Assessment of Credit Activities by Partners for Development in Bosnia & Herzegovina

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List of Acronyms

AMFO	Association of Microfinance Organizations
BiH	Bosnia and Herzegovina
FDI	Foreign Direct Investment
FIPA	Foreign Investment Promotion agency
GDP	Gross Domestic Product
IFA	Independent Farmers Association
MFI	Microfinance Institution
PFD	Partners for Development
REZ	Regional Development Agency
SME	Small and Medium Enterprises
SVO	State Veterinary Office
USAID	United States Agency for International Development
USDA	United States Department of Agriculture
VAP	Vrbas Agricultural Program

1. **Background**

Before its independence in 1992, Bosnia and Herzegovina (BiH) was one of the poorest of the six republics that made up the former Yugoslavia, despite a large number of industries, including the Yugoslavia defense plants that employed a large proportion of the population. During Bosnia's nearly four year civil war from early 1992 to late 1995, there was wanton damage and destruction to much of the economy and infrastructure, death of about 100,000 people, and displacement of about two million people, representing almost half of the population. BiH now remains one of the poorest countries in Europe with GDP per capita (2007 estimates) of $7,074 compared to central and eastern Europe's average of $14,691 or Euro area average of $32, 903 in 2008[1]. For the most part, agriculture remains in private hands, but farms have been small and inefficient, and net food imports increased dramatically in the aftermath of war.

Considerable progress has been made since peace was reestablished following the Dayton Peace Accords of late 1995. BiH is still regarded as a transition economy, and official unemployment in BiH is approximately 40% (though actual unemployment may be closer to 25-30% given jobs in the informal or "gray" sector). Much reconstruction has been achieved through meaningful progress in structural reforms to strengthen the basis for sustained, private sector-led growth - especially small and medium enterprises (SMEs) and foreign direct investment (FDI) acceleration that has spurred economic growth and job creation[2] Over 5.5 billion Euros (about $7-7.67 billion) of FDI was invested in BiH from 1994 to 2008.

Table 1: Foreign Direct investment in BiH by sector (1994-2008)

Sector	Percent FDI 2008
Manufacturing	48.8
Trade	24.3
Services	12.3
Banking	6.7
Transport	4.0
Tourism	2.1
Real estate	1.4
Telecommunication	0.3
Other financial services	0.1

Source: Central Bank of BiH, FIPA

In the immediate post-war reconstruction phase, the BiH government identified the agricultural sector as a priority to spur development activities (in part because so much of the manufacturing sector had been damaged or destroyed during the war). PFD began operating in BiH in April 1993, with much of it work during the war focused on distribution of seeds so that families could grow food, and also on repair of damaged schools and clinics. Geographically, most of PFD's work was in central BiH where fighting amongst all three main ethnic groups had been intense.

[1] Source: International Monetary Fund, World Economic Outlook Database, October 2008 edition.
[2] Source: Bureau of Public Affairs: Electronic information service, January 2009.

Beginning in the later 1990s, and mainly through support from the U.S. Department of Agriculture (USDA), PFD initiated a more integrated agricultural program to build local capacities and improve household livelihoods. These activities have included policy strengthening and technical assistance to the State Veterinary Office (SVO, within the Ministry of Foreign Trade & Economic Relations) on border veterinary control and access to credit, quality inputs and markets to crop and livestock farmers.

2. **Assessment Objectives and Methodology**

This report specifically highlights the outcome of an assessment of the PFD Credit Program conducted in April 2009.

2.1. Assessment Objectives: The main objectives of the assessment were to:

i. determine the impact of PFD credit program in Upper Vrbas region of central BiH
ii. distill lessons learned from this program that will be useful for the improvement of new and ongoing PFD credit activities
iii. share findings and recommendations with local partners in BiH to improve ongoing credit implementation

2.2. Assessment Methodology: Both qualitative and quantitative methods of information gathering were used, viz;

i. Quantitative information was collected from records and documents provided by PFD and Independent Farmers Association (IFA), a local organization supported by PFD (see Section 3.2); as well as 100 questionnaires administered to farmers in the region.
ii. Qualitative information was gathered through observation and enquiries, using semi-structured interpersonal interviews

PFD personnel developed the assessment questionnaire in-house and contracted IFA to conduct the interviews. Field test of the questionnaire conducted by two IFA personnel in 2-3 days and this provided input for reviewing and finalizing the questionnaire. Two IFA interviewers gathered information for the assessment by interviewing 100 randomly selected farmers that received loans from the program. Data collected were entered into excel spreadsheet by IFA personnel using a pre-determined coding system in preparation for analysis. Basis analysis of these data, using percentages, averages and simple comparisons, provided additional statistics for writing this report.

3. Description of the Credit Program

3.1. Goal and Objectives

The goal of PFD's credit program is to ensure access to resources, including credit and quality inputs, to farmers in Upper Vrbas Region of Bosnia and Herzegovina. This, PFD envisions, will: (a) enable farmers to increase production and productivity of their agricultural activities (crop and/or livestock production); (b) increase employment; and (c) increase household income. The credit program is implemented across six municipalities of the Upper Vrbas Region – Bugojno;

Donji Vakuf; Gornji Vakuf-Uskoplje; Jajce; Slpovo; and Mrkonjic grad – through four microfinance institutions.

