EGYPT ASSESSMENT REPORT❉

Executive Summary

UNDP in partnership with the Social Fund for Development has agreed to pilot a MicroStart project under its Job Creation Program as an effort to promote income generation among the poor. The development objective of MicroStart Egypt is to improve access to appropriate financial services offered by local organizations to the economically active poor in order to enhance their economic activities, increase their revenues, and create and consolidate employment.

Ultimately, the supply of microfinance services is expected to contribute to alleviation of poverty and to economic growth. The immediate objectives of this project are as follows:

1. Strengthen the institutional, organizational, and technical capacity of participating local organizations to provide microfinance services to the economically active poor.
2. Increase the financial capacity of participating organizations to provide microfinance services to the economically active poor.
3. Contribute to the development of knowledge, expertise, and information concerning microfinance, at the level of the participating organizations.
4. Enhance the capacity of the Social Fund to manage its existing microcredit projects and to propose new ones based on best practice principles.
5. Enhance the capacity of the Social Fund to provide technical assistance and training to Sponsoring Agencies (SAs) and necessary follow on SA funded projects, as part of its responsibilities as an apex institution.
6. Contribute to the development of reporting standards within the Social Fund for the microcredit operations under the Community Development Program (CDP) and link with relevant MIS development objectives.
7. Ensure the continuity of the initiatives taken in the pilot program.

To achieve these objectives, MicroStart Egypt will consist of the following integrated components:

- **A Micro-Capital Grants Component** of up to $1,000,000 to be divided amongst participating organizations in the form of grants of up to $150,000. These grants will be disbursed in traunches according to the organizations absorptive capacity and will be used for a mixture of loan capital, purchase of fixed assets, and operational costs.
- **A Technical Services Component** of $ 500,000, which will be used to contract an International Technical Service Provider (ITSP) to provide support to the project over a three year period. From this $500,000 contract the ITSP will cover all costs of the Local Technical Service Provider who will be sub-contracted as the local counterpart.

❉ *In lieu of an Assessment Report, this document is extracted from the MicroStart Project Document and attempts to portray the state of microfinance in Egypt*

- **A Project Support Component** of $150,000, which will include monitoring and support, audits, an evaluation, and baseline and impact surveys.

- **An MIS Component** to develop information systems that will collect compile and analyze information relating to the selection, approval and monitoring and evaluation of the microfinance activities supported by the Social Fund. An assessment will be undertaken in April through which a budget will be determined.

Introduction

Microfinance's Contribution to Poverty Alleviation

Both partners enter into this agreement with a joint understanding that credit and savings provide informal sector households and microenterprises with the liquidity and flexibility to respond to rapidly changing needs and opportunities:

- At a minimum, liquidity enables households that are living at the margin to better manage crises and risk by smoothing their incomes and consumption. Increased liquidity enables households to respond to opportunity. By enabling households to take advantage of greater investment options, access to finance can enable households to increase their income.

- What is known about the uses of income by the poor indicates that increased income is directly used to improve the quality of life in terms of better nutrition, health, shelter, and education as well as business investments.

- Some microfinance services also provide *social intermediation* – a way for severely restricted people to begin making contact with the formal institutions that manage society’s resources and to access these resources on a permanent basis.

From an economic perspective, access to microfinance services enhances the contribution of microenterprises to the economy by:

- Supporting employment in microenterprises – a major source of income for poor households, particularly important during economic contractions;

- Supporting an increased supply of goods and services to low-income populations; and,

- Improving the efficiency of the movement of capital to productive uses.

I. National Context

A. Country Situation

1. Political and Administrative Structure

Egypt is an Arab republic headed by the president, Hosni Mubarak, who was re-elected to his third six-year term in October 1993. The majority party in parliament supports the government under the Prime Minister, which is the National Democratic Party. The constitution of 1971 provides for the separation of powers between the executive, the legislature and the judiciary. Officially Islamic law is the principal source of legislation but the Napoleonic code is a more significant progenitor. The head of the state is the president of the republic, nominated by a two-thirds majority of the People's Assembly and elected by referendum. The People's Assembly of 444 directly elected members and ten additional members nominated by the president exercises legislative power. Although formally accountable to parliament, the prime minister is the president's primary lieutenant, responsible for implementing his policies throughout the bureaucracy. The key ministries are Defense, Foreign Affairs, Information and the Interior.

Role of NGOs

The official number of NGOs registered in Egypt under Law 32 varies between 13,000 and 15,000; however, out of this number only about 500 are considered to be active. Most of these NGOs have been created by the government to implement social programs and operate under the supervision of the Ministry of Social Affairs (MOSA). They are largely active in urban areas and focus mainly on social development and welfare, providing services to approximately 5.5 million beneficiaries. As such, These NGOs play a significant role in the Egyptian society by acting as conduits for large amounts of government and donor money targeted for social programs. However, because most have been created to execute government projects and lack an independent institutional identity, many lack the accountability, financial and human resources and administrative structure necessary to be more long-term development partners.

In the last few years, new laws have been introduced regarding the role of NGOs in the Egyptian society and old existing laws are being reexamined, such as law 32 passed in 1964 to control the operations and activities of NGOs. This law gives the state the power to refuse any application for establishing a NGO, to liquidate or re-organize or merge NGOs or to appoint members of the boards of NGOs. Law 32 also requires that NGOs providing integrated services, such as microlending and other social services keep their bookkeeping records separate.

Recognizing the important role that NGOs play in Egypt, the government has invited NGOs to participate in a national dialogue to find ways to accelerate the process of development. Consequently, the government is in the process of reformulating Law 32, and as a new participatory approach, a draft copy of the new law is being shared with NGOs for their comments.

2. Socio-Economic Situation

Situated in Northeast Africa, Egypt shares borders in the west with Libya, and in the south with Sudan. It is bounded on the east by the Red Sea and on the north by the Mediterranean. The surface area of Egypt is 997,739 square kilometers, of which only 35,190 square km is settled and cultivated. About 95% of the land is uninhabitable desert.

Egypt's population of more than 65 million continues to grow at the rate of 1.3 million people per year or 2.17%. 99% of the population live in the narrow strip of the Nile valley, which runs the length of the country, and in the Nile Delta. Population density in non-desert areas is therefore high, at about 1,381 per sq. km in 1985. Greater Cairo with more than 13 million inhabitants in 1995 has a population density of over 32,000 per sq. km.

The economy in Egypt is dominated by the service sector, which including public administration accounts for half of GDP. Within this, tourism and the Suez Canal are important sectors. Agriculture remains an important economic activity, even though less than 3% of Egypt's area is arable land; 32% of the population earn their living from agriculture. Most crops are for local consumption but cotton is a major export. Industry and mining account for approximately 17% of GDP and are heavily concentrated in Cairo and the Nile Delta. Petroleum and natural gas are mainstays of the economy accounting for around 10% of GDP. In addition, there is a large informal sector which, although no reliable data exist, may account for as much as 50% of total economic activity. The main urban centers are Cairo, Alexandria, Port Said, and Suez.

