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# ACCESS TO FINANCIAL SERVICES IN THE COUNTRIES OF THE MAGHREB

## Comparative review of the provision of microfinance services in Algeria, Egypt, Morocco and Tunisia

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## Abstract

The purpose of this study is to analyze how in the countries of the Maghreb private and state-owned financial institutions try to solve the problem of lack of access to basic financial services. In this document we assume that this problem is essentially due to an inadequate supply of microfinance services. The supply of microfinance services to the low-income population in Algeria, Egypt, Morocco and Tunisia is too expensive and the sales networks through which such services are distributed have insufficient coverage, do not use the necessary risk analysis mechanisms and are subject to inappropriate regulatory regimes.

As a result, there is unmet demand for financial services among very large segments of the population. These segments are therefore obliged to resort to considerably more costly and inefficient informal services, preventing them from attaining higher levels of economic development. The solution would be to develop a supply of financial services for the lowest-income segments that overcomes the problems we have identified.

In this study we aim to present the business models used by the leading institutions involved in microfinance in the countries of the Maghreb. We also propose to analyze the policies adopted by the governments of these countries to ensure that the lowest-income segments have access to financial services. Our ultimate objective is to identify best practices in the implementation of existing innovations in the banking industry that can be combined with best practices in the formulation of public policy affecting the finance and microfinance sectors in order to extend access to basic financial services to a larger proportion of the population of developing countries.

**Keywords:** microfinance, financial services.

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## 1. Introduction

The purpose of this study is to analyze how in the countries of the Maghreb private and state-owned financial institutions try to solve the problem of lack of access to basic financial services. In this document we assume that this problem is due basically to an inadequate supply of microfinance services. The supply of microfinance services to the low-income population in Algeria, Egypt, Morocco and Tunisia is too expensive and the sales networks through which such services are distributed have insufficient coverage, do not use the necessary risk analysis mechanisms and are subject to inappropriate regulatory regimes.

As a result, there is an unmet demand for financial services among very large segments of the population. These segments are therefore obliged to resort to considerably more costly and inefficient informal services, preventing them from attaining higher levels of economic development. The solution would be to develop a supply of financial services for the lowest-income segments that overcomes the problems we have identified.

The methods we use in our analysis are as follows: first, we review the economic context in each country; second, we analyze the financial industry, especially the banking industry; third, we describe the microfinance sector and identify the main institutions involved in providing microfinance services; fourth, we consider the problem of lack of access to financial services in light of the supply factors described previously, i.e. prices, distribution networks, credit analysis methods and regulatory context; fifth, we consider the flows of emigrants' remittances received by each country; lastly, we examine the business models of the countries' main microfinance service providers and see how these institutions apply best practices in implementing their business models.

In this research paper we aim to present the business models used by the leading institutions involved in microfinance in the countries of the Maghreb. We also propose to analyze the policies adopted by the governments of these countries to ensure that the lowest-income segments have access to financial services. Our ultimate objective is to identify best practices in the implementation of existing innovations in the banking industry that can be combined with best practices in the formulation of public policy affecting the finance and microfinance sectors in order to extend access to basic financial services to a larger proportion of the population of developing countries.

## 2. Access to Financial Services in the Countries of the Maghreb

The level of financial depth in the countries of the Maghreb can be described as low or very low, depending on the country and the indicator used. Access to basic financial services among the general population is estimated at 45% in Morocco, 42% in Tunisia and 30% in Algeria. These figures are low compared to developed countries such as Spain (98%) or the United States (90%). However, they are higher than in some developing countries with higher income per capita, such as Ecuador (34%), Colombia (45%), Peru (35%) and Mexico (25%). And they are considerably higher than in other African countries with lower income per capita, such as Kenya (10%), Uganda (6.7%) and Tanzania (6.4%).

Macroeconomic indicators measuring the depth of the regulated financial system lead to similar conclusions. In the countries of the Maghreb included in this study the ratios of loans to the private sector to GDP and of bank deposits to GDP are lower than in developed countries but above the average for medium to low-income countries. As of 2003 only Algeria had indicators lower than the rest of the countries in the region, due to the political and economic crisis that devastated the country at the end of the nineties.

### Financial depth in Algeria, Egypt, Morocco and Tunisia, 2003[1]

| | Loans to the private sector/GDP | | Deposits/GDP | |
|---|---|---|---|---|
| (%) | 1990 | 2003 | 1990 | 2003 |
| Algeria | 44.4 | 11.4 | 73.5 | 63.9 |
| Egypt | 30.6 | 61.5 | 87.9 | 106.6 |
| Morocco | 34.0 | 56.0 | 61.0 | 92.3 |
| Tunisia | 66.2 | 66.6 | N/A | 59.1 |
| Avg. developed countries | 125.8 | 158.3 | 92.8 | 104.3 |
| Medium-income | 43 | 64.2 | 42.2 | 81.4 |
| Medium-low income | 39.3 | 58.6 | 41.1 | 76.9 |
| Low income | 22.3 | 27 | 36.2 | 51.9 |

A common characteristic of the countries under study (except Tunisia), and of developing countries in general, is an excess of liquidity in their regulated financial systems. The excess of liquidity (measured as the difference between the ratios of deposits to GDP and of loans to the private sector to GDP) is particularly large in Egypt and Morocco, owing to the high level of deposits in their financial systems. In Algeria the excess of liquidity is also high, though basically due to the failure of the country's financial system to generate loans, owing to political and economic instability.