PFD's credit intermediary partners receive financial resources from PFD as loans, at annual interest of 3- 5%. PFD is able to offer its credit partners this low interest rate because administrative costs for the program are covered by a grant from USDA. The four credit partners on-lend the funds from PFD to individual farmers. Partners typically require some form of collateral and guarantee from farmers before they can access loans, and set loan terms within the parameters listed below:

- Loans to farmers range from 1,000KM to 30,000KM (approximately $700 to $20,000) depending on client's need and type of agricultural enterprise.
- Loan duration ranges from 12 to 60 months which is characteristic of agricultural loans. Most agricultural enterprises, like livestock production or growing of fruit trees requires longer gestation period, while vegetable production, for example, will turn over a complete cycle in as short a time as 12 months.
- Intermediary partners charge borrowers interest rates ranging from 15-18% annually.
- Grace period of up to 24 months, depending on loan duration, may also be given on principal repayment only. Beneficiaries pay interest on their loans during the grace period.
- Borrowers do not receive any form of pre-loan training and are not required to make pre-loan savings also. In fact, until late 2007, MFIs in BiH (and most states of the Balkans) were not allowed to receive deposits from their clients.

Other activities of the credit program include:

1. Organization of Farmers Association: the credit program supported the establishment and development of the Independent Farmers Association (IFA) of the Upper Vrbas Region through which PFD has strengthened local and private agricultural operations. The role of IFA is to organize individual farmers into a membership group or cooperative that enables them to achieve economies of scale in accessing credit; purchase of agricultural inputs and farm implements as well as in the sales of their produce. IFA also serves as liaison between farmers and local authorities in addition to providing technical assistance to farmers.

2. Ensuring Access to Markets: PFD has been improving access to markets for farmers through organized cultivation and bulk sale of produce such as fruits, berries and medicinal herbs. Through the credit program, PFD pioneered the cultivation of raspberries by local farmers by providing credit, improved seeds and other inputs. In partnership with IFA, it also ensures the availability of ready markets by negotiating with buyers to offer better prices for produce at harvest.

3. Agriculture Sector Coordination and Extension: in collaboration with IFA, Regional Development Agency (REZ), and the respective municipalities, PFD supports agricultural extension services that provide technical assistance to farmers in the areas of cultivation, management and harvesting of raspberry. Most recently PFD, through its credit program, promotes agricultural production and marketing information exchange between farmers, service providers and small and medium scale enterprises.

3.2. Credit Program Partners

PFD has been implementing its credit program through four experienced microfinance institutions namely; LIDER, ProCredit Bank, MIKROFIN and UPI Bank. In 2004 PFD also established and supported IFA to organize farmers into associations/cooperatives so as to achieve better service delivery.

Independent Farmers Association (IFA)

Independent Farmer Association (IFA) is a not-for-profit, non-governmental organization that works in Upper Vrbas Region helping member farmers with technical assistance, consultations and public representations to create better conditions for agricultural development. IFA was formed in 1999 (registered with the government in 2004) with support from PFD. With current membership of about 130 due-paying farmers IFA was established to:

a. assist in developing the agriculture sector of Upper Vrbas region and to partner in development projects financed by PFD
b. organize farmers in the Upper Vrbas region into cooperatives that enables them to achieve economies of scale in accessing credit; purchase of agricultural inputs and farm implements as well as in the sales of their produce
c. develop a database of agricultural potentials to help promote the region's agriculture as well as assist the municipalities in the region development long-term strategic plans
d. provide technical assistance and advisory services to farmers that will help improve productivity and marketing of their produce

In 2004, PFD also supported a partnership between IFA and the Regional Development Agency (REZ) for Central Bosnia and Herzegovina to implement the Vrbas Agriculture Program (VAP). The project focused on strengthening the organizational capacity of the four municipalities of this region through training and technical assistance. PFD employed an executive director for the project and supported two agricultural officers in each municipality. Office equipment and vehicles were also provided as support to each municipality but the project could not be sustained by the municipalities after PFD stopped providing support in 2006.

4. Credit Program Results

Monitoring system: The MFI partners on a monthly basis provide reports on their loan portfolio performance to PFD, monitoring such indicators as number and amount of new loans; distribution of loans according to size and business venture; as well as the portion of the portfolio at risk. While the partners provide PFD will regular financial reporting, including on loan repayments, the reporting does not include means of measuring the partners' degrees of profitability or operational self-sufficiency.

Also, it is only when there are severe defaults cases in repayments that MFI loan officers track borrowers for recollection: borrowers must make repayments at partners' offices as it would be quite expensive for the partners to travel to each borrower to collect repayments.

4.1. Credit Program Outputs: Table 3 below highlights the aggregate output of the credit program of PFD's four MFI partners as at March 31, 2009.

