

CASE STUDY: Improving corporate governance

Vision Fund Caucasus

The key to efficient microfinance: the art of management professionalism

**Author: Durdona Kadirova
April 2011**

Introduction

World Vision International (WVI) has been active in the Caucasus region in organizing a network of microfinance institutions (MFIs) for more than 10 years. There are three leading WVI MFIs in the region, namely SEF International in Armenia, AzerCredit in Azerbaijan and MFO Credo LLC in Georgia. As of the writing of this report, all three MFIs have become self-sustainable. Starting in 2007, Triple Jump Advisory Services has been working in close cooperation with WVI by providing technical assistance to subsidiaries of WVI on different operational aspects affecting MFIs. The most recent advisory services project in the Caucasus, and the subject of this case study, focused on improving corporate governance structure, as well as its legal status, the development of Supervisory Board and Management Board functions and strategy and business plan development. These services provided by Triple Jump Advisory Services for the three WVI MFIs to improve corporate governance took place between 2009 and 2010.

Background information

SEF International operates in the Republic of Armenia. It was established by WVI in 1997. In late 2008 a new CEO was hired to lead the company in the next stage of growth. In addition, a Management Board was created within SEF's organizational structure.

During this period of transition, the Supervisory Board and Management Board of SEF experienced the need for outside advisory services and technical assistance to ensure that its management bodies would continue to manage the MFI's operations well, with an appropriate management style. TJAS, being a long term partner of WVI, proposed its services to SEF, and the governance project was carried out between 2009 and 2010.

AzerCredit is one of the leading MFIs of the Republic of Azerbaijan. It was initially established in 1996 as AzEF (Azerbaijan Enterprise Fund). Later, in 2002 it was renamed AzerCredit LLC and obtained a license from the Central Bank of Azerbaijan. In February 2009 a new Regional CEO was appointed both for AzerCredit and for Credo LLC. Prior to this, she had been working as the CFO in another WVI affiliate in another country. Because her appointment as Regional CEO of AzerCredit and Credo LLC was a new experience for her, she needed mentoring and guidance. In addition, as a result of the world financial crisis, the MFI had adopted very cautious and conservative operational policies. There was a need to improve corporate governance procedures and to strengthen the role of the Supervisory Board. It was also necessary for the management of AzerCredit to develop a new strategic development plan.

Credo LLC operates in the Republic of Georgia. It was established by WVI in 1997 initially as Georgian Entrepreneurs Fund (GEF). In 2005 GEF obtained local accreditation and was renamed MFO Credo LLC. In 2009, despite the instability in the country following the Georgia-Russia conflict, the management of Credo was able to take the necessary steps to avoid the negative effects of a weak economy, and even managed to increase the portfolio through the introduction of a new Rural Loan Product. In that year, Credo became the leading MFI among providers of agricultural

lending facilities with 18 percent of market share. In order to continue its steady development, Credo needed strong corporate governance policies and procedures, as well as improvement of management working style.

Approach Overview

After thorough analysis of the situation of the three MFIs by the regional TJAS senior advisor, TJAS placed a consultant with twenty years of experience in executive management in leading banks, extensive practice in executive business coaching in the financial sector and familiarity with the region to carry out the technical assistance.

The governance project covered the following basic tasks for all three MFIs:

- i) Assist in developing the list of competencies needed for the management team members.
- ii) Assist in making the management teams more professional, including working method, set-up, roles, scope and focus.
- iii) Assist in developing proper communication of the strategy and business plan to relevant interested parties and stakeholders.
- iv) Support increase of professionalism of the Supervisory Boards and their members, including their working method, set-up, scope, focus and strategy.

In the course of the TA process, the consultant identified the problems and weak points in the activity of the Supervisory Boards and Management Boards of the MFIs. In order to resolve the problems revealed, the consultant recommended an interactive team-building workshop for all management personnel of the three MFIs, which was then held in Bakuriani, Georgia. During the workshop Board members from SEF, Credo and AzerCredit exchanged views on their relevant activities and operations. According to the Board members, this lively exchange gave them a feeling of self-confidence in their role and helped them to understand their importance to the MFI. Several sessions took place on the following topics:

1. Improving the functioning of the Supervisory Board, including the main roles and responsibilities of the board members, frequency of the meetings, board minutes and Supervisory Board guidelines.
2. Improving how the MFI management presents its annual or quarterly performance to the Supervisory Board members. The presentation format consists of the achievements, statistical data, SWOT analysis, as well as outstanding issues.
3. Improving management style, from an authoritarian, top-down way of managing to a collective and collaborative one, in a way that any employee is comfortable in approaching his/her line manager without any barriers or obstacles.