UNDP's human development index ranked Egypt 109 out of 173 countries. The GDP per capita is $1,210. Figures for the 1996/97 fiscal year indicate that real GDP grew by 5.3% and inflation averaged 6.2%. Foreign capital inflows amounted to $1.4 billion; foreign currency reserves were $20.3 billion; and external debt was $28.8 billion.[2] Import volumes increased by 10% from the previous year due to strong domestic demand. While non-oil merchandise exports proved sluggish, export of services increased, with earnings from tourism up more than 20% from the previous fiscal period.

The 1997 Human Development Report for Egypt indicated that 23% of Egyptians lived below the poverty line, including 7% who lived in absolute poverty and 42% of the poor lived in urban areas; whereas, 58% live in rural areas. The rate of poverty in rural areas in Upper Egypt was 67% higher than that in urban areas in the same region. With respect to illiteracy, population statistics in Egypt indicated that about 39% of the population were illiterate. A survey estimated the unemployment rate, when adjusted for underemployment, to be around 21% and 85% of the unemployed are between the ages of 19 and 29, and most are recent graduates.[3]

The informal economy in Egypt is a major absorber of labor and provider of a wide range of goods and petty services. According to a 1994 Labor Force Sample Survey (LFSS), those who were privately employed outside establishments constituted 60% of the total workforce (15-64 years) in urban areas. If you consider members of the workforce under the age of 12, the number is much greater. Therefore the majority of the urban workforce in Egypt undertakes their economic activities in the back streets, on the pavement or are simply itinerants.

3. Cultural Context

According to a 1986 census, 94% of the population is Muslim (almost all are Sunnis) and almost 5.9% adhere to the Coptic faith, the indigenous Egyptian form of Christianity. In addition, approximately 50,000 Egyptians belong to other Christian sects (Greek Catholic and Orthodox, Maronite, Protestant, and Syrian Catholic). There is a small and declining Jewish community.

There is still a wide gender gap in Egypt particularly in terms of absolute poverty, with poverty significantly more prevalent among female-headed households (43.2%) than male headed households (34.3%), when using affordability of basic needs of food and clothing as a poverty indicator (Ministry of Insurance and Social Affairs). Large disparities between men and women persist in rates of unemployment, earnings, literacy and school enrollment at all educational levels, as well as overall education attainment. There is also a wide gap between the number of men and women possessing identification cards that are necessary for obtaining any social services, accessing formal financial services or engaging in formal sector employment activities.

4. Finance and Banking

The Central Bank of Egypt controls the banking system and directs monetary, credit and general banking policies through the usual means of discount and interest rates, liquidity and reserve ratios. As of 1997, Egypt's banking system included 28 commercial banks (4 of which are state-owned and 24 are private and joint venture banks), 32 business and investment banks (11 private and joint venture banks and 21 offshore banks), and 4 specialized banks (1 industrial development bank, 2 real estate banks, and 1 principal bank for development and agricultural credit). The total number of branches is 2,325. Furthermore, the saving system of the postal office has the capacity to reach the poor through its 2,900 outlets.

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2 Delegation of the European commission in the Arab Republic of Egypt (1997 annual report)

3 World Bank Staff Appraisal Document of SFD

Liberalization of the financial sector in Egypt has been taking place since 1991. Credit controls have been eliminated and interest rates and foreign exchange regimes have been liberalized. With the introduction of modern banking regulation and the revitalization of the domestic stock market, Egypt was placed among the top five emerging markets. Reforms of the financial sector led to the creation of instruments for controlling liquidity and management and have made domestic financial assets more attractive.

Further deregulation of the Egyptian banking sector is possible. A Central Bank of Egypt survey showed that the state continues to play a major role in Egypt's financial sector. The four state-owned commercial banks, the National Bank of Egypt, the Bank of Alexandria, the Banque du Caire, and the Banque Misr, dominate the sector due to their size in terms of assets, deposit base, and branches accounting for 62% of the banking system's total assets.

Microfinance Sector

The majority of microcredit in Egypt is provided by NGOs. Law 32 prohibits the mobilization of savings by these organizations, restricting their operations to the delivery of credit only. According to a recent World Bank Survey, Egypt's microfinance providers are serving nearly 75,000 borrowers and have about $55 million in outstanding loans (Brandsma and Chaouali 1998). However, 95 % of the estimated potential borrowers are still being left unserved.

Commercial banks are generally not interested in lending to the microfinance sector, finding the loans too small, and too costly to administer. For the most part microenterprises must finance their activities through family members, ROSCAS, pawn brokers and moneylenders. A major exception to this, however, is the National Bank for Development (NBD), the only commercial bank in the country that has established a separate unit to provide financing to the entrepreneurial poor. NBD has become a major supplier of microfinance in Egypt and has found that, through slight modifications of their procedures, they are able to manage these new services in a profitable way. As of June 1998, NBD's current outstanding loan portfolio for its micro operations totaled 12.3 million (Tucker 1998). NBD's development goal for its microfinance operations is to expand microcredit to all its branches by the year 2000.

The Egyptian Small and Micro-enterprise Association (ESMA) is a recently formed network established to link the various players in the microfinance sector to exchange information and experiences with the aim of promoting best practice in the region. ESMA has the potential to play an important coordinating role both in Egypt and the region as a whole, however, is currently in the process of finding a new coordinator for its operations.

B. UNDP Country Office

1. Strategy[4]

The strategy of UNDP in Egypt for the period between 1997 and 2001 is to combat poverty with the ultimate goal of helping Egypt further its sustainable human development. Priority will be given to programs that aim to(1) integrate sustainable human development concepts into national strategies, policies and programs; (2) dramatically reduce rural-urban dichotomies and other socio-economic disparities within and between Egyptian governorates; and (3) enhance governance through establishing strong partnership between the state and civil society organizations, and through women's empowerment. UNDP will focus on three broad thematic areas: Poverty Eradication, Protection of the Environment, and Good Governance.

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3 The UNDP strategy and programme overview sections are based on the Country Cooperation Framework (which establishes the basis for cooperation between the country and UNDP) and the Job Creation and Poverty Alleviation in Egypt: Strategies and Programmes.