Table 3: Aggregate output of PFD/BiH credit program MFI partners as at March 31, 2009

Outreach Information	LIDER	PROCREDIT	MIKROFIN	UPI BANK	TOTAL (PFD)
Number of partners	1	1	1	1	4
Number of active clients	158	363	455	121	1097
Number of active female borrowers	62	96	109	13	280
Percentage of active female borrowers	39	26	24	11	26
Number of borrowers (cumulative)	262	656	778	289	1985
Number of female borrowers	95	177	189	17	478
Percentage of female borrowers	36	27	24	7	24
PFD Contribution	**(Amount, KM)**	**(Amount, KM)**	**(Amount, KM)**	**(Amount, KM)**	**(Amount KM)**
Loan Fund (cumulative)	876,158	1,955,830	2,080,026	3,169,892	8,081,906
Financial Information	**(Amount, KM)**	**(Amount, KM)**	**(Amount, KM)**	**(Amount, KM)**	**(Amount, KM**
Amount of loans disbursed	651,500	2,035,550	2,948,000	1,503,390	7,138,440
Average loan size	2,487	3,103	3,789	5,202	3,596
Amount of loans outstanding	233,456	662,340	1,342,198	193,695	2,431,689
Amount of loans outstanding in arrears	13,688	13,065	4,823	52,695	84,271
Current/active loan portfolio	247,084	751,678	1,425,598	174,103	2,598,463

Since its inception in 2003, the credit program has achieved the following as at March 31, 2009:

- Over 1,900 borrowers have benefitted from the credit program, 24% of them being female clients
- Current number of active borrowers is over 1,000 (about 26% female)
- PFD has provided 8,081,906KM (over $5.5 million) as loans to the 4 partners
- As of March 2009, PFD loans outstanding with the four MFI partners is 3,569,462KM (approximately $2.46 million) in addition to estimated interest earning of 191,357KM (approximately $132,000), which is approximately 5 percent of the loan amount.
- Aggregate partners' loan outstanding is 2,431,689KM (approximately $1.6 million) as of March 2009; and portfolio at risk averages 3.5%.
- Available data from partner reports show that PFD Bosnia credit program has been able to create over 100 new jobs and sustain over 1200 existing jobs in the agriculture sector since inception

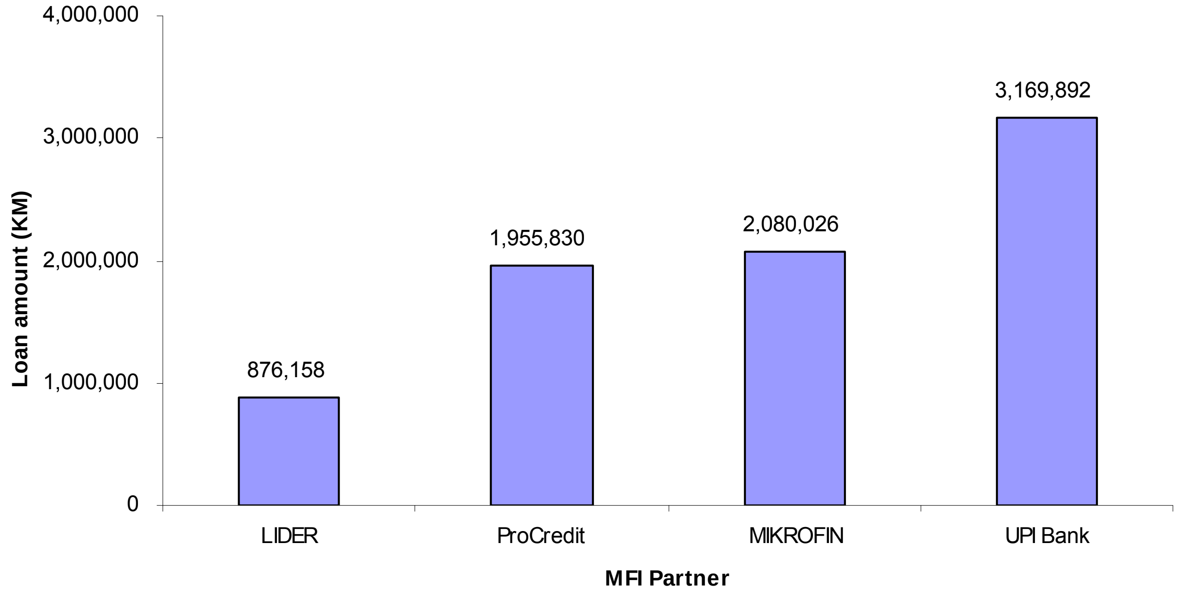

Figure 1: Distribution of PFD loans (KM) to credit partners

4.2. <u>Credit Program Impacts:</u> PFD credit program has contributed to the socio-economic development of the Upper Vrbas region of Bosnia and Herzegovina as can be extrapolated from the outcome of analysis of the assessment conducted on questionnaires administered to 100 farmers, as well as personal visits made to participating organizations and beneficiaries of the credit program.

4.2.1. Outreach: Analysis of data collected from assessment of 100 farmers who are beneficiaries of the credit program shows that 20% of the beneficiaries are females cutting across the three dominant Bosnian ethnic groups (Bosniak; Croat; and Serb). Figure 2 shows the distribution of loans by ethnicity and gender. Nine percent of the loans were to Croats. This may be an indication of the sampling method but this is also a reflection of the actual situation, as most of the Croats that are farmers run larger operations that require more investment than can be provided through PFD's microcredit program.