The low level of access to credit, and to microfinance services in general, is attributable, first, to the regulation of the prices of microfinance services. Second, the scant reach of financial distribution networks does not allow mass access to financial services. Third, the use of inappropriate credit analysis methods prevents inclusion of the informal economy. Lastly, the inadequate regulatory and policy framework does nothing to solve the problems of supply.

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[1] World Development Indicators, 2005.

Regulations imposing maximum interest rates (usury rates) are one of the main factors contributing to the lack of access to credit in Tunisia and Morocco.[2] In Morocco regulated financial institutions are subject to central bank-imposed interest rate caps, while microfinance associations are not. These associations lend at market rates (averaging 20% to 30%), which explains their growth, without this having diminished the demand for microcredit. In Tunisia, too, regulated financial institutions must respect interest rate caps imposed by the central bank. Moreover, unlike in Morocco, the interest rate at which microcredit associations are permitted to lend is capped at 5%.[3]

In Algeria and Egypt, by contrast, interest rates are unregulated. In Algeria prices have been liberalized and interest rate caps were abolished in 2001; at present the average rate for consumer loans is 25% to 30%. In Egypt, too, prices are liberalized; the average rate for loans by specialized microfinance institutions is currently around 30%.

The second reason for lack of access to financial services in the countries under study is the scant reach of banking distribution networks. This deficiency of the banking networks is offset, however, by the density of these countries' postal services networks. The large postal network is an inheritance from a shared French colonial past and an asset which, properly used, could be a catalyst for growth in banking penetration. In Morocco and Tunisia, moreover, the postal and banking networks are complemented by a network of microcredit associations. As of September 2006 this network consisted of 800 branches in Morocco and 200 in Tunisia.

## Banking and postal distribution networks in Algeria, Egypt, Morocco and Tunisia[4]

| Density per 100,000 inhabitants | Bank and Postal service | Banking agencies | Postal agencies | ATMs |
|---|---|---|---|---|
| Tunisia | 20.16 | 9.04 | 11.12 | 8.29 |
| Egypt | 17.03 | 3.51 | 13.51 | 1.00 |
| Morocco | 12.73 | 7.26 | 5.47 | 7.56 |
| Algeria | 13.46 | 3.43 | 10.03 | 1.06 |
| Western Europe | | 44.66 | | 66.81 |
| Asia | | 8.13 | | 9.40 |
| Eastern Europe | | 7.39 | | 13.78 |
| Latin America | | 7.02 | | 12.48 |
| Africa | | 2.06 | | 3.48 |

The third factor explaining the low level of access to credit in the countries of the Maghreb is the use of inappropriate credit assessment methods by lending institutions. The methods used are inappropriate to the informal economies in which these institutions operate, as they take no account of income for which there is no documentary evidence. Lack of experience in the granting of small loans on a large scale is another factor that has prevented institutions from developing efficient credit analysis systems.

An alternative is to develop centralized credit analysis systems where credit risk is analyzed on the basis of an individual or company's payment record with other institutions. A centralized

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[2] CGAP, 2005.

[3] Except for ENDA, an NGO which has been authorized to lend at market interest rates.

[4] Authors' calculations and Beck, Demirgüc-Kunt, and Martínez Pereira, World Bank, 2006.

system of this kind is known as a central credit bureau and may be state-owned or private. However, the credit bureaus that exist in the countries of the Maghreb are of no use, as they report only high value loans. Consequently, in Algeria only 0.2%, in Egypt 1.5%, in Morocco 2.3% and in Tunisia 11.6% of the population have a credit history in their country's public credit bureau. In none of the countries are there any privately owned credit bureaus.

## Credit registry coverage in Algeria, Egypt, Morocco and Tunisia[5]

| Region or Economy | Legal Rights Index | Credit Information Index | Public registry coverage (% adults) | Private bureau coverage (% adults) |
|---|---|---|---|---|
| East Asia & Pacific | 5.0 | 1.9 | 3.2 | 10.1 |
| Europe & Central Asia | 5.5 | 2.9 | 1.7 | 9.4 |
| Latin America & Caribbean | 4.5 | 3.4 | 7.0 | 27.9 |
| Middle East & North Africa | 3.9 | 2.4 | 3.2 | 7.6 |
| OECD | 6.3 | 5.0 | 8.4 | 60.8 |
| South Asia | 3.8 | 1.8 | 0.1 | 1.3 |
| Sub-Saharan Africa | 4.2 | 1.3 | 1.5 | 3.8 |
| **Algeria** | 3 | 2 | 0.2 | 0.0 |
| **Egypt** | 1 | 2 | 1.5 | 0.0 |
| **Morocco** | 3 | 1 | 2.3 | 0.0 |
| **Tunisia** | 3 | 3 | 11.6 | 0.0 |

The fourth reason for the low level of access to financial services in the countries of the Maghreb is the lack of an appropriate legal framework for finance and microfinance activities. While the regulated financial sector in the Maghreb has been liberalized in recent years, the microfinance sector remains over-regulated and under-supervised.

