

Two Approaches to Microfinance in Siberia:

A Case Study

by

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Natalia and Anya have known each other for several years. In their respective cities they head small microfinance organizations that began at the same time, but have taken different approaches. They have come to a regional conference on Microfinance to discuss the issues, obstacles and possibilities for microfinance in Siberia.

Together at the table they discuss the difficulties of funding, taxes and regulation.

Everyone can agree that these are the challenges they face every day. Both organizations are headed by university professors who together received their first microfinance training while at Woman's Leadership Conference in the United States. Both organizations have been formed to help women gain access to capital, however, the women that each wanted to focus their microfinance activities on highlighted a serious difference in philosophies.

In Novosibirsk Natalia's microcredit cooperative, 'MicroCred' works with women who are established small business owners. "The poorest of the poor are people who it doesn't make sense to help with microfinance", she says. "They are too unreliable to risk loaning money for enterprises."

Anya's organization, 'Bridge' focuses on helping very poor women who either have or are just starting very small moneymaking enterprises in Irkutsk. "Poor people don't need a detailed business plan, they just need an opportunity," she states.

The cities that they operate in, Novosibirsk and Irkutsk, are similar in many ways. They are both regional centers in Siberia going through the sometimes painful adjustments of politics and economics in transition after the disintegration of the Soviet Union.

Microfinance organizations in Russia have struggled against many obstacles to gain momentum. Government regulations and policy concerning lending organizations, especially on a small scale, have been restrictive and arbitrary. Organized crime often collects additional money from entrepreneurs on top of the crippling government taxes, making it impossible to start or sustain a business.

Bureaucratic obstacles are not the only ones that have been a challenge to the organizations. Borrowing money for repayment with interest is an idea that many older Russians find distasteful and smacking of usury. It is an attitude that is difficult for many people to change. Though many people see the utility of loaning and borrowing money, the experience often leaves them with a bad feeling. Natalia says that even as an economist and the leader of a microfinance organization, she struggles with the fact that collecting interest on a loan goes against the values she has lived with all her life. Anya has fewer reservations about being involved in lending money, seeing it as a way to get resources into the hands of the poor.

By 1994 many 'Investment Banks' had appeared in Moscow, offering amazing rates of return after only short investments. These banks were only pyramid, or 'Ponzi' schemes, and many Russians who had invested their life savings eventually lost everything. With little or no experience in dealing with financial organizations in a western, capitalist model, they were lured in by the promises of a quick profit. The memory of this nationwide phenomenon still lingers with many Russians, and their distrust of borrowing, loaning and investing remains.

In spite of the distrust for investing and borrowing, many Russians consider starting their own small enterprise as a way to secure their future. Many Russians see unfulfilled niches for business opportunities all around them. Unreliable paychecks or pensions already force many people to find ways to supplement their income. For the approximately fifteen per cent of the population of each city who are unemployed this is even more of a necessity. Finding funds for starting a small enterprise is difficult for many of them. Banks in Russia give very few small business loans, and the return on a loan of what amounts to five hundred dollars is not considered to be worth a bank's time or processing costs. Borrowing from family, dealing with pawn brokers and a very few microlending organizations are other options for Russians interested in taking out loans. Each of these options may be inappropriate for many people because funds aren't available, or people feel the interest rates are too high.

Group Loans

The experiences of the two organizations with group lending have been very different. Bridge's loans have so far been exclusively to groups, while MicroCred has tried group

lending only once. They are of different opinions on whether group lending is appropriate for the cultural setting.

During Soviet times people sometimes formed ‘mutual self help’ cooperatives that facilitated rotating savings, but Natalia thinks that for small business people, there is not currently an incentive for group lending. MicroCred’s loan officer who managed their group loan says, “People live and work separately... unless they are cohesive this is a problem. It is possible to do team building, but it would take time.” Natalia agrees adding that people just don’t trust each other in the uncertain business climate of Russia today “It is too difficult. Though we learned from the experience, we will not do it again,” she says.

Anya believes that group loans not only help to ensure the payback of the money, but also builds solidarity among the women borrowing. Her group loans have gone to women who were either starting an enterprise together, or who already shared common business interests and already know each other well. With both groups that have received loans from Bridge, the money was to fund some kind of cooperative effort by the group.