1. Program Overview

During the 1997-2001 period, UNDP will concentrate its core resources on six programs falling under the three thematic areas identified above. Below is an overview of these programs:

A. Promotion & Advocacy for the Development of a National Strategy to Eradicate Poverty

This program, which falls under the theme of poverty eradication and sustainable livelihoods, will help bring the social dimension and poverty issues to public awareness and public debate. The overall objective of the program is to increase the GNP per capita to $4,100 by the year 2017 and improve the well being of all Egyptians. The program aims to create interest in human development and poverty; strengthen the data base and support studies that generate meaningful information about problems and issues in human development and poverty; assist in the translation of this information into strategies, policies and programs; and build the necessary avenues through which policy and program options are incorporated into the national planning agenda. The strategy for this program centers on: i)improvement of data and information on human deprivation; ii) raising awareness among policy makers in Egypt; and iii) encouraging contribution of the civil society in the policy dialogue.

a. Support to Key Initiatives Aiming at Satisfying Basic Needs & Eliminating Socio- Economic Disparities

This program constitutes the practical component of the theme of poverty eradication and sustainable livelihoods area. This strategy aims to: i) enhance income-earning potential among the disadvantaged groups; ii) encourage entrepreneurial activities; iii) improve social support and action to alleviate poverty; and iv) mainstream Sustainable Human Development concepts of growth with equity.

b. Capacity Building for Environmental Management, Protection and Control

This program, which falls under the theme of protection of the environment and the sustainable use of natural resources, will reinforce Egypt's commitment to environmental protection. The strategy aims to: i) build institutional capacity for environmental management, protection and control; ii) mobilize resources through well-developed environmental projects' portfolio; iii) create environmental awareness among the various sectors, public and private as well as in local communities and the civil society at large; and iv) protect the global environment.

c. Sustainable Utilization of Natural Resources and Promoting the Use of Appropriate Technology

This program, which falls under the theme of the protection of the environment, will support the government's strategy to develop and implement new means of protecting and sustaining the resource base. The program centers on: i) building capacity needed to support efforts in water, land and energy management and use; ii) helping demonstrate "environment friendly" development schemes and building entrepreneurship among women and youth for operation and management; iv) helping protect the cultural heritage; and v) transferring appropriate technologies to sustain resources with focus on global issues.

d. Management Development

This program, which falls under the area of sound governance, will support the government in carrying out its new and revisited role under the Economic and Structural Adjustment Program (ERSAP) which was launched in Egypt in 1991. The strategy for this program is to: i) support the economic reform process by establishing a technical secretariat to monitor the implementation of ERSAP; ii) enhance global partnerships through building national capacities for international negotiations; and iii) help undertake civil service reform.

e. Civil Society Empowerment

This program, which falls under the area of sound governance, will support the government's efforts to encourage and facilitate the involvement of Civil Society Organizations (CSOs) in assisting the Government of Egypt with the implementation of its development plans. (CSOs) are a major contributor to Sustainable Human Development and a means to ensure that development is people-centered. This program's immediate objectives are: i) to promote an enabling environment for CSOs to contribute effectively towards Sustainable Human Development through supporting their grassroots activities and capacity building needs as well as providing them with access to information and skills and ii) to advocate the promotion and strengthening of partnerships among CSOs, the State and the Private Sector.

C. Social Fund for Development

In 1991 the Government of Egypt undertook an Economic Reform and Structural Adjustment Program (ERSAP) under the supervision of the World Bank and the IMF to deal with the economic challenges being created by falling oil prices and the gulf war. The Social Fund was created as part of the structural adjustment package to help mitigate the possible negative impacts of reform; to help reduce poverty through supporting employment generation and community development efforts; and to provide help to Gulf returnees. The Social Fund to this day continues to act as an autonomous governmental institution, working through NGOs, PVOs and local communities to provide development opportunities through its five programs: Community Development, Enterprise Development, Human Resource Development, Institutional Development, and Publics Works.

The major role of the Social Fund is to channel funds to select target groups by investing in activities that benefit the poor and deprived areas. Its objectives are to assist in the short term the low income population groups most directly affected by the economic reform measures; and in the medium term, to strengthen the government's capacity to design and monitor poverty alleviation policies and to help develop and/or modify existing social programs, including safety net programs. It is intended to ensure the full realization of vulnerable groups' potential by promoting their human development and by providing access to productive resources and economic activities.

The Social Fund supports microcredit operations under the Productive Activities Component of its Community Development Program, intended to support income generating activities of low income population groups. Through this program local Sponsoring Agencies (SAs) are provided with a mixture of loans and grants (loans for onlending and grants for capacity building) to provide credit opportunities to the poor. Credit is given for start-up productive activities and can be used to finance working capital, training and/or equipment, and support activities such as handicrafts, consumer delivery services, food processing, animal breeding and small horticulture production. Credit is targeted to poor individuals identified through social surveys undertaken by the Fund, with a preference given to female heads of households. All credit programs supported by the Social Fund offer integrated services, which are seen as necessary for a complete microcredit scheme.

Loans given by the SFD are done so in the form of a line of credit to the recipient institution. The term varies according to project nature at a 7% simple interest rate. The grace period for repayment on the loan capital also varies, but interest payments commence immediately on the full amount of the loan. The intermediary in turn is only allowed a 1% spread to cover its risks. The effective cap on interest rates charged to the client make it extremely difficult for the recipient institution to maintain the value of its loan fund, because it is not able to charge enough to cover its operating costs or the cost of inflation, let alone to allow for growth. Consequently, many of these institutions will find that they have no loan capital left once they have repaid the SFD loan to continue their credit operations. While grants are also provided for capacity building, a condition for these grants is the sustainability of the project upon the withdrawal of SFD support, which will be very difficult to meet under the above described loan terms.

Since 1992, the Social Fund has distributed roughly 61 million LE in microcredit through its Community Development Program to over 56,000 borrowers, 68% of whom have been men and 32% women. The average loan size has been 1325 LE. During phase I, SFD MIS has developed a set of tailored applications to help the SFD in project management and administrative functions. One of the MIS modules was the loan tracking system for the CDP's Productive Families Projects. The system has over 45,000 records covering all the governorates working with SFD in microcredit, with a total loan sum of L.E 55,000,000. It produces a set reports that analyze loan allocation, type of activities, repayments, etc. This system tracks project finance and disbursements schedules. The Phase II strategy for the development of this MIS is meant to overcome the shortcomings of Phase I in the field of project evaluation, tracking of output indicators, as well as covering the social aspects of the project. This will involve the collection of more detailed information for monitoring and decision making of its micro portfolio such as outstanding loan portfolio, arrears, efficiency ratios, etc.

2. Relationship to MicroStart

MicroStart, which will be UNDP's first microcredit intervention in Egypt, will fall under UNDP's thematic area of poverty eradication and sustainable livelihoods and will contribute to the broad objectives by enhancing income-earning potential among the disadvantaged groups and encouraging entrepreneurial activities, shared by both UNDP and the Social Fund. In addition the project's focus on microfinance best practice will help the Social Fund as it begins laying the groundwork for its Phase III strategy, which will include incorporating innovation, sustainability and an approach to strengthening partnerships in the development process.