Moreover, economic and financial theory shows that lending to the private sector is fostered by the development and enforcement of property laws. According to World Bank statistics, the laws of the countries of the Maghreb do not protect creditor's rights and so are not conducive to lending. The World Bank assigns Algeria, Morocco and Tunisia a score of 3 out of 10 and Egypt 1 out of 10. This is below the average for the countries in the region (3.9 for the Middle East and North Africa) and for OECD countries (6.3).[6]

Looking at the countries individually, in Tunisia the regulatory context is unfavorable to microfinance not only because of the 5% interest rate cap on microloans, but also because the state-owned Banque Tunisienne de Solidarité has a monopoly and is not adequately supervised. In Egypt there is no legal provision for the necessary institutions, such as non-bank financial institutions, to carry out microfinance activities in the regulated sector. In addition, supervision of the unregulated sector is inadequate.

In Morocco the government has enacted a Microcredit Associations Law to solve the problem of interest rate control in the regulated financial sector. However, the prohibition on deposit-taking by microcredit associations threatens these institutions' future development. In Algeria,

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[5] "Getting Credit," World Bank, 2006.
[6] "Getting Credit," World Bank, 2006.

finally, the right policies, in terms of institutions and pricing, are in place; the challenge is to ensure that the supervisory system allows the microfinance sector to develop.

## 3. Economic Environment and Regulated Financial System

The countries of the Maghreb included in this study are medium-low income countries on a global scale. In 2004[7] Morocco had a per capita income of US$ 1,730, Algeria US$ 2,730, Tunisia US$ 1,520 and Egypt US$ 1,250. Only Algeria, thanks to its substantial oil revenues, had a per capita income above the average for the Middle East and North Africa region (US$ 2,241) and for the medium-low income countries (US$ 1,918).

In macroeconomic terms all the countries in our sample have enjoyed sustained economic growth, both absolute and per capita. The trend in macroeconomic prices also has been favorable in recent years, with stable exchange rates, low inflation and (for developing economies) relatively low real interest rates.

### Macroeconomic trends in Algeria, Egypt, Morocco and Tunisia[8]

| 2005 | % Chg GDP 1995-05 (annual) | Inflation: Consumer Price Index (%) | Balance of Payments on Current Account (% GDP) | Government debt (% GDP) | Government deficit/ surplus (% GDP) | Discount/ interest rate (%) |
|---|---|---|---|---|---|---|
| Algeria | 3,9 | 1,6 | 18,35 | 25,9 | 13,8 | 4 |
| Egypt | 4,7 | 4,9 | 4,8 | 38,4 | -6 | 10 |
| Morocco | 3,6 | 1,0 | 0,1 | 35,3 | -3,3 | 3,25 |
| Tunisia | 4,9 | 2,0 | -2,8 | 66,5 | -2,6 | N/A |

Remittances have contributed to the countries' positive performance. As a proportion of GDP they go part of the way to explaining economic growth in some of the countries. And as a source of foreign currency they have contributed to the macroeconomic stability mentioned earlier, thanks to their beneficial impact on the current account balance and interest rates.

Remittances have played a particularly important role in Morocco, where they reached US$ 4,200 million in December 2004, accounting for 8.4% of GDP. Egypt stood second in volume of remittances received, with US$ 3,300 million in 2004, equivalent to approximately 4.19% of its GDP. Algeria was third, with US$ 2,500 million, or 2.94%, while Tunisia received US$ 1,400 million, representing 4.96% of its 2004 GDP.

However, any analysis of the economic impact of remittances must consider not only the macroeconomic indicators, but also other indicators that take account of the extreme distribution of wealth in these countries. A relevant indicator for this purpose is the ratio of remittance income to individual income by income quintile. Bearing in mind that remittance recipients generally belong to lower-income groups, a relevant comparison would be between remittance income per capita and the gross income of the lowest-income groups. The table below shows this comparison, prompting highly relevant conclusions.

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7 Per capita income measured by the Atlas method. World Development Indicators, 2005.

8 World Development Indicators, 2005.

## Economic impact of remittances per income quintile[9]

| Economic impact per income quintile, 2004 | Morocco | Algeria | Tunisia | Egypt |
|---|---|---|---|---|
| Quintile 1 | 27.55% | 9.70% | 17.74% | 8.47% |
| Quintile 2 | 16.90% | 5.86% | 10.34% | 6.02% |
| Quintile 3 | 12.10% | 4.22% | 7.19% | 4.73% |
| Quintile 4 | 8.41% | 2.99% | 4.91% | 3.57% |
| Quintile 5 | 3.84% | 1.59% | 2.25% | 1.67% |

As can be seen in the above table, in 2004 remittance income as a percentage of the total income of the first income quintile was 27.55% in Morocco, 9.70% in Algeria, 17.74% in Tunisia and 8.47% in Egypt. Remittance flows are therefore very important for the low-income segments of society and so need to be included when estimating their income. In particular, they need to be included in any credit risk analysis, as income from the informal economy is part of the ability to pay and so must be taken into account when deciding whether to grant credit.

The regulated financial sectors of the countries under study are at different stages of liberalization and de-nationalization. They are also characterized by low profitability, high levels of default, high liquidity and high capitalization. Algeria could be said to be the country that started to liberalize most recently, as its financial industry is still dominated by state-owned banks, which control 92.6% of banking assets and 93.3% of bank deposits.[10] At present its priority in financial policy is to strengthen its financial system by developing infrastructure and regulations that help improve the efficiency of banks and other organizations such as Algérie Poste and the country's cooperatives.