MicroCred

Philosophy

From the beginning, MicroCred has targeted helping women entrepreneurs who already own small businesses. Its members consider MicroCred to be a resource for women who cannot access credit from the banking system in Russia. MicroCred is viewed by its

members as an experiment, and not a full-fledged microfinance organization. It is the hope of Natalia and other MicroCred cooperative members of MicroCred that microfinance will help Russia bridge the gap in available credit by preparing borrowers to be ready to work with banks when banks become ready to deal with small borrowers. As MicroCred's lawyer states, "we are providing financial support to small businesses, but also we provide a mentality. Our real value is social rather than financial. Civil society is more powerful than legislation; people have to understand that their possibilities will expand if they conduct business honestly. We are creating a culture of integrity."

Natalia adds that there are three kinds of client that MicroCred can help in this transitional time: 1) businesses that are too small for banks ever to deal with and microcredit organizations only rarely, 2) micro-businesses that are slow to grow but sustainable, and 3) businesses that are expanding quickly and need to be trained on how to deal with banks. It is the last two that she views as the focus of her work, hoping to develop strategies through the work of MicroCred than can eventually be expanded into a fully developed microfinance organization or shared with new organizations operating in the region through the experience of her staff and volunteers as they move from MicroCred into other organizations.

The City

Novosibirsk

Population: approximately 1,400,000

The city of Novosibirsk was small before World War II, but developed rapidly in the post-war years to its present size. Sitting on the Ob River and the trans-Siberian railroad, it is a transportation hub and a manufacturing center. Since the break-up of the Soviet Union small businesses have begun to spread not only in the commercial center of the city, but also in the surrounding residential neighborhoods (called micro-regions) and bazaars of the city. One of the micro-regions is Academgoradok- ‘Academic City’, a collection of institutes and colleges near Novosibirsk where Soviet scientists worked in relative comfort and isolation. Now it’s a desirable suburb of Novosibirsk, where the blocky apartment buildings that house the majority of the city’s population are surrounded by trees and separated by patches of forest. The concentration of highly educated people dependent on unreliable government wages as academics has contributed to an entrepreneurial spirit in the community. Small businesses are common throughout the town, and people say that though taxation is high, mafia interference is not as common as it once was.

The Structure of MicroCred

Cooperative Members Group

The cooperative is composed of all the people investing in MicroCred; each has put in money to provide the loan capital for the loans that have been made so far. Regardless of investment (a minimum of 300 rubles) each member has one vote. The Cooperative members are the four women who have contributed loan capital to MicroCred as of the summer of 2002. The role of the Cooperative Members Group is to:

- Approve annual report

- Approve balance sheet
- Elect Council members
- Vote to exclude members if necessary
- Approve (but not design) policies

The Council

The Council (or Chair of Council) is composed of three people. The Council can be expanded if necessary according to the by-laws, but so far this has not been needed due to the small, experimental nature of the organization. The Council has the following responsibilities:

- Design MicroCred policies
- Approve loans
- Determine interest rates and payment schedules for each individual loan

The Executive Board (the Director)

Though titled the Executive Board in the by-laws the executive power of MicroCred is concentrated solely in the Director. Natalia was the director of MicroCred from its creation until late July of 2002. Currently MicroCred's chief accountant is acting director while Natalia devotes herself to other professional tasks. The responsibilities of the Director are:

- To sign all the official contracts between MicroCred and it's borrowers
- To oversee the operational activities of the both the paid and volunteer staff

Volunteer Staff

The volunteer staff of MicroCred is primarily composed of current and former students and faculty members at the Siberian Academy of Public Management. They perform many of the day-to-day bookkeeping and administrative chores that keep the small organization running. They volunteer their time for a variety of reasons, ranging from gathering experience for professional careers to working for their current professors as an extension of their studies.

Each of the loan officers for MicroCred is a volunteer. Natalia continues to try to administer one loan at a time herself to keep in touch with the issues as things change in the region and in her organization. Tanya, a current Council member does the same. Other loans are administered mostly by Olga M., a commercial credit manager, who is just beginning her career at a bank in Novosibirsk. She is impatient to actually work with small businesses, something she gets little opportunity to do in the very conservative lending climate of her work.

Professional Staff

Currently MicroCred has only one paid staff person: Oxana G., a private practice lawyer, acts as legal counsel for MicroCred. Her work for MicroCred editing the by-laws, writing loan contracts and researching a legal way to register the organization was previously without pay, but she currently receives a small salary for her work. Under new legislation, as a registered financial organization, MicroCred is required to have legal counsel to represent them in case of litigation.