The Social Fund is in a strong position to meet the growing demand for microfinance by supporting NGOs and bank intermediaries in their efforts to increase outreach and provide a sustainable service in the communities where they operate. SFD's vision for phase II emphasizes sustainanbility at all levels. MicroStart will help the Social Fund in its pursuit of the sustainability for the development efforts it finances and for greater leverage for cost sharing within the communities it supports by helping to integrate microfinance best practice in the operations of its current and/or potential support recipients. Additionally, at the level of the SFD itself, MicroStart, through its involvement of SFD management in trainings and other various aspects of project implementation, will assist SFD to continue to innovate in the ways it manages the larger microcredit operations under the CDP.

An International Technical Services Provider (ITSP) will be selected and contracted by the Egypt Country Office and the Social Fund for Development, with the support and advice of the Special Unit for Microfinance (SUM) in New York. The ITSP will be responsible for managing the program, and will sub-contract a Local Technical Services Provider (LTSP) to act as its local counterpart in the implementation of the project. Prior to sub-contracting, the ITSP will submit its selection of the LTSP to the Egypt Country Office and the Social Fund for approval. As it is the ITSP who enters into a contractual arrangement with the LTSP, the ITSP should have complete autonomy in selecting its local counterpart.

The ITSP and LTSP will work with the management of the CDP (microenterprise division) to develop a detailed workplan for the project, complete with objective, activities and outputs. The proposed action plan and other major strategic and planning documents will be submitted to the Steering Committee for approval. The Steering Committee, chaired by UNDP Egypt and the Social Fund, will set the major program policies, approve the annual action plan, approve the selection of participating organizations, approve the distribution of traunches to the participating organizations, etc. (See II.F. Implementation Arrangements).

One of the selection criteria for participating organizations is that they are currently working in the target zones of the Social Fund and/or UNDP, or that they are willing to do so in the future. This will promote the linkages of the components within these two programs. Efforts will be made wherever possible to ensure exposure to the principles and practices of sound microfinance to key individuals even to those areas not covered through workshops and/or seminars. Extensive resources and documentation will be made widely available.

D. Donor Interventions in Project Areas

1. **United States Agency for International Development (USAID)**

USAID is the largest funder of microfinance initiatives in Egypt, with unofficial estimates crediting AID with financing roughly 70% of all activities in the sector. USAID's support to the sector is mainly targeted at established organizations that have a track record in successfully providing microcredit services. An initiative is currently underway to provide lines of credit to up to 60 new and existing microcredit operations to capitalize their loan funds. The estimated project budget is $45 million and will be provided through a newly established guarantee mechanism called the Credit Guarantee Corporation (CGC). USAID is working with Environmental Quality International (EQI) to identify potential recipient organizations, in addition to the foundations they have created and continue to support, interested in creating new microcredit branches to absorb this capital. The implications of this initiative for MicroStart are minimal in the short term, as most start-up organizations will not be able meet the funding requirements (i.e. sound financial statements, portfolio management reporting). However, the CGC represents a substantial source of capital to which MicroStart partner organizations can be linked once they have developed their systems and can provide clear and transparent reporting.

E. Conclusions Regarding Donor Support

In Fayoum there is surprisingly little donor support to microfinance activities. FAO, IFAD and the Dutch government fund projects on a very small scale with no apparent strategy for expansion. Most of the donors appear to be concentrating their support in other priority areas with higher poverty figures and, as mentioned before, are mainly focussing on more established organizations as intermediaries for credit. MicroStart will contribute to the microcredit sector in Fayoum, and to Egypt more broadly, by focussing on young start-up organizations, a group largely overlooked by donors looking for sound investment partners. MicroStart's integrated package of technical assistance and start-up capital will help these organizations develop the basic financial statements and transparent reporting systems that will, among other things, help them to access additional donor funding and/or commercial sources of capital needed for long term sustainability.

In addition, there is a very large gender disparity in terms of the clients being reached through current microcredit interventions in the country. Of the estimated 75,000 clients currently being served nationwide, only approximately 12% are women. While there were some institutions that had large number of female borrowers in Fayoum (El Elam CDA and the Family and Community Development Association), these were special women only projects that did not reflect wider efforts to increase outreach to women for more mainstream credit schemes. MicroStart, with its commitment to increased access for women to microcredit services as well as the benefits derived from these services, will significantly contribute to this process.

II. Program Justification

A. Location

The piloting of the activities under this program will begin in the Governorate of Fayoum with the expectation that the Governorate of Qena, a priority area for UNDP, will be included in this pilot effort at a later date with Luxor as a potential project area. A separate feasibility study will be taken to explore opportunities in Qena, as well as other potential governorates as seen fit.

The governorate of Fayoum is located 100 Km south west of Cairo and occupies an area of 4549 Km^2, 8% of which is water, 39% is cultivated area, and 63% is desert and housing. As of 1997, the total population of the governorate is 2.04 million (450,000 households) with an average population growth rate of 2.45%. 22% of the population is urban (59% between the ages of 15 and 60) and 78% is rural (60% are between the ages of 15 and 60). The percent of women in the governorate is 48%. Unemployment hovers around 9%. More than 60% of the rural population and approximately 38% of the urban population is illiterate. The governorate is divided into five administrative districts: Fayoum, Sinuris, Tamia, Itsa and Ibshawai. Within the five districts, there are five cities and one hundred and fifty nine villages. The governorate houses ten campuses of Cairo University and 14 vocational training centers. The economic centers provided by the five cities located in Fayoum as well as its close geographic proximity to Cairo, allows for direct access to major markets for the sale and distribution of local production.

B. Demand for Microfinance in Fayoum

The governorate of Fayoum's main sources of production come from the use of its rich natural resources through mining, farming, and fishing. The majority of the labor force is involved in agricultural production with winter crops of wheat, beans, onions and garlic and summer crops of cotton, tomatoes, corn and olives. Other products cultivated include mango, orange, grapes, and aromatic medical plants, which account for a significant portion of the country's export. 11% of all aromatic production for export is cultivated in Fayoum. The prevalent industries in the governorate include ceramics, olive oil, dairy factories, cotton weaving and tourism. In addition, most rural families supplement their household income with various cottage industries, such as basket weaving, food production and livestock**.**

Based on the current number of households in Fayoum, which is roughly 450,000, the potential demand for microfinance is approximately 90,000 households. In addition, a study recently conducted by a group of consultants commissioned by the governorate showed that in Fayoum, 35,000 households were headed by women. These women are either divorced or widowed and living at best on their monthly pension of 50 LE. One of the governor's priorities is to encourage programs that allow these women to earn enough income to provide for their families and to insure the well being of their children. Through MicroStart and other development programs, NGOs and other intermediaries can increase the level of outreach to the poor segment of the population.