In addition, the consultant, on his visits to each MFI, mentored the CEOs in their efforts to improve and change the management style from the authoritarian one used by previous CEOs to a more collective and collaborative style. The consultant was also actively involved in drafting the strategy and business plan for each MFI for the period of 2010-2012, guiding the institutions to make them more detailed and customized documents, showing clearly the direction of the institution, specific targets and ways to achieve them.

The statistics below indicate the positive effect of the technical assistance provided by TJAS on the results of the three MFIs.

	in USD		SEF INTERNATIONAL UCO		AZERCREDIT LLC		CREDO LLC	
	2009	2010	2009	2010	2009	2010	2009	2010
Outreach								
Nbr. of branches	7	9	6	7	14	16		
Nbr. of staff	64	83	209	277	267	362		
Nbr. of staff in credit and front office operations	23	33	94	129	125	189		
Nbr. of active borrowers	4 501	8 219	32 207	35 880	22 892	43 172		
<i>Male</i>	2 341	4 141	18 358	21 232	14 255	25 147		
<i>Female</i>	2 160	4 078	13 849	14 648	8 637	18 025		
Nbr. of active clients	4 501	8 219	32 207	35 880	22 892	43 172		
<i>Male</i>	2 341	4 141	18 358	21 232	14 255	25 147		
<i>Female</i>	2 160	4 078	13 849	14 648	8 637	18 025		
Nbr. of loans disbursed during period	4 501	11 198	34 961	41 024	28 763	54 140		
Value of loans disbursed during period	6 788 106	9 114 802	34 763 471	46 321 150	28 928 767	46 848 753		
Value of Write-Offs during period	197 028	240 930	0	37 544	1 079 150	172 992		
Variations to previous year								
LOAN PORTFOLIO								
Gross loan portfolio (segmentation)								
% for agricultural activities	31%	21%	48%	51%	48%	59%		
% for production/craft activities	7%	4%	3%	2%	3%	2%		
% for services/trade activities	36%	31%	48%	45%	42%	28%		
% for consumption & others	26%	44%	1%	2%	7%	11%		
in Net Portfolio	-14,67%	35,98%	18,74%	33,34%	-22,17%	68,48%		
in Nbr. of Staff	14,29%	29,69%	20,11%	32,54%	9,88%	35,58%		
in Nbr. of Clients	-1,21%	82,60%	49,74%	11,40%	4,74%	88,59%		
Portfolio Quality								
Rescheduled (no current arrears)	0,64%	0,34%	N/A	N/A	1,62%	0,37%		
Total > 1 day (PAR1-rescheduled)	5,88%	3,84%	0,55%	0,39%	1,02%	0,02%		
Total > 30 days (PAR30-rescheduled)	5,21%	2,86%	0,36%	0,29%	0,92%	0,02%		
Total > 30 days + rescheduled (PAR30)	5,85%	3,21%	0,36%	0,29%	2,53%	0,40%		
Financial Structure								
Earning capacity of assets								
Gross Loan Portfolio / Total Assets	63,15%	84,21%	82,06%	88,72%	78,40%	74,86%		
Non-earning assets / Total Assets	21,54%	10,33%	10,12%	6,55%	9,97%	6,68%		
Efficiency & Productivity								
Portfolio Yield	24,95%	24,97%	43,25%	40,58%	38,89%	44,41%		
Operating expense ratio	15,17%	17,75%	28,35%	27,10%	23,35%	25,39%		
Portfolio Rotation	110%	138%	169%	168%	138%	181%		
Average disbursed loan size	1 508	814	995	1 129	1 006	863		
Cost per loan	196	173	151	156	258	163		
Number of loans per loan officer	203	269	343	278	183	228		
Number of loans per staff member	73	107	154	130	86	119		
Credit staff as % of staff	36%	40%	45%	47%	47%	52%		
Sustainability								
Return on Equity (ROE)	-9,73%	0,42%	20,38%	12,77%	21,83%	48,65%		
Return on Equity (ROE) excluding donations	-26,60%	-0,35%	20,06%	12,77%	21,83%	43,49%		
Return on Assets (ROA)	-2,06%	0,10%	3,33%	1,99%	3,12%	7,82%		
Return on Assets (ROA) excluding donations	-5,63%	-0,09%	3,28%	1,99%	3,12%	6,99%		
Operational self-sufficiency (OSS)	90,89%	97,58%	109,85%	104,49%	111%	128%		
Profitability Analysis								
Net Margin	-10,90%	0,52%	9,12%	4,30%	10,07%	21,89%		
Interest Margin	12,65%	15,99%	32,11%	30,02%	30,13%	33,62%		
Operating Margin	-27,26%	-2,26%	12,04%	9,36%	11,85%	25,48%		
Net Financial Margin	22,79%	53,87%	77,10%	59,61%	67,38%	80,62%		

Despite the conservative credit policy the MFIs adopted as a result of the financial crisis, all three managed to increase both their portfolios and number of active clients by the end of 2010, as follows: (i) SEF International – portfolio increased by 35.98%, number of active clients increased by 82.60% ; (ii) AzerCredit – portfolio increased by 33.34%, number of active clients increased by 11.40%; (iii) Credo LLC – portfolio increased by 68.48%, number of active clients increased by 88.59%. As a result of portfolio and client growth, all three MFIs significantly increased the number of staff members.

