have chosen because it's long existence since 1995. Its purpose was to provide financial help to borrowers who are in dire need of a credit, a major problem in transition countries like Romania and a way of evading the cycle of poverty. In the 16 years of its existence in Romania it offered more than ten different products, creating a broad client platform and also added value within Romanian society through investments in start-ups or education. By analyzing the outstanding per product we highlight through the net result and profitability that not all of them are suitable for the current Romanian market conditions, proven by the fact that some products are not meeting the customer needs. Because the financial crisis did not affect Romanian economy until the end of 2008 and early 2009 spreading in almost all economic sectors, we focus to present key statistics of the institute, that reflect the changes that took place after and before the unprecedented impact of the crisis identified in the drop of number of active borrowers or active loans and in the changes in clients' perspectives on the their situation after the crisis or their intention to lend money. In the third part we try to recommend possible lessons from the crisis by which the position and the fulfillment of the institutes needs and their clients can be improved, which may help guide both Romanian or foreign microfinance institutes affected by the crisis.

Keywords: crisis, microfinance institution, product portfolio, customers
JEL codes: G01,G11, G21

1. Introduction

In the last decades, for a number of reasons, the microfinance sector has reached a considerable development and it is now confronting a real crisis. Some of the reasons why Microfinance institutions (MFIs) are now in a difficult situation are the multiple lending, borrowing over the top sums and offering high interest rates, alarming decline in credit repayment (Hartungi, 2007) although not a single MFI has gone bankrupt, and the microfinance sector seemed to be stronger than expected. Another reason is the fact that the financial market has changed and all its players within. Even though forecasts exist that the economy will recover in 1-2 years the post-crisis period is always quite difficult, especially because of the lack of information and because of the prevailing uncertainty.

1.1 Defining microfinance

A microfinance institution is an institution that describes itself as providing "microfinance." (Watkins and Hicks, 2009). The MFIs, (microfinance institutions) play after market principles, but try also to improve the lives of the poor (Rashid and Rahman, 2009). The products of Microfinance institutions (MFIs) are destined for emerging and developing markets. Some examples of products are: mainly microcredit, savings deposits, insurances and pension products. The main criticisms engages equally political and philosophical matters, but also as economic and management problems, and the loan targeting strategies (Hartungi, 2007).

1.2 Important Microfinance institutions from Romania

In Romania of early '90s the first international NGOs offering microcredit were: Soros Open Society Foundation, Menno Economic Development Associates, World Vision International and Confederation Swiss Government. Significant changes[1] took place between the years 2003 and 2007, as a result of the legislative changes and the government need to attract new investors.

The regulatory framework for microfinance in Romania was defined through a specific law only in 2005 (Nolan, 2010). The institution "O" chosen by us is together with Patria Finance Credit and Express Finance one of the first MFIs in Romania. Patria Finance Credit former GEPA, has an experience of 14 years in this field, belonging to the Romanian American Enterprise Fund ("RAEF"). Competitors[2] in 2010 would be Express Finance, Integra–ROM, Patria Credit, ROMCOM and the best Pro Credit Bank.

2. Relevant Case study on a Romanian financial institution

As a financial institution "O", and former foundation, since 1995 and as a financial regulated non-bank organization recognized by BNR (Romanian National Bank) in 2007, is profit-oriented trying to offer financial services, by lending money and creating through this process added value within society. The Institute was created in 2000 as a partner of an international financial institution, and has been offering in the 16 years of its existence in Romania eleven different products.

In the beginning many international organizations helped the institute with loans and technical assistance. Only through this help was the institute able to develop strong relationships with banks and other similar organizations within the financial sector. SMEs became prior clients in a fast changing and developing environment like Romania. During that period, banks were not adequately prepared and limited to meet the needs of these new players on the market (Matthäus-Maier, 2007).

In the nine cities where the institute is already present namely: Alba Iulia, Bistrița, Brașov, Cluj-Napoca, Miercurea Ciuc, Oradea, Reghin, Sibiu, Târgu Mureș work a total of 35 credit officers. The strength of the microfinance institution was achieved through a very personal close connection, between the borrowers and the credit officers, so the credit intermediaries, chosen especially to have been born and living in the same region where they are operating, selling their products. Therefore they could actually establish a precise picture of the social and cultural environment of the country and the market.