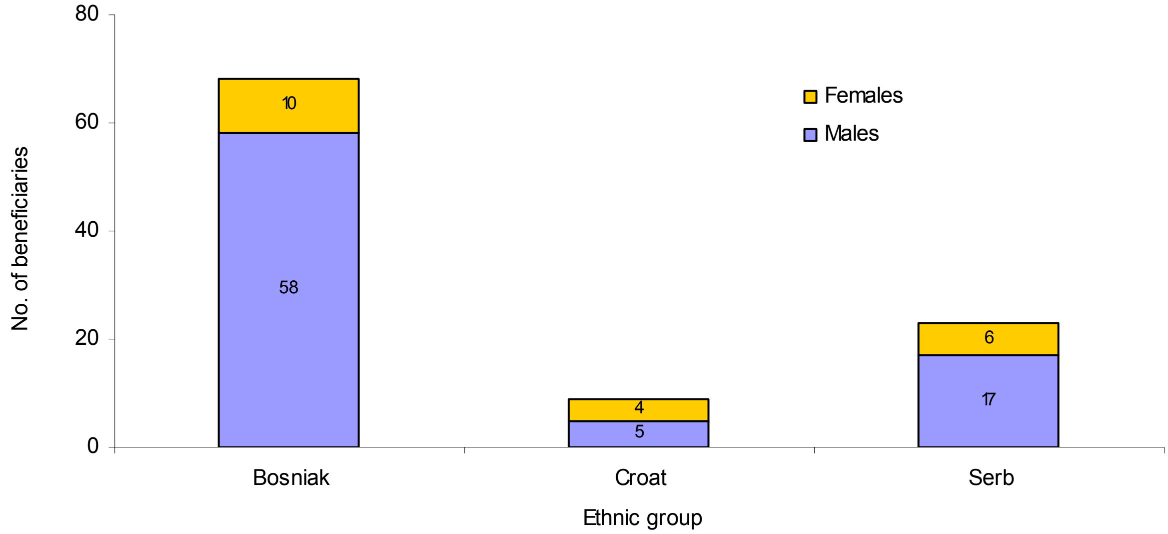

Figure 2: Loan distribution by ethnicity and gender

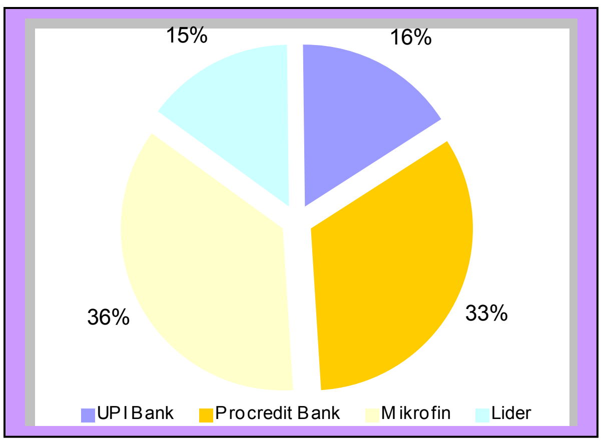

Figure 3 shows loan distribution by partners as revealed in the assessment results. Thirty-six percent of the farmers received loans from Mikrofin, 33% from ProCredit while 16% and 15% of farmers got their loans from UPI bank and Lider respectively.

Figure 4 gives an indication of beneficiary farmers' perception of the quality of partners' service delivery.