Egypt is at a slightly more advanced stage of the regional liberalization process. Following the privatization of the Bank of Alexandria in 2006, state-owned banks account for 43.70% of banking assets. Egypt's financial policy is currently focused on rescuing the state-owned banking sector through further privatizations and divestments of public-private joint ventures. The profitability of state-owned banks is very low (ROA, 0.2%), as a result of their high ratio of non-performing loans to total loans (24.2%), due to widespread corruption.[11]

Tunisia has reached a third stage of liberalization. Private-sector commercial banks outweigh the public sector, accounting for 39.1% of the assets of the regulated financial system, thanks to the privatization process begun in 2002. However, private-sector banks are not very profitable (ROA 0.6%, ROE 7%), owing to high rates of default (20%)[12]. Following the 2002 banking crisis, privatization and the banking law reforms of 2001 and 2006, the aim is to reinforce credit risk controls.

Of the four countries studied, Morocco is the one that has gone furthest in liberalizing and privatizing its financial system. Its financial system has little state ownership, although the royal family holds shares in the leading private-sector bank (ATW), while the leading

[9] Authors' calculations based on World Development Indicators, 2005.
[10] CGAP, 2006.
[11] USAID, 2006.
[12] Association Professionnelle Tunisienne des Banques et des Établissements Financiers (APTBEF), 2006.

cooperative bank (BCP) is state-controlled. These two entities lead a highly concentrated banking industry, with the top three institutions accounting for more than 40% of the loans and deposits of the regulated financial system.[13]

## 4. Overview of the Supply of Microfinance Services

The colonial past of the four Maghreb countries studied here explains the importance of the postal system as a leading player in the provision of microfinance services. In all four the postal service, with its extensive distribution network, is the leader in microsavings and distribution of remittances. In none of them, however, does the postal service have the legal power to lend; in none of them, therefore, does it provide microcredit. Optimizing the postal service distribution network for the distribution of microfinance services would thus lead to significant financial deepening in Algeria, Egypt, Morocco and Tunisia.

### Distribution network of the national postal service by country[14]

| | |
|---|---|
| Algeria | 3,271 post offices, one per 10,000 inhabitants |
| Egypt | 10,000 post offices, one per 7,400 inhabitants |
| Tunisia | 1,112 post offices, one per 9,060 inhabitants |
| Morocco | 1,673 post offices, one per 18,290 inhabitants |

Of the four countries studied, Algeria has the least developed microfinance sector. The Algerian government is therefore encouraging the distribution of microfinance services via the postal distribution network, which has a considerable reach. Egypt is the only one of the four countries in which the banking industry has a significant presence in microfinance. In Morocco the microfinance sector is dominated by microcredit associations, whose development is a regional best practice. Lastly, in Tunisia the microfinance industry is a state-owned monopoly, organized around Banque Tunisienne de Solidarité (BTS).

### 4.1. The Microfinance System in Algeria

Algeria's microfinance system, like its regulated financial system, is the least developed of those studied. A wide variety of institutions offer microfinance services, although the supply is insufficient to meet the potential demand. Part of the reason for the inadequate supply is that the banks lack the means to penetrate the microfinance market and are not strategically oriented to do so.

Algérie Poste, the postal service provider, is Algeria's largest financial service provider. There are also fifteen non-governmental organizations (NGOs), some of which provide microfinance services. In third place is the Algerian cooperative system, which is the largest provider of microfinance services in rural areas. As part of the ongoing reform of the country's financial system, the Algerian government has taken measures to strengthen these providers. It has also adopted a variety of public policies aimed at increasing the availability of such services.

[13] Auerbach Grayson, 2006.
[14] CGAP, various years.

*Algérie Poste*

Algérie Poste, the postal service provider, is currently Algeria's biggest provider of microfinance services. It has the country's largest branch distribution network, handling 7.1 million current accounts with more than a million transactions per day. Algérie Poste has three organizational layers: a central services division, eight territorial management units and 48 postal units, each responsible for its province or *wilaya*.

At present Algérie Poste offers a wide range of microfinance services, either directly or under third-party agreements. It can be considered the only provider of microfinance services in Algeria and unique in the region, given its size, network density and information system capacity. Its star product is the postal checking account, although it also distributes savings accounts (in association with CNEP Banque), transfers of remittances (in association with Western Union), mortgage loans (in association with CNEP Banque) and its own ATM cards for cash withdrawals (180,000 as of year-end 2005).

In 2002 Algérie Poste became a government corporation, with the capacity to offer both postal and financial services. As a public corporation Algérie Poste was made organizationally and functionally independent of the Ministry of Telecommunications and Postal Services, which became the regulatory authority. This means that Algérie Poste must be self-financing.

The financial services area generates approximately 80% of the corporation's revenues and employs almost 1,400 of its 25,000 employees. Algérie Poste manages 7.1 million postal checking accounts, representing deposits of approximately US$ 3.9 billion. It also has 3.6 million savings accounts, with some US$ 2.86 billion in deposits. As of December 2005 total funds deposited with Algérie Poste came to US$ 6.76 billion, representing 12% of the total deposits in the country's financial system. Remittances are another important financial service provided by Algérie Poste, which in 2004 handled 31 million transactions in a total amount of approximately US$ 34 million.