For MFIs, the motivation of the agent is a mission-oriented one, since the institute follows the purpose of alleviating poverty in developing countries (Jiwani, Morris and Husain, 2011), theory that can be in our opinion a valid explanation also for the institutes employees.

2.1 Change of important key figures of the studied financial institution after the crisis

This paper is based on our case study research at the financial institution "O". There were relevant some different discussions with employees and some of the institute's internal documents that were analyzed as a valuable source for our research. The potential for MFIs to offer an opportunity of reducing poverty is significant, although in order to do that it must find and recognize efficient products and services designed for the costumers. The question is how the crisis affected the portfolio.

The product portfolio of the institute in the years before 2009 was created from eleven various types of loans. Areas targeted by these loans were: services, agriculture, manufacturing and trade.

We examined that over a period of five years, before the financial crisis, the microfinance institution "O" has provided loans worth13.223 mil. EUR. It is not bad for the Romanian market, although by the end of 2008 a similar institute from Malawi, for example, registered 33.835 active loans (Thurow & Kilman, 2009).

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[1] http://www.startups.ro/luna-aceasta-va-aparea-o-noua-directiva-pentru-microcreditare
[2] http://www.mixmarket.org/mfi/country/Romania

Surprisingly, despite the financial crisis and a slow-down of the country's economic growth, we noticed in 2009 (Table 1) only a slight drop in the number of the active borrowers, but there was also a more important decline of the outstanding portfolio in EUR.

Table 1: Key microfinance indicators

	2005	2006	2007	2008	2009
Outstanding Portfolio in EUR	3,6 mil.	10,1 mil	13,3 mil	18,3 mil	14,1 mil
Active borrowers	1,348	1,684	2,457	2,938	2,723
Active loans	1,135	2,155	3,118	3,632	3,183
Staff	30	40	45	64	70

Source: www.mixmarket.org and data from the institute

Differences between the Romanian institutes' types of loans and the types of loans offered in other countries exist due to country-specific market characteristics (Turvey, 2011). The loans are the reflection of the development in the Romanian society as well as in the Romanian financial sector. From the 11 different types of loans, offered, we have chosen 4, the most relevant for our research and Romanian microfinance market.

In 2002, the trend in Romanian microfinance market was to give "overnight" loans. In the case of this type of loans, a borrower could become almost everybody with no guarantees. The "O" loan was the fastest alternative offered by the institute and it was granted within 24 hours after the application of the borrower. During the period between 2006 and 2007, the result was always 4%, but dropped to 3% in 2008. For Romanian borrowers who did not owe much liquidity for an unexpected expense, it was a real opportunity to quick access money. The loan "C" introduced in 1997 targeted entrepreneurs who had their operations in trade and services with an outstanding of 48% in 2006, of 45% in 2007, and of 42% in 2008. It is clear that it was not so hard affected by the crisis and the development followed a steady trend. When it comes to acknowledge the importance of this type of loan, within small and medium sized enterprises from emerging countries, is a wide consent. The importance lies in the fact that these enterprises face difficulties in accessing finance. So without this type of support there would not be a dynamic small business sector and no middle class could ever arise.

Through choosing trade and services the microfinance institute fosters two main activity domains of Romanian SMEs. The rapid development of SMEs (Stokes & Wilson, 2006) was based on the development of the service sector, preferred by small businesses because it is one of the most dynamic sectors of the economy. In general, Acs, Audretsch and Evans distinguish several stages of the economic development, characterized by the predominance of different sectors of economy and different levels of labor employment. With the "M" loan in 2003 the institution tried to give a chance to all the parties interested in the medical sector, both doctors, pharmacists, dentists and students attending medical universities. It has the lowest proportion of the entire outstanding of the institution. The motive behind it was the long tradition of higher medical education in Romania. The start-up loan so the "S" loan, is primarily meant for start-ups or young enterprises that are less than three months old. We have chosen this loan for the fact that in hard economic times for these clients, it is a chance of overcoming this challenge. Banks, such as ING, BRD, Unicredit Ţiriac Bank, Banca Transilvania, Banca Carpatica, or Millennium Bank, CEC Bank, through the Start program, BCR, Raiffeisen, Banc Post, Miro Bank although not yet present on the micro credit market, have their interest rates limits lowered for this type of enterprises, because they have seen the potential of SMEs[3].