Figure 3: Loan distribution by partners

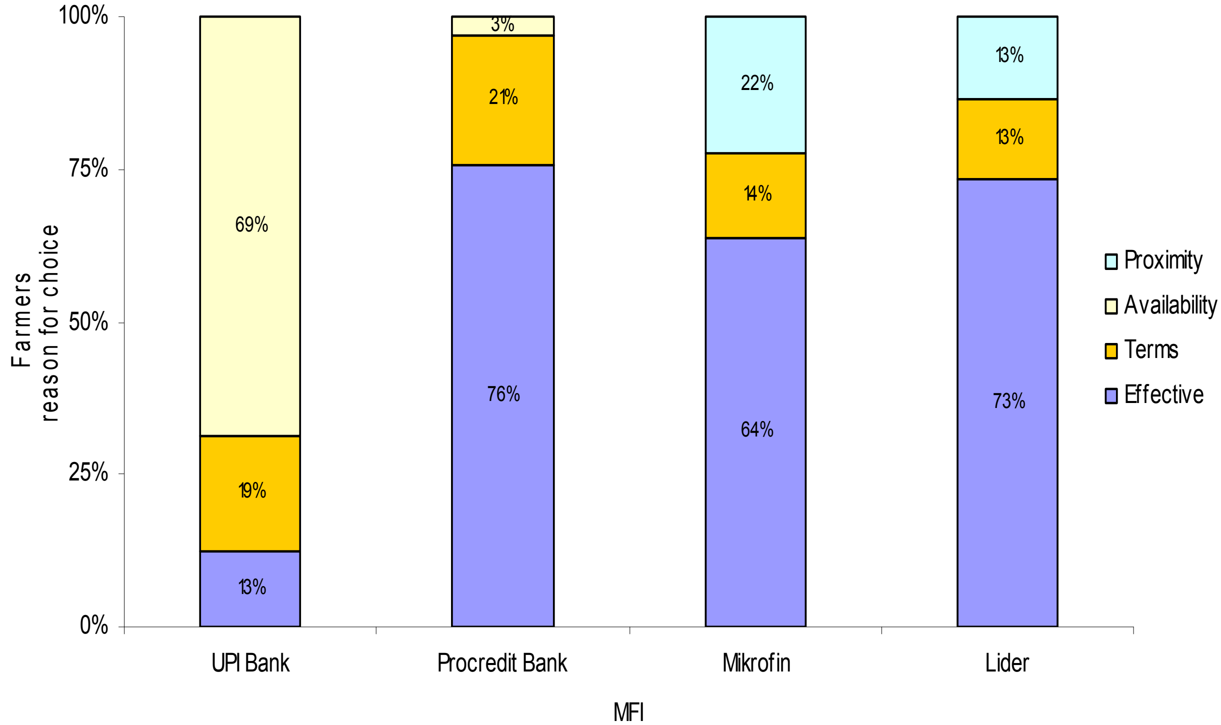

Figure 4: Farmers perception of partners' service delivery

The assessment results shows that majority of farmers learned about the possibility of accessing credit through partners from friends and relatives (48%), while 14% got the information through their interactions with IFA. This is an indication of the effectiveness of information dissemination among peers and the possibility of increasing sensitization on available credit facility spurring farm expansion and subsequently improved livelihoods. Figure 5 shows medium through which farmers received information about availability of credit facility.

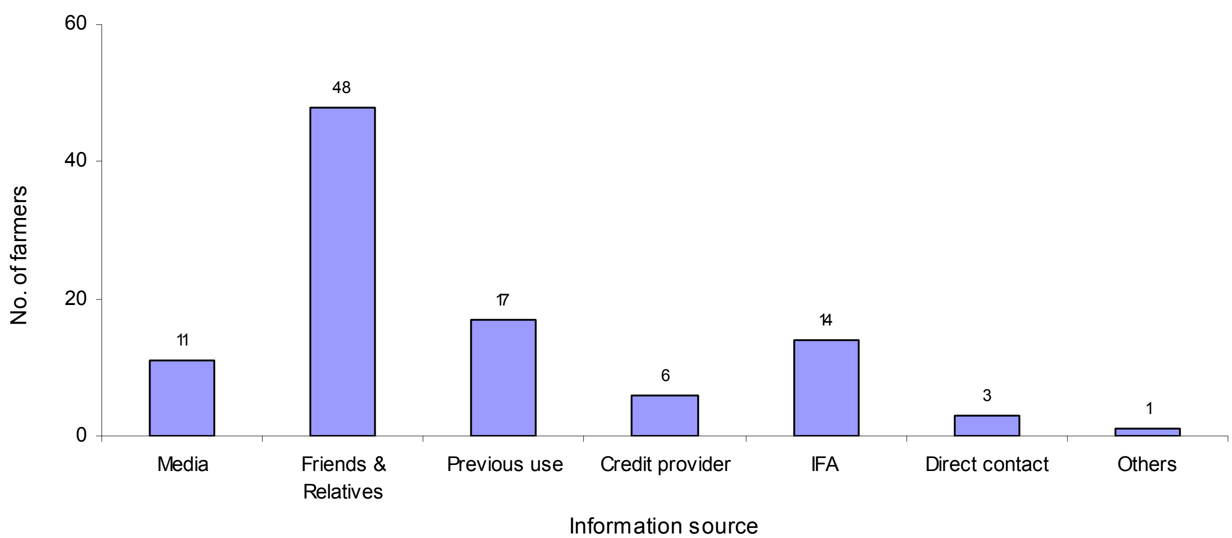

Figure 5: Farmers sources of information on availability of credit facility

4.2.2. Loan use and benefits to farmers: Seventy–six percent of the farmers interviewed during the assessment used loans for various agricultural production ventures including production of fruits, berries, livestock, beekeeping and vegetables with over 90% of these businesses confirming that they made profit from utilizing the loans. While 7-33% (as shown in the chart below) of the various business ventures were able to create new jobs, 62% of the berry farmers were able to create new jobs. This could be due to the high labor requirements of berry farming especially during harvest, but also a reflection of PFD's investment in berry production in the region through provision of credit, improved seeds and technical assistance, as well as organizing the farmers and facilitating access to markets in collaboration with IFA. Figure 6 shows farmers' use of loans, percentage that made profit, and percentage of new jobs created by business venture.