Clients and Borrowing

MicroCred targets currently existing businesses owned by women in Novosibirsk.

No money is spent on advertising to recruit borrowers: members of the cooperative or their acquaintances recommend them.

MicroCred has not yet made loans to rural borrowers because of the longer repayment periods. “Nine months is the amount of time it takes a piglet to be a pig that is worth any money,” Natalia says, “our loans so far have been mostly for three months, with the longest being six months.” She adds that in the near future they may expand to medium sized towns that act as regional centers outside of Novosibirsk to loan money to people who operate small service-based industries such as sewing, retail businesses, or even agricultural businesses that need short-term financing to arrange for transportation of their crops.

To date, MicroCred has made 13 loans to 11 different clients. Loans have ranged from 6,000 to 30,000 rubles (about \$200 to \$1000) with the average being 15, 292 rubles (about \$500). MicroCred charges approximately 3% to 5% monthly (36-60% annually) interest on loans. The rate is determined by the Council depending on the risk and ‘social impact’ of the loan, but is generally about twice the current banking rate. Borrowers have their choice of paying directly in cash to their MicroCred credit manager or paying through their bank to MicroCred. To avoid the banking fees most choose the former option. MicroCred has a 100% repayment rate, though timely payments have been an issue on some loans.

Beginning in 2002 MicroCred has allowed cooperative members to withdraw their money with interest. Money can be withdrawn after the loans for which it was used was used have been repaid.

Loans have been given for a variety of purposes, from expanding business to helping get through seasonal lulls. MicroCred has so far not given consumption or education loans to borrowers with whom they are personally acquainted with, though such loans have been seriously considered several times.

Accounting

Chief Accountant, Svetlana S., developed MicroCred's bookkeeping according to commercial standards by applying microcredit-specific principles she learned trainings in Nizhny Novgorod. Financial reports are filed with the Central Bank every three months as required by law. Svetlana S. and Katya F., a student volunteer, work to keep the financial records up to date and prepare the financial reports that are needed for re-registrations and tracking purposes.

Portrait of a Borrower- Novosibirsk- July 2002

In the offices of MicroCred, a businesswoman arrives with her teen-aged daughter. It's summer in Novosibirsk, Russia. A city of over a million people, Novosibirsk is Siberia's largest. On the day of their visit to MicroCred, it's hot and sunny, and the teen-ager is wearing one of the fashionable net-knit outfits that are popular this summer. The businesswoman is the owner of a small, local company that manufactures the clothes her daughter is wearing. She has come to take a small loan from the credit cooperative MicroCred to expand her line for the fall to include clothes for younger people. Children will be starting school in a couple of months, and she needs money for materials and labor to roll out the new line in time.

The loan is small by American standards, just a few hundred dollars, but the loan process is taken very seriously. Her loan officer Svetlana reviews the contract that has been prepared, carefully sews it together and covers the knot on the back of the small bundle of papers with a piece of white tape. Natalia, the director of MicroCred then signs the document and the tape and stamps every page with the seal of the credit cooperative. After the businesswoman also signs all the documents, her loan officer gives her the money in cash. Over the next three months, she will pay it back on a bi-weekly basis, each small payment, made in cash, goes into the cardboard box MicroCred uses as its cash drawer between trips to the bank. The interest on the loan is high: twice what local banks might charge. Local banks make very few loans to small businesses, and never for so small an amount. A few hundred dollars at the right time of year will give the borrower the chance to expand her operations, and hopefully, pay back the loan and be left with her business a little larger and a little more secure.

Bridge

Philosophy

Bridge has been strongly influenced by the Grameen philosophy of microfinance. The philosophy of the organization has been the philosophy of its founder, Anya. Before being introduced to microfinance, she was involved with other efforts in her community to help those that were falling through the ever-widening cracks in the system. She found her experience working with a citizen's initiative group and a local NGO to be too removed from the problems she saw around her. Volunteer work organizing clothing collections for a local group that distributed the clothes to families in need and a local mental hospital brought her into contact with the poorer members of her community.

While visiting the United States in 1999, Anya met with representatives of Grameen Trust and the next year was offered the chance to travel to Bangladesh to study the operations of the Grameen Bank. Though the Grameen Bank had no plans to begin operations in Siberia, Anya returned with a solid understanding of their approach to microfinance which she was determined to put into action.