MicroStart in Fayoum would add to current interventions by unifying and strengthening what already exists and subsequently would help these organizations further along the path of sustainability and growth. MicroStart focuss on those organizations with demonstrated commitment to business-minded, sustainable practices and quality in management, reporting and accounting. Microstart in Fayoum will cover both rural and urban areas depending on the focus of the partner organizations. Whether an urban or rural focus, almost every institution visited expressed that there is a strong demand for microcredit in Fayoum and that capital constraints and lack of adequate sources of funding are the main constraints to meeting this unmet demand.

C. Local Interventions

1. International NGOs in the project Areas

a. Care

Institutional Characteristics:
Care is providing microfinance services under its GSME Program through four local NGOs, which it established in 1994 for the sole purpose of providing microcredit to the poor. Care has worked with these organizations from their inception, starting with the selection and formation of the Board of Directors to the recruitment training and management of the staff.

Markets and Clients:
The NGOs are located in four Governorates in Upper Egypt, Fayoum, Qena, Aswan and Sohaq, covering the District of Fayoum, Abshaway, Tamiah, Etsa and Sannoures. While they currently only serve their respective capital cities, they are licensed to service the entire governorate.

Technical Assistance:
Care set up a line of credit at the local bank in the amount of $200,000, in the form of a guarantee. Care provided these NGOs with the initial Board training, training in lending methodologies and financial management, as well as helped to set up and implement all of the organizations operating procedures, reporting systems and manuals. Care has also organized a network with the 4 NGOs, in an effort to provide their associations with a support system and to help them build relations with commercial banks.
Products and Services:
Care began these organizations with a grant provided by USAID of 540,000 LE to be used for operating costs and loan capital. Care provides funding to these organizations in the form of loan guarantees drawn on local banks. The Egypt Overdraft Fund (EOF) line of credit is available to the NGOs at 11% and is drawn down through checks paid to the individual clients, which are cashed directly at the bank or through the NGO at a service charge by the bank. The NGOs in turn on lend to the clients at a 14% flat interest rate.

Quantitative Summary of Micro Operations:
Each NGO has loan capital totaling approximately 600,000-700,000 LE and together they have 2300 active clients (4,000 total combined clients served to date). Each program reached operational self-sufficiency after 3-4 years and is currently operating at 95% financial sufficiency. Their combined portfolio in arrears is 4-5% and portfolio at risk 7-8%. Care has written no loans off to date. The average loan size of its programs is 2200 LE and is lent through individual loans to clients at a 14% flat interest rate. Current operating cost ratio is 10-15% and cost per client 100 LE.

Growth Strategy and Needs:
Care would like to expand its operations in Fayoum, with a specific plan to pilot a new program to finance women entrepreneurs. Currently, only about 10% of Care's clients are women and they would like to experiment with expanding their outreach. They have considered using group lending methodologies to reach this market, but have not been encouraged by the limited success of Save the Children and UNICEF with this strategy. They are very interested and committed to expanding their outreach to women; however, lack the expertise and experience in this area. In addition they are currently negotiating with USAID to provide technical assistance in cooperation with EQI to the $45 million, 4-year program with the CGCs to open 60 new microfinance-lending units in Egypt.

b. Foundation for International Training

Institutional Characteristics:
FIT is a Canadian based NGO which was established in 1976 as a non-profit development services organization with a focus on capacity building of PVOs and NGOs contributing to development. FIT works in the areas of small and microenterprise development, education, population and health, governance and partnership and participation. All FIT projects are conducted on a cost recovery basis and have received funding from a number of donors and other partner organizations, including CIDA, various UN agencies and multilateral development banks. FIT has a Technical unit of 85 people, providing support to the multiple projects ongoing in the country.

Markets and Clients:
FIT provides microcredit services to the Governorates of Qena and Aswan through its Women's Initiative Fund Project, started in cooperation with the Ministry of Social Affairs (MOSA) in 1993. FIT's focus is 100% women and provides its services through two local banks, the National Bank for Development (NBD) and the Agricultural Bank for Development and Credit (PBDAC). While they do not currently have operations in Fayoum, they would like to expand to this area through their established relations with PBDAC.

Products and Services:
FIT supported the development of separate micro windows within National Bank for Development (NBD) in Luxor and Agricultural Bank for Development and Credit (PBDAC) in Qena by providing grants for operating costs and loan capital in the amount of approximately 1.6 million LE. In the case of NBD minimal training was required as FIT's grant was used to expand the methodology in place since 1987. Additional training of staff was provided to PBDAC, as well as training at the client level in the form of business advisory and other services such as

apprenticeship arrangements for start-up businesses. International TA undertaken to date includes work with the EU, Care, ILO, Dutch, CRS, GTZ.

NBD and PBDAC in turn onlend to low income women with existing and start-up businesses at 16% flat plus 8% Insurance and fees and 13% flat, respectively. PBDAC requires loan collateral and has a mandatory savings component. NBD requires no collateral; however, has an obligatory insurance component. Credit is provided for individual working capital loans and is made available through mobile units in the case of NBD and through the Bank office in the case of PBDAC. Loan sizes are up to 2,500LE for NBD and 5,000 LE for PBDAC. Loan terms range from 10-24 months with an average loan size of 2000 LE. NBD provides graduated lending schemes; however, PBDAC only provides one-time loans.

Quantitative Summary of Micro Operations:
As of May 1998, total outstanding number of loans was 3,500. They have disbursed 13,500 loans to date. Total number of active clients is 2,200. Repayment rates for the two programs are between 98-95%.

2. Local Organizations in the Fayoum

The microcredit programs in Fayoum are all quite similar in terms of their application procedures and collateral requirements. None of the organizations that we visited require collateral, but instead rely heavily on personal guarantees (one or two) and a signed IOU check from the borrower that can be used in a court of law in the case of default. This threat of jail, as well as heavy social pressure, greatly obviate the need for any physical collateral or other types of solidarity group mechanisms. Application processes are simple and generally entail a loan application detailing the amount requested, purpose of the loan, and requested loan term. A feasibility study follows which involves a simple cost benefit analysis with the client, verification of the business to be undertaken and a reference check. And in the case of loans that specifically target divorced or widowed women, a spouse's death certificate or divorce certificate might be required. Turnaround time for the disabuse of the loan range from 24 hours to several months, depending on the availability of loan capital and length of waiting lists, which in some cases are considerable. Most of the organizations do not have staff dedicated solely to the microcredit operations, but instead use their staff to manage different projects or loan products. NGOs by law are not allowed to mobilize savings.

None of the NGOs that we visited in Fayoum were sole purpose microcredit institution, but instead offered integrated services, and handled their microcredit components as projects rather than integrated parts of their operations. Even the banks with their focus on financial services managed their credit operations according to the source of donor funding, with PBDAC maintaining different interest rates and eligibility requirement depending on the different donor terms. For the smaller NGOs this project distinction appears to allow them to distance themselves from the commercial interest rates they charge, explaining to clients and others that these rates were pre-determined by the donor and not by them.

a. Agricultural Bank for Development and Credit (PBDAC)

Institutional Characteristics:
PBDAC is a state bank that was created by President Nasser to help poor farmers and rural households through the provision of financial services. Its extensive branch network effectively provides services to every community in Egypt, as well as a source of employment for most rural families. In 1993 it began providing poor rural women microfinance services using bank funds and continues with this program today. More recently PBDAC has initiated two donor-sponsored projects through the support of the Dutch Government and IFAD.