Algérie Poste has 3,271 post offices, all of which offer financial services. This total breaks down into 1,636 main offices and 1,635 secondary offices, with an average density of 9,100 inhabitants per post office. The density is higher in the capital, Algiers, and other large cities such as Oran and Constantine.

Algérie Poste's technology platform allows it to offer an online account management system and electronic payment facilities. At year-end 2005 Algérie Poste had more than 200 ATMs and was planning to increase the number to 1,400 by the end of 2008[15]. This expansion of the ATM network was to be accompanied by the installation of 1,000 point-of-sale terminals in the period 2008-2009.

Through its alliance with the French postal service Algérie Poste hopes to significantly improve the capacity and quality of its financial and postal services. At present Algérie Poste does not have authorization to originate loans, although it could enter into distribution agreements with banks or finance companies to provide loans through postal checking accounts. It has a partnership agreement with CNEP Banque and is negotiating with finance companies specializing in consumer credit.

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[15] CGAP, 2006.

Before Algérie Poste can become a major catalyst for banking penetration in Algeria, it must meet certain challenges. First, it must develop and optimize its technology platform. Second, it must improve its internal audit and control systems, especially as regards liquidity management. Third, it must improve the efficiency of its processes to ensure profitability and not have to rely on government subsidies. Fourth, it must seek distribution alliances with credit providers and so become de facto a universal postal bank. Fifth, it must deal with overcrowding in some city post offices, especially in Algiers, where the number of customers per branch is very high. Sixth, it must diversify its sources of revenue, as currently 64% of its income comes from investments in government debt. Lastly, it must optimize its large customer base, especially the approximately 50% of inactive customers, through cross-selling.

## 4.2. The Microfinance System in Egypt

Of the four countries of the Maghreb studied, Egypt is, together with Morocco, the one in which microfinance has developed most significantly in recent years. According to UNCDF,[16] the development of microfinance in Egypt is attributable to two factors: first, the diversification of the products offered by NGOs, including group risk analysis methods and loans aimed primarily at women; and second, the development by Egypt's banking industry (unlike that of any other country in the Maghreb) of specific strategies for serving customers who demand microfinance services .[17]

As the following table shows, as of June 2004 NGOs served more customers in the microfinance segment than banks. However, almost 50% of the portfolio of microloans was granted by banks. The figures in this table are approximate, as there are no exact data on microfinance services in Egypt. The table does not include the microloans provided either by the Principal Bank for Development and Agricultural Credit or by NGOs not financed by USAID. Even so, we believe it gives a rough idea of how the portfolio of customers and loans was shared among the various providers.

Since then, however, despite not having up-to-date data on the activities of all the NGOs and banks, we believe, based on the performance data provided by Banque du Caire, that the portfolio of microloans generated by banks is much larger than that generated by NGOs.[18] The regulatory context is much more favorable to the provision of microfinance services by banks than by NGOs.

[16] Brandsma, J. and D. Bujorjee, 2004.
[17] So-called downscaling strategies.
[18] Banque du Caire doubled its loan portfolio between 2003 and 2005.

## Provision of microloans in Egypt by type of provider (June 2004)[19]

| | Active customers (June 2004) | EGP loans | USD loans |
|---|---|---|---|
| **NGO** | **183,262** | **219,162,564** | **35,348,797** |
| ABA | 39,917 | 52,497,503 | 8,467,339 |
| AsBA | 49,432 | 48,834,300 | 7,876,500 |
| DBACD | 26,752 | 30,808,235 | 4,969,070 |
| ESED | 39,097 | 52,150,467 | 8,411,365 |
| SEDAP | 5,078 | 6,862,083 | 1,106,787 |
| SBACD | 15,585 | 19,054,168 | 3,073,252 |
| LEAD | 3,474 | 1,820,414 | 293,615 |
| SPDA Fayoum | 2,397 | 2,558,750 | 412,701 |
| SCDA Sohag | 1,164 | 3,755,372 | 605,705 |
| Aswan | 366 | 821,272 | 132,463 |
| **Banking sector** | **95,026** | **196,181,521** | **31,642,180** |
| Banque du Caire | 63,426 | 118,341,519 | 19,087,341 |
| National Bank For Development (2003) | 22,600 | 50,840,002 | 8,200,000 |
| Banque Misr (Sept 2003) | 9,000 | 27,000,000 | 4,354,839 |
| Principal Bank for Development and Agricultural Credit | N/A | N/A | N/A |
| **TOTAL** | **278,288** | **415,344,085** | **66,990,977** |

In recent years the banks have become the leaders in microfinance in Egypt. Their extensive branch network, their excess liquidity and their technology platforms have allowed them to take the lead in a market previously led by NGOs. So far, however, the banks have concentrated on offering individual microloans and have not exploited the potential for cross-selling.

The National Bank for Development (a privately owned commercial bank) was the first commercial bank to start a microfinance business, in 1987, backed by USAID. Subsequently, Banque du Caire (a state-owned commercial bank), and Banque Misr (a state-owned commercial bank) also started operating in the microfinance segment, the former in 2001 and the latter in 2004. In addition, the Principal Bank for Development and Agricultural Credit, with its large branch network, has been responsible for the distribution of subsidies and loans to the rural segment. Since 1993 it has also distributed microloans, though only in the rural areas in which it operates.