The City

Irkutsk

Population: approximately 587,000

Irkutsk straddles the Angara River, which flows from Lake Baikal. It's proximity to the lake, it's position on the trans-Siberian railway and now, it's closeness to overland routes to China have made Irkutsk a bustling, if remote, city. Irkutsk has a number of colleges

and technical institutes. The city has many small shops and several large bazaars, as well as many smaller, neighborhood areas where people sell food and goods on the street. Vendors in the bazaars report that though the mafia does collect money from most of them, craftsmen, or people who have produced the products that they are selling, are exempt from paying the 'extra-legal' taxation.

The Structure of Bridge

Bridge continues to be a one-woman show for the most part. Anya finds borrowers, acts as loan officer and raises funds from overseas sources as best she can. Originally there were five women involved in the formation of Bridge. While four women remain listed on the registration as officers of the governing board, only Anya and her accountant are truly involved in the activities of the organization.

Anya's first goal is to get money to the poorest of the poor. She energetically pursues funding from outside sources and immediately turns donations into loans for groups of women. She often approaches potential donors with a specific project and dollar amount in mind, presenting the specific need of a group of women to individual donors. She is passionate and devoted to securing loans for these groups of women, taking on nearly all of the work of her organization herself.

Tatiana wants Anya to move toward changing the registrations status of Bridge, from a credit cooperative to a fund, fearing that if the organization grows, it would be possible for Anya to lose control of the operations of the organization to a board of directors because of the by-laws required of a cooperative.

Clients and Borrowing

Anya networks through the community, tapping into other organizations working with the poor to identify potential borrowing group members. Because her borrowers have been referred to her from other organizations that act as their references she feels more secure in lending money to them. It has also been her strategy to use the referring organizations to exert social pressure on borrowers to pay back their loans, but she has not had to resort to this yet.

Bridge has loaned only to two groups of borrowers since it was formed. The first group was five women who make hats to sell in the bazaar in the center of town. This group of hat sellers took out their first four-month loan for 9,000 rubles (\$300). The next year, they took out a second four-month loan for 24,000 rubles (\$800). The rate of interest on the loans was only 3% monthly. Anya has decided that because of her low overhead costs in administering the program, she should keep her interest rates low as well. The second group that has taken a loan from Bridge is paying back their loan at 3.5% monthly, since they are just starting a business by converting an empty apartment into a childcare center.

Anya has three more groups waiting to borrow money. Because all of her loan capital comes from donations from the United States, she faces a real bottleneck in her operations as cash comes in when she can convince a benefactor to give a few hundred dollars. In the future she hopes to entice Russian investors to put money into the organization as an investment, but for now she continues the process of getting just

enough money for one loan from a charitable person or organization, and putting it immediately into the hands of waiting borrowers.

Accounting

Tatiana has been Bridge's accountant for the last two years, having taken over from her sister who helped Anya form the organization. She files quarterly reports and is helping to reregister the organization as a fund in the near future, but has little interaction with the day-to-day activities with the clients themselves. Bookkeeping for Bridge is relatively simple, but helping fill out paperwork for the registration process is sometimes complicated.

Portrait of a Borrower, Irkutsk- August 2002

Shanghai' is the name of the labyrinthine central bazaar of the Siberian city of Irkutsk. Shuttle traders running between China and Irkutsk sell leather jackets, shoes, kitchenware and switchblades. Merchants gather by wares, fishing nets next to fishing nets, fur coats next to fur coats, and in one corner of the bazaar, near the entrance, are the hat sellers.

The boxy fur hats are traditional in Russia, protecting against the cold Siberian winters. Making them is a local cottage industry. Katrina has worked for five years making the hats to support her family. Her husband died seven years ago, leaving her to raise two sons, now both in their late teens. Katrina is a trained nurse, but low wages and progressive deafness began to make it hard to for her work in a hospital. She finally chose to leave the hospital to nurse her own boys, both of them battling heroin addiction in their teens. Five years later, her sons have completed a twelve-step program but she has slowly gone almost completely deaf and cannot return to nursing. Now she supports herself and her two sons by making hats and selling them in the bazaar.