Markets and Clients:
PBDAC currently has three different microfinance programs operating out of their branch network in Fayoum, which consists of 5 district branches, 41 village units, and 168 satellite offices. With its extensive branch network reaching into every remote village, PBDAC has come to be known as Egypt's village bank. The bank funds start-up activities where there is prior expertise in the areas of cattle and poultry raising, vegetable trading, and provision of

various services. Aside from its Rural Women Project, PBDAC loans are primarily for farmers and farming households (90%), with 70-75% of the clients being men.

Products and Services:
PBDAC provides microloans up to 1500 LE to adults with skills in productive activities. The loan term depends on the type of activity, but generally is up to one year with as much as a 7 month grace period. Commercial interest rates are charged (11% for 1-12 months and 13% for over one year). It is the policy of the bank to encourage clients to open savings accounts upon which they pay a rate of approximately 10%. Interest rates offered ***decline*** with the length of the deposit account. Currently on its donor funded credit line PBDAC does not offer repeat loans for they feel that given their limited resources it is better to provide more people credit once than fewer people credit repeatedly.

Quantitative Summary of Micro Operations:
Data provided inconclusive

Growth Strategy and Technical Needs:
The PBDAC branch in Fayoum would like to see the establishment of a separate micro division to increase the outreach and scale of its operations. However, all decisions regarding expansion and training are made at the central level and the branch managers have little say in the development or direction of their operations. All of the banks accounting and portfolio information at the village and district level is sent to the central branch where it is recorded manually and then fed into a database. The central branch has the computer capability to generate monthly, quarterly and annual reports on outreach portfolio and efficiency ratios. None of the reports are then fed back to the originating unit, as no analysis or management decisions are taken at the village or district level. The bank's current MIS does not account for the different loan products separately; however, they do have separate reporting formats that they generate to meet their donor requirements for the two micro projects.

b. Community Development Association, El Ealam

Institutional Characteristics:
The Community Development Association of El Ealam was created in 1966 under a presidential decree to implement projects under the Ministry of Social Affairs, with the objective of creating jobs. It began its operations by providing free vocational training and classes on the Koran for girls, and then began to market the products made through the association. It split the income with the young women and was able to use this to construct the building where they are today. Currently the CDA houses a nursery, and social clubs, and continues to provide vocational training. It began its microcredit in 1991 with a grant from Care in the amount of 15,000 LE. The institution appears to have successfully combined its social focus with the delivery of microcredit in a very professional fashion, providing personal services to their clients with strict terms for late payments and default. The NGO staffs 23 employees with a separate staff for the credit operations, consisting of a credit officer and an accountant who doubles as an extension worker for all payments due to the NGO.

Markets and Clients:
The Community Development Association of El Ealam continues to focus their activities on needy women and in June of 1998 began a new credit program with FAO targeting widows and heads of households between the ages of 18-35. The CDA loans primarily finance activities such as cattle and poultry raising, vegetable trading, and palm "weaving" through the purchase of raw materials. The NGO does not give cash, but instead sets up a line of credit with the supplier of the raw materials who then provides these inputs to the clients. Currently it has a 100-person waiting list and is considering upping its loan size to meet the growing demand.

Products and Services:
The CDA provides loans for up to 30 months (with an average term of less than a year) and a one-month grace period. Loan sizes range from 200 LE to 1,500LE loaned at an interest rate of 13% for the Care project and 5% for the FAO project. The NGO is able to maintain these two very different interest rate structures because they are

serving distinct client populations, with the clients under FAO having been selected through a household social survey. The other clients are identified through door to door community outreach. Because the NGO sets up a line of credit with the supplier for the borrowers, there is no need to negotiate directly with a bank. In addition to the loan products the association still has a training program. The women are provided training and raw materials at no cost and the association helps market their products. In exchange the women donate a percentage of the profit from their sales to be invested back into the association. This training is entirely voluntary and not linked to the credit program. The program is still subsidized by annual donations from the Ministry of Social Affairs.

Quantitative Summary of Micro Operations:

The CDA El Ealam has loan capital totaling approximately 90,000LE (65,000LE for the Care project and 30,000 from the FAO project) and serve a total number of active clients of approximately 672-772 (600-700 from the Care project and 72 from the FAO project). The average loan size of the CDA's Care program is 500 LE. Current operating cost ratio is 10-15% and cost per client 100 LE and the NGO has a 100% repayment rate.

Growth Strategy and Technical Needs:

The biggest constraint to further growth for this association is limited loan capital, with the second being limited infrastructure to support this growth. According to the Chairman of the Board (who is also the general manager), the association is achieving operational sufficiency, with a slight reserve for recapitalization of the loan fund. This even after he lowered the interest rate from 16% to 13%, at the end of the Care project, to adjust for the decline in national commercial interest rates. However, the growth is slow and is not keeping up with current demand. The association would also benefit from training in basic accounting, financial planning as well as computers. Currently all of the record keeping is done manually and is extremely basic. They also have plans for expanding their training center and providing greater marketing opportunities to their clients.

c. Family and Community Development Association

Institutional Characteristics:

The Family and Community Development Association was in 1997 to serve female headed households. It is an integrated service deliverer, providing credit for start up employment activities as well as basic training, literacy classes, and health care services. It started its credit operations in February 1998 with a loan from the Social Fund and continues to be one of its loan recipients. The association has a nine-member Board, an accountant and manager supplied by SFD to manage their micro credit program, and 27 staff. The credit project has its own staff assigned by MOSA (1 accountant and 10 extension officers all of whom are women) who are also responsible for the supplemental training and social service delivery, as credit under SFD is oftern twinned with training or other social services.

Markets and Clients:

The Family and Community Development Program is licensed to services all of the Fayoum Governorate, and currently covers 8 villages and two suburbs. They identify “beneficiaries” through social surveys on family well-being indicators done by the SFD and submit the list of potential beneficiaries to the Board for approval. Loans are provided for start-up activities and are often twinned with some basic training. While loans are given for productive activities such as livestock, handicrafts or equipment, these loans are often used to meet basic subsistence needs, rather than to grow a business or to slowly build up loan size for larger activities.