At present, therefore, three state-owned banks and one privately owned commercial bank are active in the microfinance segment. The three commercial banks serve the customers with the highest purchasing power in the microfinance segment. The Principal Bank for Development and Agricultural Credit specializes in financing microloans in the rural sector. The NGOs that specialize in microfinance and community development programs make up the rest of the supply, aimed at the lowest-income segments.

[19] USAID 2006, World Bank, 2004.

## 4.3. The Microfinance System in Morocco

Morocco has become the regional leader in terms of the development of its microfinance sector, with approximately 42% of the total number of active borrowers in the whole MENA region (Brandsma, Bujorjee 2004). This development is not only very substantial but also quite recent. The microcredit law passed in 1999 gave NGOs, among other privileges, the ability to offer microcredit without being restricted by the price caps that regulate credit in the financial industry. The positive attitude of regulators and supervisors has also greatly assisted the development of the industry.

The microfinance industry in Morocco has also benefitted significantly from financial sector deregulation. In recent years, deregulation has allowed microfinance institutions to get funding from the country's banking and financial industry. As the financial sector has gained in solvency and stability, banks and finance companies have been able to offer better rates and conditions of funding to MFIs.

Currently, under the 1999 law regulating microcredit associations and following the merger of Zakoura and Fondation Banque Populaire, there are 10 NGOs with a license to grant microcredit in Morocco. Under this legal framework all associations must register with the Ministry of finance but are supervised by the Central Bank under delegation from the Ministry.

Commercial banks have established close relations with microcredit institutions. Crédit Populaire du Maroc (CPM) controls the third-largest microcredit association, Fondation Banque Populaire pour le Micro-Crédit (FBPMC). This association was founded by CPM and receives operational support and funding from its parent. CPM envisions that its foundation will not only promote economic and social development through microcredit, but also will allow CPM to gain new customers, migrated from its microcredit subsidiary. CPM has established a global strategy in which it starts by offering services at the base of the pyramid (FBPMC) and then, once these customers become bankable by CPM, migrates them to the parent institution. CPM also finances the development of other microcredit associations, with the result that the industry leaders are among its most important corporate customers.

The 10 active microcredit associations that operate in Morocco are very different, however, in terms of size, growth, target segment, credit methodology used and product offering. The microfinance sector is highly concentrated, with three organizations controlling approximately 95% of the sector's active customers and outstanding credit. These three organizations have a national profile and extensive presence in urban areas (except ARDI) through a very dense and growing distribution network that allows them to enjoy significant growth in assets. Furthermore, the flexible, balanced approach adopted by the regulators and supervisors of the microfinance sector in Morocco has allowed MFIs to expand their product offering to services other than microcredit. The growth of the three leading associations has been funded by local commercial banks, which have realized that these institutions are properly managed and represent highly profitable, low-risk investments.

The other microcredit associations are smaller and very different not only from the majors but also from one another. Some are focused on serving remote rural areas; others concentrate on serving the poorest of the poor. These smaller organizations have low efficiency ratios, are not financially sustainable and so are donor-dependent for their operations. In order to become sustainable like the other three majors, they would need to merge, gain scale and improve their efficiency ratios.

The recent crisis has hit both the major and minor microcredit associations. Indeed, business growth (since 2001 microcredit associations have seen yearly customer growth of 40%) has not been matched by an increase in organizational ability to follow up their customers' loan repayment performance. As a result, the second most important microcredit association (Zakoura) had to be rescued by merging it with Fondation Banque Populaire. Although it seems that the worst of the crisis has already passed, most microcredit associations will still suffer from high delinquencies in 2010. As a result, in order to strengthen the sector and enforce stricter supervision the Ministry of Finance is considering ways of transforming the microcredit associations into regulated financial institutions.

The credit risk analysis methodologies most commonly used by microcredit associations in Morocco are group-based. In recent years, however, leading microcredit associations have also started to grant individual credits, using individual credit analysis. The law that regulates microcredit associations originally only allowed the financing of commercial activities, but the regulator has now also authorized microcredit associations to grant home loans for improvements in sanitation, water and electricity. As a result, microcredit associations have been able to enlarge their product offering. However, microcredit associations do not yet provide remittances, payments, savings or insurance.

The thin line that separates consumer lending and microcredit in most developing nations does not apply to Morocco. Because of price caps, neither commercial banks nor finance companies can compete with microcredit associations. Consumer finance is therefore offered to totally different customers, while banks and financial companies cannot profitably serve the customers of microcredit associations. This is one of the reasons why banks such as CPM and Crédit Agricole have created microcredit associations: to be able to serve these customers without being limited by price capping regulation. In addition, these institutions plan to serve these customers throughout the cycle of their expected economic development, migrating them to the parent institution when the time comes.

The strengthening of the relationship between microcredit associations and banks is one of the sector's main development opportunities. The Fédération Nationale des Associations de Microcrédit (FNAM) was originally created under the microcredit associations law in order to strengthen these alliances and promote synergies between banks and microcredit associations. This law forces all registered microcredit associations to be part of FNAM.

FNAM should represent all microcredit associations when dealing with government institutions and supervisory entities. In theory, its main goal is to support the sector by bargaining collectively for resources and developing an internal code of conduct that defines clear operating standards for the sector. This type of representative federation exists also in the banking and financial industry, where there are several different associations, likewise with forced membership for banks and financial companies.