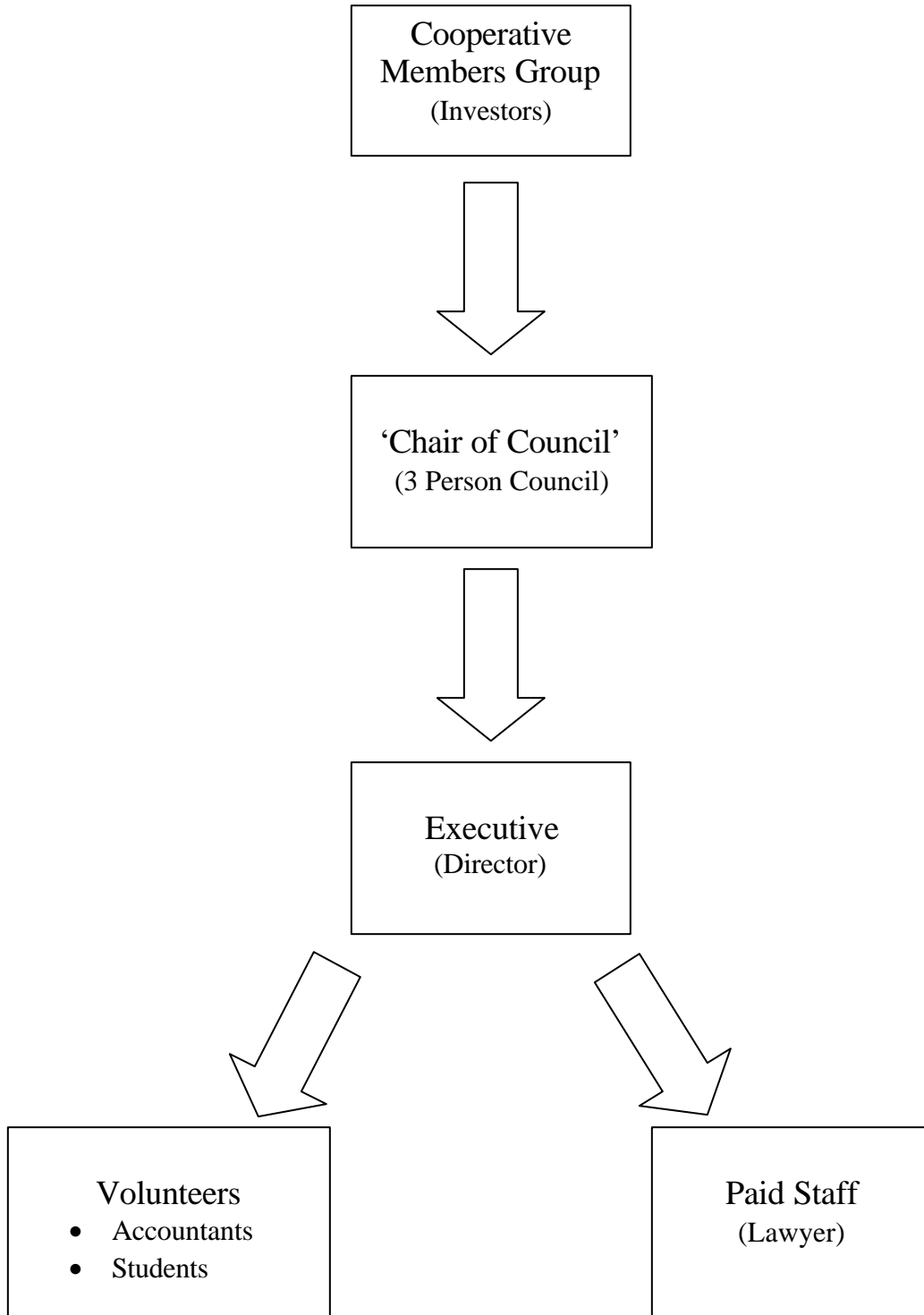
The women selling hats stand side by side, at the same time competitors and partners. They watch each other's merchandise when one has to step away. They drink tea and laugh together. Five of them, including Katrina, have also taken out a loan from the microfinance organization, Bridge. With the money, they can buy furs as a group in bulk and get a much better price, improving their profit margin dramatically and ensuring they have enough hats on hand when the demand rises in the fall. It is summer and business is slow. People are looking at swimsuits and watermelons this time of year, but summer is short and winter is long in Irkutsk. People will buy hats soon.

"Am I optimistic about the future?" Katrina only pauses to make certain she heard the question shouted into her ear correctly then smiles again brightly, "Of course! The future must be better than the past! It must!"