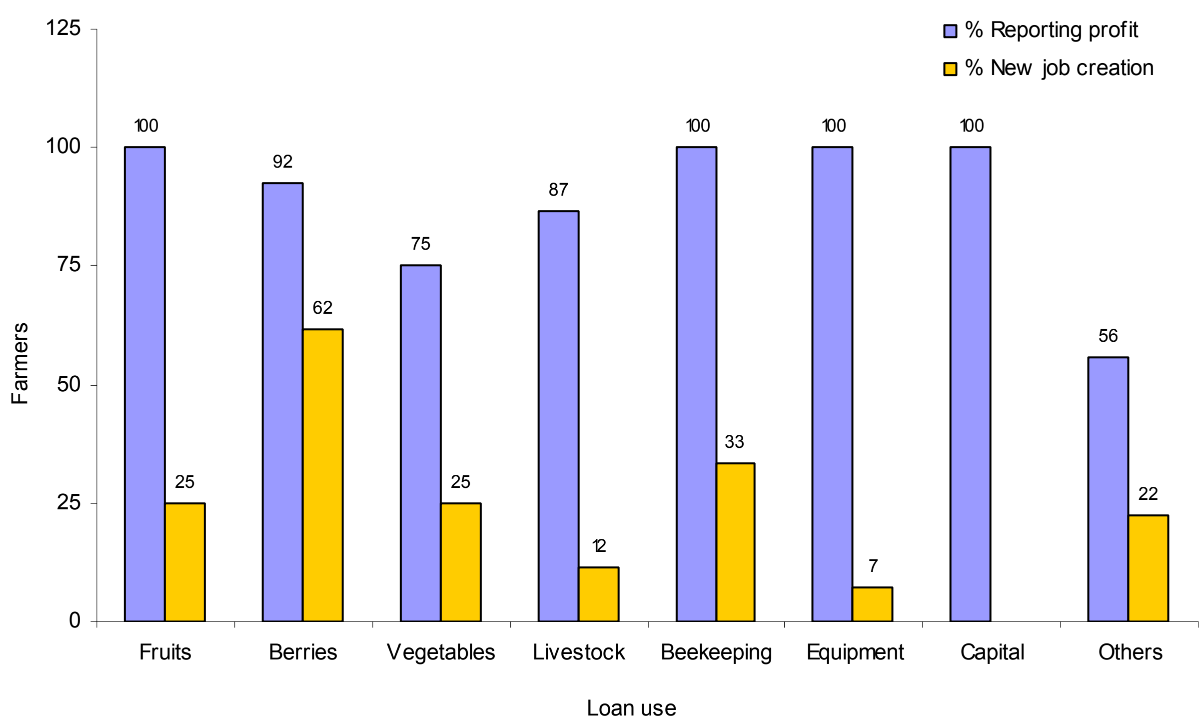

Figure 6[3]: Farmers loan use, percentage that made profit and percentage of new jobs created by business venture

From the assessment results 52%, 13%, and 4% of the interviewed farmers are engaged in livestock, berries and vegetables or fruit production respectively. All of the fruit farmers sell their produce through middlemen; 54% of the livestock farmers sell in the open market, while 33% sell through organized contractual arrangements. Most of the berry farmers (about 77%) interviewed sell their produce through contract arrangements facilitated by IFA with support from PFD. This may be the reason for the high profitability reported by the berry farmers, most of who have

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[3] Equipment in this chart refers to farmers that use their loans for the purchase of farm implements (tractors, plows, etc.). While capital refers to farmers that use such loans to procure raw materials, chemicals or labor.

expanded their operations and therefore created new employment opportunities in the region. Figure 7 shows the market outlets of farmers engaged in various production ventures.