In the case of the microfinance sector, however, FNAM has not been very successful in representing the sector. Its short history has been full of internal problems among its members, due to differences between bigger and smaller entities. In spite of the technical assistance provided by international donors such as Planet Finance and USAID (action for strengthening microfinance associations), FNAM has very limited resources for undertaking its responsibilities. Its ability to represent the industry has also been seriously damaged by internal differences among members, especially with the federation's president. However, the current crisis the sector is suffering may enhance FNAM's position in terms of its ability to enforce the supervision of the sector and create economies of scale.

Summarizing, Morocco is a unique case in terms of the development of its microcredit industry. Although, as in neighboring countries, the Postal Service is the leading institution in the collection of microdeposits thanks to its distribution network, the competitive microcredit business model that microcredit associations have developed in Morocco is unparalleled. In Tunisia for example, microcredit is offered almost exclusively by the government-run Banque Tunisienne de la Solidarité. On the other hand, Egypt is the only country in the region where the banking industry has some participation in microfinance, in particular in microcredit.

Despite the current crisis, we believe that microcredit associations are the best practice for the supply of microfinance services, especially microcredit, in the region. The success of their business model is explained not only by their specific value proposition, tailored to the needs of the unbanked, but also to the synergies they have generated with the banking and financial sector. However, the current restrictions on the products they are allowed to offer limit their potential for growth.

## 4.4. The Microfinance System in Tunisia

The microfinance system in Tunisia has developed significantly in recent years, with an estimated 63,736 active borrowers at the end of 2003, placing Tunisia third in number of active borrowers in the Middle East and North Africa region.[20] Approximately 84% of these customers were customers of the microlending program of Banque Tunisienne de Solidarité (BTS), the government-owned entity responsible for managing the state-subsidized microfinance program. The rest were customers of the microfinance NGO ENDA Inter-Arabe.

There are no banks engaged in microlending, due to interest rate caps of 5% imposed on such activities. These caps are the greatest problem for the development of sustainable microfinance in Tunisia. Therefore, despite the liberalization of the financial and banking sector, the microfinance system suffers from strict, suffocating regulation that prevents its development.

### *Banque Tunisienne de Solidarité (BTS)*

Under the 1999 Microcredit Law, BTS oversees the Tunisian microfinance sector. Approximately 200 associations currently hold permits from the Ministry of Finance to operate as microlenders in Tunisia under the BTS microlending program. Under the Microcredit Law these association receive interest-free loan capital from the BTS, which must be onlent at a rate not exceeding 5% per annum.[21] To continue participating in the program they must maintain a principal repayment record of 80% of the funds borrowed from the BTS. However, the lack of data on the management of this program prevents efficient monitoring of either the associations' payments to BTS or end customers' payments to the associations.

Under the Microcredit Law all the recipients of BTS funds must be registered as associations in accordance with the 1959 Law on Associations. However, they do not need to form a separate association dedicated exclusively to microlending in order to operate in the BTS-funded

[20] UNCDF, 2004.
[21] Including all types of fees.

microlending program. As a result, the institutions participating in this program are very heterogeneous and very often lack the technical expertise to carry out the activity efficiently. They have neither in-house training programs for their employees nor access to BTS-financed training programs.

Furthermore, due to the 5% interest cap for microfinance services and the estimated high rate of default, income does not cover the management costs of the microloans. The associations therefore rely on highly motivated but not always professionally qualified volunteers. Another option used by the Tunisian associations is to subsidize their microlending activity by attracting foreign donations or carrying out other activities. The unsustainability of the model also makes it impossible for the associations to obtain funding from organizations other than BTS,[22] which prevents them from developing.

Another requirement of the BTS lending program is that no participating association may have more than 4,000 active customers. This limitation makes it impossible to achieve internal economies of scale within the microfinance institutions operating under this program. BTS also directly manages, through its own branch network, a lending program to young graduates for business start-ups. This program has an estimated default rate of more than 40%. Furthermore, the loans are in larger amounts than those offered by the microfinance associations, up to US$ 7,000 for undergraduates or US$ 36,000 for graduates.

Most BTS lending is government funded. BTS started its operations with initial capitalization of US$ 22 million, most of it rolled over from the Fonds de Solidarité National (National Solidarity Fund), or Fund 2626. This fund was created as a national development fund, financed in part by contributions made by Tunisian businesses and individuals during an annual "national solidarity day" held every December 8. At the end of 1999 the Tunisian government created the National Employment Fund, which partly funds the program managed by BTS. Lastly, BTS also receives revenues from excise taxes such as the cigarette tax and exit taxes paid by Tunisians and foreign residents every time they leave the country. From all these sources combined, BTS receives approximately US$ 59 million per year.

Additional funding has come from the public sale of its shares and debentures on the capital markets. To complement the funding of its program BTS sold 46% of its shares to the public, although the state continues to hold a controlling 54% stake. The sale of shares was complemented by a US$ 11 million bond issue. In both cases investor motivation was not speculative, as neither the shares nor the bonds offer competitive returns.

Third, the BTS program has also received approximately US$ 40 million from international development agencies, including Japan, the Islamic Development Bank and the Kuwait Fund. However, as donor organizations have started to pay more attention to the sustainability of microcredit programs, BTS is having difficulty raising new funds internationally. To make up for this lack of funding BTS has started marketing savings products to the general public through its 25 retail branches. This new funding strategy will force it to lend its funds using different methods from those it uses at present, which may lead to a change in the conception of the program and of the institution itself.