Products and Services:

The association provides loans for up to two years to women for start-up activities, including cattle, sheep and goat raising, trading, and carpet weaving. These women are all heads of households and have been identified by MOSA as the poorest of the poor. Loans are given at 8% interest to the client; a limit imposed by SFD, and in turn the association pays 7% on the loan it received from SFD. The 1% spread that the association is left with is not sufficient to cover its operating costs, let alone to build its loan portfolio. Operational costs of the project are covered by a separate grant by the Social Fund. Consequently, the association does not provide borrowers with repeat loans. While they have a nine-month grace period to start making their payments to SFD, they do not revolve the funds for fear that they will not receive enough back in time. All collections and disbursements are done door to door, with the latter given in the form of a check which is then cashed at the bank with the help of the extension officer.

Quantitative Summary of Micro Operations:
The total value of loans disbursed to date is L.E. 300,000 with an average loan size of L.E. 702. There are 427 active borrowers who are maintaining a 99.5% repayment rate.

Growth Strategy and Technical Needs:
The current credit operations are being financed through a SFD package consisting of a L.E. 500,000 loan for onlending and a L.E. 200,000 grant for capacity building. The grant component has allowed them to hire outside consultants to provide training in computers and basic accounting, as well as to help develop and set up their current systems. The bulk of their record keeping is done manually and fed into a database, which has the capacity to provide information on each of the individual loans. However, there are no systems in place to provide reports on the performance of the loan portfolio. The only figures that they are currently able to generate are cumulative loans disbursed and cumulative number of clients to date. The association would like to expand its operations beyond the Fayoum satellite and set up additional branches. In order to do this in a sustainable fashion they will require some basic training in portfolio management and business planning. They will also need to seriously reconsider their product pricing, which will require difficult decisions regarding the setting of interest rates and working through some of the perceived equity issues. The current interest rates are predetermined by SFD, however, it is not clear whether they would increase them if they were given the chance.

d. National Bank for Development (NBD)

Institutional Characteristics:
NBD is the only private commercial bank in Egypt that has established a separate unit to provide financing to microentrepreneurs. The Bank began providing microfinance in 1987 with a grant from USAID. Through continued donor funding they have been able to set up separate credit units within 20 branch offices, which are all currently financially self-sufficient. In1997 NBD began using its own funds to expand its micro operations and has 39 additional branches providing microfinance services. Due to financial constraints, the bank did not find it feasible to set up separate credit windows, but instead offers these services as one product among many handled by regular bank staff. As a commercial Bank, NBD is very professional and works according to cost recovery principles and has a strong focus on the bottom line. NBD has a follow up department that does the initial orientation of the extension officers during training. NBD is building a training center to deal with the needs of their micro operations alone and have apprenticeship programs with organizations such as ABA for their staff.

Markets and Clients:

Last year, NBD began providing microfinance services in Fayoum through its central branch. They provide loans for services, productions and vendors, serving 23% women and 77% men. They see a great demand in Fayoum and have plans to expand their operations into two more branches.

Products and Services:
The NBD provides individual loans from 250 to 10,000 LE with an average loan size ranging between 2,000-3,000 L.E. Loan terms are for up to 10 months, with weekly repayments of interest and monthly repayments of capital (depending on the type of activity). Borrowers are required to come to the branch for an application so that they can establish a relationship with the bank (no community outreach) and then extension workers follow up with a background check of the applicant. The initial disbursement of the loan is done at the bank and mobile units are used to collect subsequent loan payments. NBD charges a 29.7% effective interest rate, which includes a flat interest rate of 16%, a 4.7% transportation fee, a 6% fee paid in advance in case of delinquency and repaid upon successful repayment of the loan, and a 2.7% compulsory insurance fee that covers funeral expenses plus payment of the loan. There is also a compulsory savings component totaling 10% of the loan (which is not deducted from but rather added to the amount loaned to the borrower) available upon successful repayment.

Quantitative Summary of Micro Operations:
In Fayoum, the current number of loans disbursed to date is 164 with a total value of L.E. 1,265,000. As of January 1999, 141 loans with a value of LE 907,168 were outstanding. The repayment rate is 99.2%.

Growth Strategy and Technical Needs:

NBD plans to expand microcredit operations to its remaining 14 branches by the year 2000. In order to set up separate micro units as was done initially with donor funding they would need to find additional grants to help with the very expensive start up phase. It is estimated that it would take approximately 400,000-500,000 L.E. for each new unit, roughly the package of a MCG under MicroStart.

e. Small Projects Development Association (SPDA)

Institutional Characteristics:
SPDA is one of the four Care affiliates and the only one operating in Fayoum. Created in February of 1996 to support enterprise development through the delivery of credit and training, SPDA began its microcredit project with a grant of 540,000 LE under a partnership agreement with Care. The NGO has an 8 member Board, which is actively involved in the management of the operations. The current operations are managed by a staff of 12 (4 administrative, 5 field officers (all men), general manager, an accountant/auditor and a cashier) with each credit officer handling approximately 160 borrowers.

Markets and Clients:
SPDA is licensed to work in the entire governorate, but is currently only operating in the capital city. It provides loans for existing small and microenterprises whose capital is less than 25,000 LE. The majority (88%) of SPDA borrowers are men. SPDA feels strongly about the importance of continued access to financial services for its clients and subsequently has chosen to prioritize repeat borrowers over new ones. The result has been an increase in the average loan size and a waiting list of 50 people. The general manager estimates that he has a monthly demand of 35,000 LE and is disbursing an average of 15, 000 LE, leaving a gap of unmet demand of roughly 20,000 LE per month.

Products and Services:

SPDA provides loans from 300-5000LE for a loan term of up to one year and at an effective interest rate of 25%. In addition to its credit program, SPDA provides its clients with vocational training, awareness classes on subjects such as taxes, pension programs, registration and licensing of enterprises, recruitment and employment and provides referrals to government agencies. They provide these services to their borrowers for free, but charge fees to other programs.

Quantitative Summary of Micro Operations:

SPDA's current outstanding portfolio is 550,000 LE with an average loan size of 2100 LE. They are maintaining their operating costs at around 10% of their average portfolio. In total they have disbursed approximately 1300 loans.

Growth Strategy and Technical Needs:

SPDA's contract with Care will end in June of this year. While they have received extensive training as part of this relationship, particularly in the area of lending methodologies, bookkeeping, accounting and strategic planning, there is still work to be done to update their MIS (developed with AID funding 5 years ago) and computerize their accounting system. Their main constraint for the moment is said to be loan capital, however, based on the documents reviewed and competing figures received, the mission team was not convinced of the quality of their current reporting system.*

f. Community Development Association Tatoun

The CDA of Tatoun was established in 1944 as a multiservice NGO and began its credit operations in 1991 with a grant from Care. The project with Care ended in 1994; however, it continues to operate this credit project through volunteer extension officers and government subsidies. The mission has no confidence in the figures or information provided during the field visit and therefore will not go into detail regarding its products, services, or client outreach.