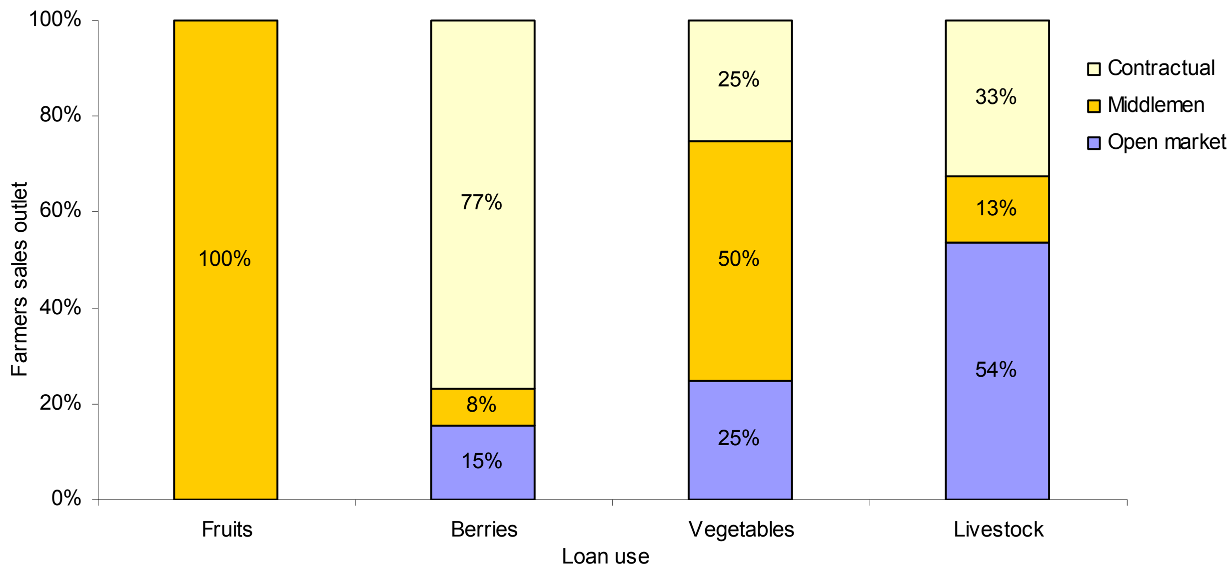

Figure 7: Market outlet of produce by various categories of farmers

Fifty-six percent of the farmers interviewed received loans ranging from 1,000 to 5,000 KM, while 17% received loans greater than 10,000 KM as shown in Figure 8. A comparison of how loan amounts affected repayments revealed that 4% of farmers receiving loans of 1,000 – 5,000 KM and 6% of farmers receiving loans greater than 10,000 defaulted in their repayment. However, over 80% of farmers in all the loan size categories are in the process of repaying their loans. Available data from the assessments shows about 97% of farmers receiving loans have some form of prior farming experience, which is an indication that some form of verification process exists before loan disbursement. However, it is not clear whether such verification includes determination of the actual credit needs of the farmer. Hence, it is apparent that some farmers in the 1,000 – 5,000 KM loan category may not have gotten enough funds to fully sustain for their operations and are therefore defaulting. Farmers in the 10,000 KM loan category may have received more funds than were necessary, and are therefore defaulting due to either mismanagement of excess funds or expanding the operations more that their managerial capabilities.

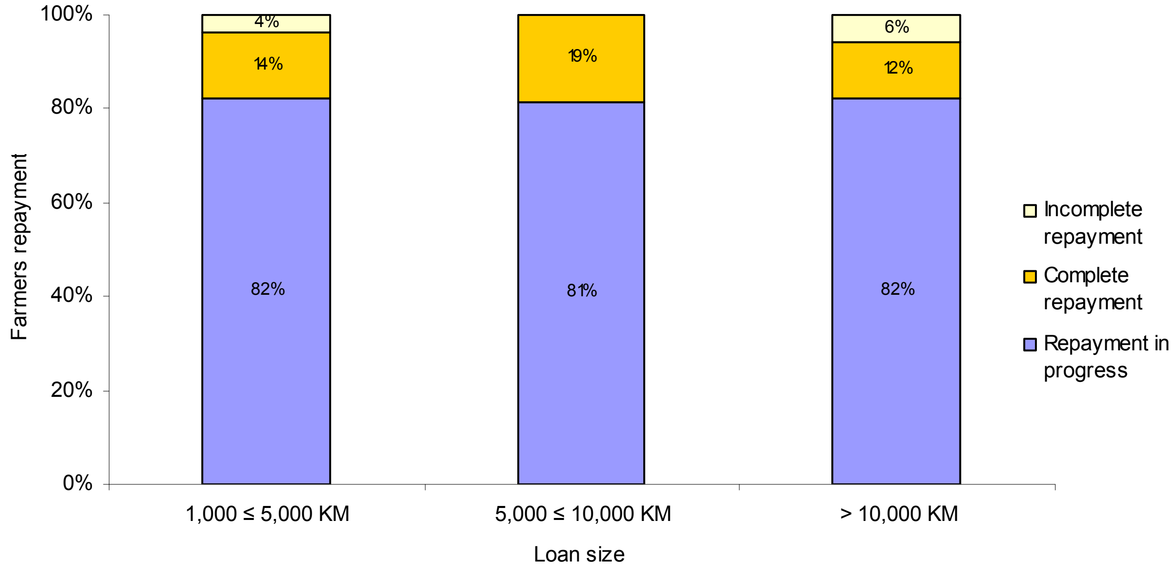

Figure 8: Comparison of loan amount categories and percent status of farmers' repayment

4.2.3. <u>Credit Program Beneficiaries Tell Their Stories</u>

i. Farmer #1 received credit of 1200KM (approximately $830) from UPI Bank in 2004 which he used in the establishment of 0.1 hectares (approximately one dunum) of raspberry plantation. The credit was provided in the form of seedlings (which PFD provided in collaboration with a local nursery); fertilizer; irrigation system; and working capital with a grace period of two years. The farmer harvested over two tons of raspberries in 2008, which he sold for about 7,000KM. With proceeds from sales over the years, he has been able to take care of his daughter (a widow), pay for his granddaughters' schools items when needed (as education is free in public schools) and has purchased a cow for his dairy needs. In 2009, the farmer has expanded his farm by another 0.1 hectares and is building a house in his farm for ease of operation, but still has 400KM of his loan left to repay.

ii. Farmer #2 has a house close to his farm. He is a retired truck driver who received a loan of 2700KM (approximately $1,862) that included seedlings, inputs and equipment for the cultivation of raspberry. He used the loan in establishing 0.2 hectares of raspberry plantation in 2004. In 2008, he harvested over four tons of raspberries from his farm and from sales negotiated by IFA made over 14,000KM excluding government incentives and 5% tax refund. He has completely repaid his loan, he said he is comfortable with his operations without a loan and has expanded to 0.5 ha in preparation for this season.