Thanks to the restructuring of the loan committees and revised staff incentive schemes, the growth in portfolio volume was also accompanied by lower PAR rates. Each MFI reduced its average disbursed loan size and learned to concentrate on its core business, giving significant emphasis to its social

mission in the region. As indicated by the sustainability indicators above, refocusing on their social mission did not compromise the MFIs' economic profitability since two of the three improved their financial performance.

In the opinion of the management of the MFIs, all positive development trends shown in the above table for almost all aspects was achieved to a certain degree thanks to the Technical Assistance provided by TJAS.

Status Report

Technical Assistance was welcomed by the management of all three MFIs, as they were eager to learn and get knowledge, in order to improve corporate governance procedures within their respective organizations. Ms. Ljiljana Spasojevich, CEO responsible for Credo and AzerCredit, noted that as a result of the TA provided by TJAS, the MFIs received very useful and practical knowledge on how a Supervisory Board can be a powerful and effective body. The Regional CEO was happy to see the members of Supervisory Boards act with an increased sense of responsibility and prepare themselves for the Board meetings in a comprehensive and serious way.

The project had a positive impact on the activity of SEF, Credo and AzerCredit in many ways, specifically in improving the role of the Supervisory Board and Management Board, which, in turn, had a positive influence on the performance of the middle management staff. After completion of the TA, every organization started to hold Supervisory Board and/or Management Board meetings on a regular basis, which had not been done before the implementation of the TJAS assignment. The MFIs also created separate committees for dealing with specific tasks and issues (e.g. problem loans committee, asset and liabilities management committee, recruitment committee, etc.) – which helped the MFIs increase their portfolios significantly while lowering their PAR at the same time, despite the difficult economic climate. Significant emphasis was given to the HR management function of the MFIs, to make sure that the quality of both existing as well as newly hired personnel was high; also incentive schemes were revised so that field staff was rewarded for increasing their loan numbers while maintaining high repayment rates. The following table shows the details of changes and improvements in various areas, as a result of the project with TJAS:

Before	After
Supervisory Board (SB)	
<ol style="list-style-type: none"> 1. This body within the company's structure had not played any significant role 2. SB members were not aware of the microfinance sector. 3. Meetings of SB were not held on a regular basis because its members underestimated their importance. 4. Discussions during the meetings were general, without indicating any specific responsible person to follow up on specific issues and without indication of the deadlines for implementation of relevant resolutions. 	<ol style="list-style-type: none"> 1. Every member of SB has realized the importance of being present in the meeting of SB and in overall results of performance of MFI. 2. Half of the SB members were newly elected, based on their skills and experience in microfinance sector. 3. Meetings started being held on a regular basis. 4. Matters discussed during the meetings of the SB are now being recorded in the minutes and implementation of resolutions and recommendations of SB are followed up by relevant officers in charge within specified time periods
Management Board (MB)	
<ol style="list-style-type: none"> 1. MB did not exist as a governing body. 2. Decision making in Credo and AzerCredit was done on a unilateral basis by CEO. 	<ol style="list-style-type: none"> 1. The Executive Management Team (EMT) was created in Credo and AzerCredit, consisting of the CEO, COO and CFO. 2. The Senior Management Team (SMT) was created, including up to seven members (executive management plus HR Manager, Audit Manager, Financial Risk Manager, Product Development Manager, etc.) 3. EMT and SMT meetings started to be held on a regular basis. 4. All operational and/or strategic matters are discussed in detail by relevant teams and decisions are taken

Before	After
	collectively. Each team member started thinking in a more creative and problem solving way.
Committees	
<ol style="list-style-type: none"> 1. Credit Committee was acting relatively slowly and in a bureaucratic manner in Credo and AzerCredit. 2. MFIs (Azercedit and Credo) did not have Audit Committees (AC), Problem Loans Management Committees (PLMC) and Asset and Liabilities Management Committees (ALCO) in their structure. 	<ol style="list-style-type: none"> 1. Credit Committee was divided into several decision-making levels. Each level of CC has its own members and approval authority limit, which increases the efficiency and speed of the loan review. 2. Audit Committee (AC) was created with the main task of implementing internal controls. 3. Problem Loans Management Committee (PLMC) was created to deal with each problematic loan case, in order to follow up with such loans immediately and effectively. 4. Asset and Liabilities Management Committee (ALCO) was established for better sourcing and use of the company's funds, as well as proper liquidity and foreign exchange risk management.
HR Management	
<ol style="list-style-type: none"> 1. No HR department and no extensive HR policy existed. MFIs (Credo and AzerCredit) had only the HR Manager in their structure. 2. Recruitment was done informally without relevant procedures and checks in place. 	<ol style="list-style-type: none"> 1. HR department was created. Relevant policies and procedures were developed and started being implemented. 2. Recruitment Committee was created. Recruitment process became structured and standardized. 3. Promotion Policy was created, which gave the employees a clear picture and guidelines on performance requirements to receive promotions.