[22] They are, however, legally authorized to receive bank loans, multilateral development funds and funds from bilateral development aid agencies.

The associations that participate in the BTS program, like the commercial banks and other credit institutions, are obliged by law to contribute to the National Guarantee Fund. The National Guarantee Fund guarantees 90% of the principal of the loans granted by the associations. BTS is responsible for paying the premiums to the National Guarantee Fund and so collects a 4% fee from the associations on the funding granted. If a borrower defaults, an association may call on the National Guarantee Fund to cover the loss, provided the association can demonstrate that it used all the means at its disposal to recover the loan.

# 5. Conclusions

The development of microfinance in the four countries of the Maghreb we have studied shows four different models of microcredit supply in countries with similar microfinancial contexts. However, all four countries have postal systems with extensive networks, which act as their countries' biggest microdeposit-taking institutions. It could therefore be argued that the four countries have a common microdeposit supply model but different microcredit supply models.

The postal service is the main supplier of microdeposits and remittances in all four countries. Optimizing the postal service distribution network should be a priority public policy objective in all the countries of the Maghreb. This should include the distribution of microcredits, whether through direct lending or through distribution agreements with third parties. The expansion of the postal service product offering could therefore be the catalyst for the financial deepening that these countries need in order to achieve equitable economic development.

## Microfinance service supply model by country

| | **Loans** | **Deposits** | **Ownership** |
|---|---|---|---|
| **ALGERIA** | Banque Postal (currently being established) | Postal Service | Public |
| **TUNISIA** | BTS | Postal Service | Public |
| **MOROCCO** | Microcredit associations | Postal Service | Private and Public |
| **EGYPT** | Banks and NGOs | Postal Service and Banks | Private and Public |

Of the microcredit supply models we have analyzed, Morocco's microcredit associations represent a best practice. Their success is attributable not only to specialization but also to synergies with the regulated financial sector. However, the prohibition on deposit-taking reduces their impact on financial deepening in Morocco and makes it difficult for them to operate.

A field study carried out in Morocco in collaboration with Morocco's leading microcredit association, Al Amana,[23] shows that the use of electronic payment systems could solve this problem. The business case analyzed shows that distributing microdeposits and microloans through electronic payment systems could improve the efficiency of microfinance associations

[23] This research was carried out with the help of Fouad Abdelmoumni, Director of Al Amana. The research in Morocco also included interviews with the Director of Morocco's second largest microcredit association (Zakoura) and senior officers of the Central Bank of Morocco and the Ministry of Finance.

and so help them bring the unbanked population into stable banking relationships. The use of electronic payment systems has benefits for the distributing microfinance institutions and for the banks that ensure their success and sustainability.

The collaboration this would involve between issuers of electronic payment instruments (banks, finance companies or even the postal service) and microcredit associations would be beneficial to both sides. For a bank, partnering with a microcredit association would be a means of gaining remittance business by effectively extending the distribution network. This enhanced capacity to handle immigrants' remittances would be particularly important for banks that have only a small share of cash transactions but a large share of credit transfers. Second, the banking partner in any such alliance would be able to acquire customers who currently are served only by microcredit associations but who, in time and given economic development, have the potential to become customers of the traditional banking system. Lastly, banks would benefit from cross-selling products that microcredit associations themselves cannot legally sell, under co-branding arrangements.

## Estimated income statement for the distribution of electronic payment instruments with microdeposit and microloan functionality by Al Amana to its customers

| **Income** | |
|---|---|
| Average microloans outstanding | 6,286,835 |
| Cash balance held on deposit | 10,607,532 |
| Banking of remittances | 2,383,715 |
| **Total Income** | **19,278,083** |
| **Costs** | |
| Central costs | 600,000 |
| Cash management costs | 900,000 |
| Cash transport | 100,000 |
| Card issuance | 7,062,860 |
| **Total Costs** | **8,662,860** |
| **Result** | **10,615,223** |

For a microcredit association (in this case Al Amana) the first benefit of partnering with a bank or finance company would be the increase in the range of products it can offer, as by law such associations can only offer microloans to micro-businesses and households. Second, it would lay the foundations for the creation of a central credit database that would help tackle the problems of cross-borrowing and a possible increase in default. Third, it would increase banking penetration and so contribute to the country's economic development. Fourth, it would encourage the use of bank remittance providers, which have significantly lower fees than non-bank providers, thus increasing the flow of remittances into the country and thus also the use of banks by the population. Lastly, microcredit associations would be able to provide better service and added value to their customers at no extra cost, thus reinforcing the relationship.

The development of microcredit associations in Morocco should be a model for the other countries of the Maghreb. In Algeria, where there are no microcredit associations, the government's Banque Postal project should be accompanied by efforts to develop such associations. In Tunisia, where the BTS-run microcredit system is constrained by an unsustainable model of government subsidization, notice should be taken of the Moroccan example, which shows the results that can be achieved by allowing free market distribution of microloans. Lastly, in Egypt, the business model of the microcredit associations should be imitated not only by specialized microfinance institutions such as the National Bank for Development but also by the leading banks, which are planning to create specific units to serve the lowest-income segments of society.

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