iii. Farmer # 3 is a dairy farmer. He received a loan of 27,000KM (approximately $18,200) in two installments from MIKROFIN, which he used in purchasing machinery (including tractor) and fertilizer for the cultivation of his five hectares fodder farm as well as his apple and cherry orchard. His ten cows produce 250 liters of milk (about

iv. Heko and Heko Fruits (H&H) is a partnership between Mohammed Heko and Cepalo Muharem. They are the most successful berry farmers in Upper Vrbas region with over 150 hectares of farmland devoted to cultivation to berry-like fruits (blackberries, raspberries, strawberries, etc.) and potatoes. H & H currently produces about 300,000 seedlings of raspberry annually for sale to local farmers. They also produce over 500 tons of potatoes per annum, which they sell to Kelly Chips (one of the largest chips-making companies in Europe), in Switzerland. Mohammed and Cepalo combine their finance/management skills and education in Agronomy respectively in running this successful business. H&H currently manage a cooperative of about 250 farmers (95% raspberry and 5% potato farmers) from whom they buy about 600 tons/year that they sell to KLAS Sarajevo. H&H collaborates with University, Agriculture Institute and IFA to provide technical assistance and capacity building to members of its cooperative. In 2009, they invested substantial funds to construct a cold storage facility which they say will boost the trade on berry-like fruits in the region.

5. Lessons Learned

PFD Bosnia credit program presents several lessons that will be very useful to other existing and new PFD credit programs. Significant of these are:

i. The Bosnia credit program methodology of providing loans rather than grants to partners presents a win-win situation for PFD and partners, as PFD can retain and revolve the bulk of such funds while the partners access funds at less than commercial rates for their operations.

ii. Working with registered organizations – the MFI partners and others like IFA – have proven to be very successful as such organizations understand the legal implications of default to the provisions of their contract. These organizations therefore work hard in adhering to contract provisions and maintaining professionalism.

iii. The Bosnia program submits a consolidated repayment report to PFD headquarters every month. This report tracks information related to the overall loans to the four microfinance institutions, amounts disbursed, their repayments (principal and interest), and net amounts outstanding. This template will be very useful to other credit programs in tracking loans to its credit program partners.

iv. From available documents, partners charge interest rates of between 15% and 18% on loans, which is low compared to interest rates in sub Saharan Africa (specifically Nigeria where interest rates range from 24-40%). One reason is that operational costs are lower in BiH, as borrowers come to make repayments in MFI offices, unlike in Nigeria where MFIs go to borrowers to collect repayments.

6. Conclusions

The PFD credit program which focuses on providing agricultural credit to farmers in the Upper Vrbas region of Bosnia and Herzegovina has been successful as evident in the following achievements:

i. The program contributed to improvements in the agriculture of Upper Vrbas region by pioneering the cultivation of berry-like fruits (including raspberries, blackberries and strawberries) through its raspberry production program. USAID in association with the Agricultural Research Institute of BiH is currently supporting farmers in the cultivation of American blueberry in the region. The first blueberry plant was planted April 2009 at Luzani, Gornji Vakuf-Uskoplje Municipality by Abid Music, an IFA member.

ii. Through provision of credit and improved agricultural technologies to farmers, the program has contributed to increased household incomes. Results of the assessment indicate that profits from the credit program contributes between 20% and 80% of household income for over 90% of the farmers interviewed) and therefore improved livelihoods of this population.

iii. There is increased production of berries in the region as a result of PFD/BiH support. This has also increased need for storage facilities and appropriate market channels. A former PFD/BiH credit program loan beneficiary that has evolved into a fruits and seedlings production company, Heko and Heko Fruits, has invested substantial funding for the construction of a cold storage facility in Bugojno for berry-like fruits. The availability of such storage facility and access to markets will spur farmers to increase their production.

iv. PFD funds constituted between 2-15% of partner MFI agricultural loans portfolio. Also, available data from the assessment shows that 86% of farmers interviewed, and all of PFD MFI partners are interested in accessing future loans. These are indications of the contribution, need and success of the program in the region.

Challenges

Despite the achievements of the credit program, there remain some challenges as shown below:

i. Though PFD partners with local governments in the implementation of program activities, most of these governments (e.g. Bugojno municipality) were not able to sustain the program activities when PFD pulled out.
ii. Besides partners submitting reports in different formats, not all the data have been sufficiently analyzed for inferences to be used for program improvements.

7. Recommendations

i. Program staff should be more acquainted with partners and their clients to get a better sense of their needs, concerns, as well as to provide technical assistance when needed.

ii. With PFD's grant operations concluding in July 2009 PFD must remain vigilant in oversight of partner repayments. It is also noted that PFD has engaged a consultant to continue to monitor such repayments and report to PFD/U.S.

iii. The credit program operated in other countries should build on the successes and lessons learned by the PFD/BiH credit program to enhance their program delivery strategies. For example, a) adapting a standardized reporting format like the PFD/BiH portfolio report and institutional loan repayment report to PFD/Washington; b) an arrangement that provides loan support rather than grant to partner MFI; and c) engaging other partners to provide additional interventions to program beneficiaries, like IFA in the case of the PFD/BiH credit program.