Before	After
	<ol style="list-style-type: none"> 4. Performance appraisal policy and procedures were modified in such a way as to clearly state rewards and penalties, depending on the annual performance results of each employee. 5. Incentive/Bonus system was improved based on the strategy development of MFIs with introduction of social benefits for employees (insurance, sport activities, etc.). 6. Team building retreats began to be held among staff members of the MFIs, making it possible for any employee to meet with a direct supervisor or executive manager to discuss clearly and transparently any job-related matter.
Policy and Procedures	
<ol style="list-style-type: none"> 1. Strategic plan and Business plan were relatively general documents, without specific details, statistics, financial projections and assumptions. 2. Targets were not set. 	<ol style="list-style-type: none"> 1. Strategic plan and Business plan were reviewed to include specifics, including a number of assumptions and financial projections, with individual targets for every branch and product. This led to an improvement of the day-to-day activities and performance of the MFIs and their branches. Branch managers use the Strategic plan and Business plan as a guideline and to keep an eye on statistical data regarding performance of their respective branches. 2. Based on Business plan projections, the management of MFIs set a target for every branch, on the level of loan officer, team, currency and product to be achieved. Such targets have made the personnel of the MFIs more responsible for their work, because depending on results (reaching the targets or not), respective incentives

Before	After
	<p>or penalties are applied. This practice has also resulted in an improved team spirit, as each member of the team now understands the significance of his/her contribution to the MFI's success.</p> <p>3. The position of Product development and Marketing manager was created, whose job it is to conduct market research on demand for specific products. Depending on the research results, the manager makes recommendations for improvement and/or amendment in product promotion strategy (e.g. recently the manager recommended application of more flexible approach to consideration of collateral).</p>

Goals achieved:

- a) The TA from TJAS was delivered in logical sequence to accompany and complement the significant change process within the top management of all participating MFIs. As a result, a synergy effect has been achieved by each party; TJAS reached its goal of improving the Corporate Governance procedures of the MFIs; MFIs obtained knowledge of best practices in corporate governance and strengthened their relevant internal policies and corporate bodies. It should be noted here that TJAS's diagnostic of needing to strengthen corporate governance in each MFI and the subsequent technical assistance project occurred at just the right time for the institutions. e.g. projects has started only after new management has been selected.
- b) The MFIs created Supervisory Boards whose members have relevant microfinance experience and equipped them with all necessary guidelines;
- c) MFIs also created a real management team and changed the decision-making process from "authoritarian" style to "collective" style;
- d) Important committees were created for dealing with specific areas of activity of the MFIs (audit committee, ALCO, PLMC, recruitment committee);
- e) Structural changes were made for the improvement of overall efficiency in the operations of the MFIs;
- f) Main internal policies and documents were amended and/or created for better risk management and internal control, which, in the future, will allow the MFIs to keep their leading position on the market.

Conclusion

Not only did the three institutions make significant and effective changes to their corporate governance during the life of the technical assistance project with TJAS, but once the TA finished, the consultant is continuing to help them to implement these changes by having been elected as independent director on each of the three Supervisory Boards. Thus, by his continued involvement, and with the changes that have already taken place, it is highly likely that the level of corporate governance and management style at SEF, Credo and AzerCredit will continue its positive development trend. It also indicates that all MFIs appreciate the role of an experienced Supervisory Board.

By improving HR practices, the MFIs have started giving more attention to their staff members on their performance and satisfaction. There have created specific positions like Product Development Manager, Assistant Risk Manager, and Marketing Manager, which shows that the MFIs are serious about strengthening their position in their respective markets. The CEO of SEF International, Mr. Garegin Gevorgian, noted that their new strategy for FY2010-2014 was developed with assistance of the consultant and that SEF will proceed further in achievement of their goals.

Overall, the following factors contributed to the success of the corporate governance project:

- The appropriate initial needs assessment completed by TJAS.
- The consultant's competence and commitment, which was proved by his voluntary participation as one of the Board members to continue with development of the activity of Supervisory Board;
- The commitment from the top management of the institutions;
- The methodology used for TJAS' TA: coaching, practical workshops and the sequencing all played an important role in the success of the project.