The groups, targeted by the institute are: SMEs or individuals with legal personality like accountants or lawyers who want to improve their living standards, and can do that through bank loans only in a limited way. In 2010 the number of active customers was 2.300 people, composed of authorized individuals and business owners, 52.8% of them being Romanian. 51.6% of them have

[3] http://www.wall-street.ro/articol/Finante-Banci/62014/Seful-BCR-Scaderea-dobanzilor-conditie-esentiala-pentru-cumpararea-de-locuinte.html

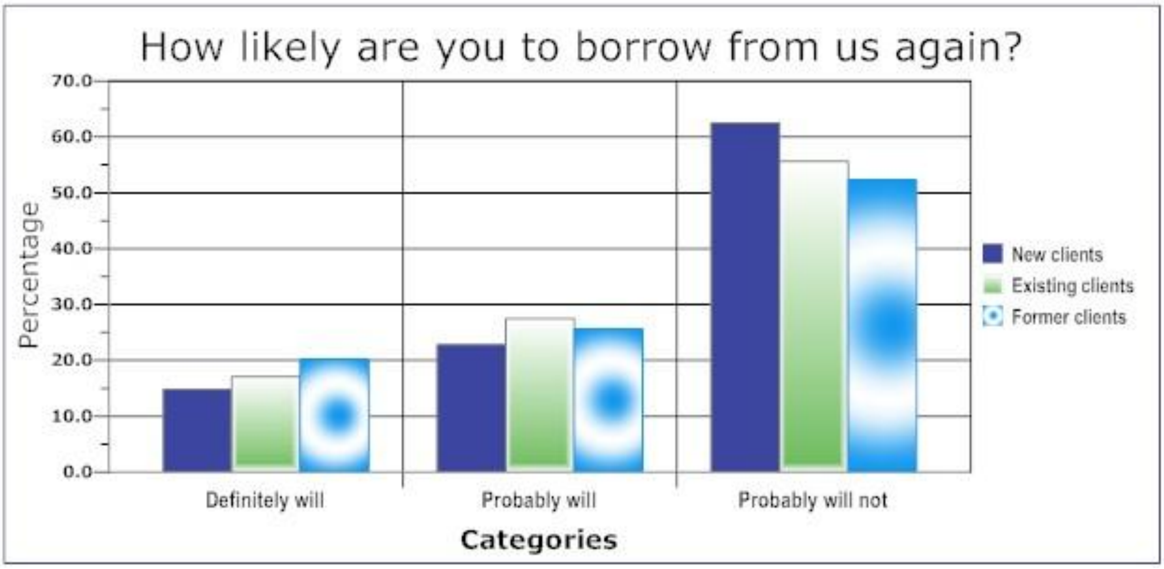
finished high school and only 26.6% have a university degree. Approximately 43% were women and 57% men (Institutes Client Survey in June 2009). According to the institute, 30% of its Romanian clients were in the 25-30 years old group, and 50% represent the percentage for the clients with more than 45 years. The smallest group is the one within 30-45 years, hence 20%. It is really concerning because the last group could be seen as the most active one in the economic environment. Because of the crisis, almost 30% of customers have temporarily suspended their activities. These demographic characteristics are important due to the fact that Chong (2010) found, that a higher level of education could predict a certain, positive pattern of the credit management practices.

In the microfinance sector financial innovation, means the understanding of the environment, subsistence of their clients and their financial service preferences. The clients of a financial institution perceive the level of quality based on two dimensions, which we will taken into account in our analogy in this paper as well. The first measures the impact of the outcome or the technical solution received by the customer and the second the impact based on the customer's perception of the various interactions with the institution (Jayashankar and Goedegebuure, 2011).