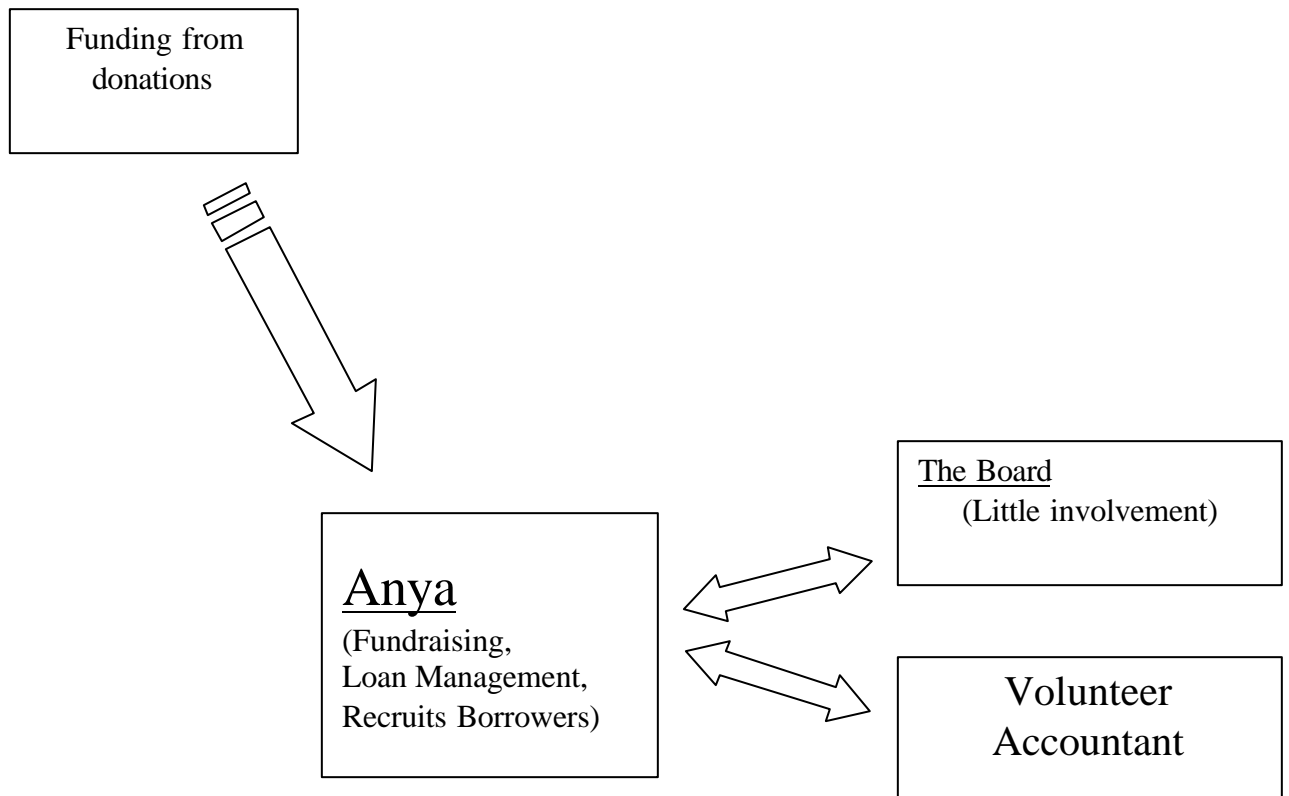
Appendix 1: Comparing the Two Organizations

	MicroCred	Bridge
City	Novosibirsk	Irkutsk
Target Borrowers	Small businesses owned by women	Group lending to poor women for small enterprises.
Funding	Member investments in the cooperative, some investment from outside sources	Donations from foreign sources for loan money, some grants for training and registration.
Group Lending	Tried once, considered a failed experiment. MicroCred doesn't believe group lending is appropriate for small businesses in Russia.	Exclusively used solidarity group lending in the Grameen manner.
Loan Officers/ Staff	Board members, student volunteers.	One person does most all the work with the help of an accountant.
Savings	No Savings Plan for Borrowers	No Savings Plan for Borrowers
Interest Rate	3%- 5% Monthly	3%-3.5% Monthly
Range of Loan Size and Average	6,000-30,000 rubles (approx. \$200- \$1000). Average: 15,000 rubles (\$500)	9,000-24,000 rubles (\$300-\$800) Average: 13,800 rubles (\$460)
Number of Loans	13	3
Number of Clients	11	2
Date Operations Started	September, 2001	October, 2001
Unemployment in the City	14.9%	15.1%

Appendix 2:
MicroCred Organizational Structure



Appendix 3:
Bridge Organizational Structure



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