Based on the data collected (Figure 1) from the survey completed in 2009 by institution's clients (23% of active customers) that were interviewed, we have been developing some conclusion, whether or not, after the crisis all four products or only some, are suitable products for the institute's portfolio or not.

A real issue after the financial crisis was the lost of trust, this why it is so important that only 30% of active customers didn't believe that the institution had clear values and 70% so the majority that it did. This is a clear proof and result of the loan officer's friendly, respectful and honest attitude. In 2009 due to the financial crisis the customers were much more pessimistic in comparison to 2008, being convinced of their limited capacity of sustaining their family. This was expected since Romanian customers spent a large part of the income on provisions. While in 2008 30% of customers believed they would borrow again from the institute which was a good sign, in 2009 the percentage dropped dramatically to 19%. As expected, the clients tend to open savings accounts, and lost their confidence in the loans potential**.**

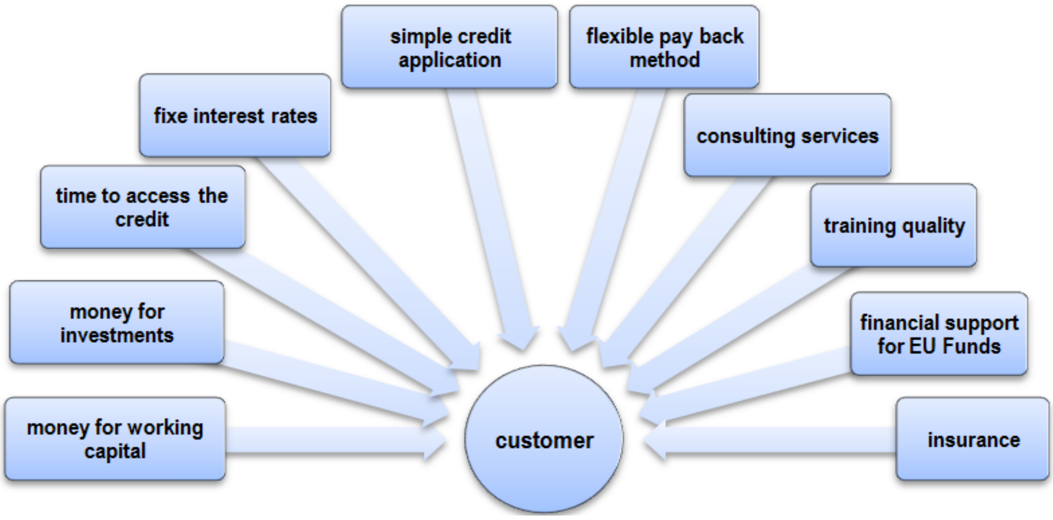
Figure 2: Customers' return probability



Source: data from the institute

As to be able to analyze if a product meets the customer's needs the ten most important ones were chosen for analysis (Figure 2): money for working capital and short-term costs, money for investments, time to access the credit (between 2 and 5 days), fixe interest rates, simple credit application, flexible pay back method (including grace period), consulting services, training quality in (accounting, taxes), financial support for EU Funds and insurance.

Figure 3: Identified needs of the microfinance institutions' customers



Source: data from the institute

Table 2 shows what needs have been met and by which of the four products it was done. By using the number 1, we specified the fulfillment of the need, whereas the number 0 stands for their failure. We had also to consider that some products were not designed for specific needs. So we used the term irrelevant for those needs. We can see that some needs like simple credit application, are not met by most products, only the O loan met this need.

Table 2: Customers Needs

Customers Needs	Loan C	Loan S	Loan M	Loan O
money for working capital and short-term costs	1	1	irrelevant	1
money for investments	1	1	1	irrelevant
time to access the credit (between 2 and 5 days)	1	1	1	1
fixe interest rates	1	1	1	1
simple credit application	0	0	0	1
flexible pay back method (including grace period)	1	1	1	irrelevant
consulting services	1	1	1	1
training quality in (accounting, taxes)	0	0	0	0
financial support for EU Funds and	0	0	0	0
Insurance	0	0	0	0

Source: data from the institute

The fact that the financial support for EU Funds and insurance were also perceived negatively is in our opinion not so important. The loan "C", introduced in 1997, and "S" have weaknesses concerning the simple credit application and also support for EU Funds and insurance. We think that in the case of these types of loan there are real issues. The goal was to help small and medium sized enterprises, in order to raise working capital for raw materials or needed devices and systems. A credit application in times of crisis must be an assessment tool to identify the amount and duration of a credit; therefore small and medium sized enterprises depend directly on the correlation of the level of quality of the information given. If this procedure is complicated, than the entrepreneur who is dealing with dangerous situations and is struggling for his small business survivor, working from early morning until late evening, does not have the time or the patience required to go through the process.

Table 3: Profitability of the 4 products in 2008

Product	Loan “C”	Loan “M”	Loan “O”	Loan “S”
Profitability	6,76%	-64,81%	62,01%	-15,36%

Source: data from the institute

In 2007 “C” provided a high net profit, a year later, so the year 2008 the profitability declined dramatically. The loan “M” was the best well-directed product from the portfolio; however the outstanding continued to drop. We believe this happened due to the strong competition, for example from Librabank who offered a various number of loans[4] for doctors. Other reason is the fact that after the financial crisis the majority involved in the medical field, experienced high labor and material costs, because of the fact that the population is getting older and new diagnostic and therapeutic procedures are costly.

3. Discussions and Conclusions

It is clear that the financial crisis affected the intuition, a fact that we have seen in a drop of active borrowers. By affecting the customers and especially their perception and confidence in the future, in the economic environment and their desire to start a business - the institution has suffered some tremor. The biggest problem is not only that trust is difficult to rebuild, but also liquidity. Therefore, we consider that the strategy of the institution should be to rebuild the trust of their clients through a step by step development and reanalyze the clients’ profile and whether the offered product meets their needs or not. Microfinance cannot, in our opinion, eradicate poverty only through the help of loans, in spite the fact that it can contribute to establish a functional financial market. In the Table 4 we have presented our conclusions based on the indicators presented above, providing unique, first-level insights into MFI product portfolio.

Table 4: Rankings of the 4 products

Product	Loan „C”	Loan „M”	Loan „O”	Loan „S”
Outstanding	Rank 1	Rank 4	Rank 3	Rank 2
Growth Rate	Rank 1	Rank 4	Rank 3	Rank 2

Source: author’s calculations

It is obvious that micro-loans offered by the institution have their disadvantages. As a customer you can not apply for a loan over the internet, this is why this method or another should be applied to reduce bureaucracy which was always mentioned at all analyzed loans as an important issue. The required time for the analysis of customer data should be shortened. Another advantage mostly in this period is the offer of a partial repayment-free period.

The simplification of the loan application process is in our opinion a key customer requirement for each product segment also for the loan “C”, the best product, although it satisfied other customer’s needs very well and it registered a sustained growth and high profitability like seen in table 3.

The problematic product remains loan “O”, because it is unprofitable with a negative growth and we think it should be removed from the institute’s product portfolio, also because in the actual crisis situation, this type of loan is mostly blamed.

In the same situation is product loan “S”, with small outstanding, weak or no growth, lower profitability with low demand in the market.

In the case of loan “M” we do not see the potential of this segment anymore and would also eliminate this product from the microfinance institutions portfolio.

We believe that the competitive advantage of the microfinance institution we have chosen consists of the attention given to the understanding of the customer and the nursing of personal

[4] http://www.librabank.ro/Profesii_liberale/Medici/Credite

relationship through understanding their problems and the situation they are facing after a crisis. In the evaluation process primarily not the repayment capacity of the potential customer should be important but the credit management practices. Therefore if this advantage is not sustained properly, it will be used by the competitors. Loan officers got used to the fact that they had less time to attend customers regularly due to a rapid increase in number of customers in the last years, and this routine should change.

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