D. Conclusions Regarding Local Interventions in Fayoum

General Lack of Institutional Capacity

In general the information generating capacity of the organizations visited was limited. Most of the organizations had difficulty producing basic information on their loan portfolio (such as value of loans outstanding, total number of active borrowers, and portfolio in arrears) and more technical figures on operating efficiency ratios were virtually unattainable. Financial statements were non-existent. Conflicting figures on loan terms and interest rates were given, with no means to verify or corroborate the self-reported data. Of those organizations that were able to provide more detailed reporting information, many did so as part of donor requirements and did not appear to have internalized the importance or significance of these reports as management tools.

This stems in large part from the nature of NGOs in Egypt. Many have been created by the Ministry of Social Affairs to implement government projects and therefore lack a strong Board with a vision and mission for the institution independent of their sources of funding. In most cases operations appeared to be highly centralized with the overall responsibility for the management of the loan portfolio lying either with the donor or the central office, with little accountability at the branch level. This is evidenced by the type of reports being generated by these organizations. For example, all of the organizations visited could provide information on individual clients (balance outstanding, monthly payments of interest and capital, and any delinquency problems). However, none of the NGOs could provide portfolio quality reports with

* There was another NGO visited called the Community Development Association Tatoun, which was established in 1944. However, the mission had no confidence in the figures or information provided during the field visit.

cumulative figures on outstanding loan portfolio, arrears, number of active borrowers, etc., which are critical for making management decisions relating to the credit operations of the organization.

Outreach vs. Banking Mentality

All of the organizations visited are facing severe capital constraints, which has resulted in long waiting lists and the adoption of strategies to deal with this increasing demand for credit that are counter to long run objectives of sustainablilty. For many, this has meant suspending dispersals of new loans in order to preserve precious loan capital for servicing existing clients. This has resulted in larger average loan sizes and a movement away from needier borrowers as organizations continue to give loans to their best clients who have an established credit history. Others have chosen not to offer repeat loans at all thinking that a one-time distribution to a greater number of people will have a bigger development impact. However, experience has shown that microfinance clients will require continued to access microcredit as their economic activities increase and grow and are in need of additional inputs. First time clients of a microfinance organization will want to borrow larger amounts after the initial loan is repaid, or they want to borrow more than once to support the working capital requirements of their economic activities. One-time access to a micro loan does little to help people work themselves out of a cycle of poverty.

In addition, experienced microfinance institutions have found that repeat access to loans has proven a powerful incentive for clients to maintain high on-time repayment rates. If the client thinks that the organization will be around in the future, and that they will benefit from this continued relationship there is a higher incentive to repay. If the organizations in Fayoum want to meet their development objectives effectively (i.e. to provide valuable financial services to the poor on a sustainable basis) they will need to focus on becoming financially viable through a business orientation, which will include sustainable pricing practices and leveraging commercial sources of funding.

Lack of Cost Recovery Pricing

Most of the institutions visited in Fayoum claim to be operationally self-sufficient, covering their operating costs with a mixture of interest income, loan fees, and other operating revenue. However, due to the large degree of subsidies provided by the government and other donors, it is difficult to tell if this is in fact the case. Financial sustainability is more elusive, with NBD being the only institution that appears to be making a profit on its micro portfolio, which it has used to subsidize other Bank operations. It is not clear that the organizations visited have a sound understanding of full cost interest rates or how to calculate them. The result is that these organizations are unable to build up their lending capital because they are not charging fees and interest rates that cover their full costs of delivering the services to their clients. These costs include the cost for operating the service, a provision for bad debt, inflation and other cost of funds (such as borrowing) and a percentage for capitalization of the loan fund to ensure more clients can be served.

Those that are financing their operations on borrowed funds from the Social Fund (such as the Family Community Development Association) are unable to become financially viable because the lending cap imposed on them limits the spread they are able to earn. The result is that these organizations become little more than disbursement mechanisms, as they are unable to build their capital bases and remain dependent on donors to continue operating their credit schemes. At the current rate, they will not be able to finance new borrowers or continue to provide financing to existing clients who may need loans to finance their enterprises.

Grants vs. Loans for Start-Ups

Given their limited experience in delivering microcredit and the capacity building needs identified, many of these fledgling organizations would benefit greatly from a Micro-Capital grant, which would help them defray the very high operational costs associated with the start-up phase. The grants will be used for technical assistance for institutional capacity building, and loan funds can establish a strong base for the institution to grow. In the long run, this initial grant investment will go far in leveraging the growth of these organizations by allowing them to focus in the short term on their lending methodologies, reporting and monitoring systems and outreach strategies, rather than on how they are going to finance their credit operations. Through appropriate pricing policies, these organizations should soon be able to cover their costs of lending and will be strong enough to borrow funds to meet growing demand or strategies for future growth strategies.

Since savings is currently not a mechanism available for NGOs in Egypt to finance continued growth, even with appropriate pricing policies these organizations will need continued access to capital after the pilot project is over. Therefore linkages with other loan programs such as those offered by the Social Fund or other donors is essential for the long term viability of these institutions and their ability to provide the poor continued access to microcredit. Through their participation in MicroStart these nascent organizations can work toward becoming borrowers in the future by focussing on their financial management and reporting systems. Once they have established transparent financial track record that reflect their accurate financial position they will be viewed by potential lenders as well as donors as strong candidates for loans or grants to capitalize expansion.

E. Expected Outcomes

The MicroStart pilot program in Egypt will be implemented over three years. The expected outcomes of the program are as follows.

1. Participating local organizations will have an increased capacity to provide microfinance services to clients consisting of the economically active poor.
2. The number of clients served by participating organizations will increase at least 30% per year during the course of the pilot program.
3. Effective management systems and procedures will be in place in participating organizations at the end of the pilot program.
4. Appropriate financial products and services for the target clientele will be provided by participating organizations by the middle of the pilot program.
5. Excellent management of the loan portfolio and of client/member savings will be the norm at participating organizations by the middle of the pilot program.
6. Interest rates will be charged that are sufficient to cover all operating costs by the end of year three with an objective of reaching financial sustainability.
7. Participating organizations will have a viable financial strategy for building their loan portfolio through capitalization, grants, and loans, and for ensuring the financial stability of the institution as a whole.
8. Best practice standards of reporting will be incorporated into the SFD’s microcredit operations at the level of the recipient organization and linked with the CDP MIS, which will eventually be used to manage SFD’s microcredit portfolio.
9. Impact studies on clients of participating organizations will be carried out and results disseminated in coordination with the global MicroStart program.
10. A number of trainings for other SFD recipient organizations on reporting standards will have been carried out and ongoing processes initiated to promote sector wide learning and exchange.
11. The capacity of the LTSP, the Social Fund and UNDP key microfinance designate will be increased through participation in trainings, workshops, and round table discussions, and linkages to global network of MicroStart programs.

12. A sustainable continuation of the MicroStart initiative beyond the pilot program will be ensured through the efforts of the Social Fund, UNDP, the ITSP and LTSP by the end of the pilot program.

F. Potential Participating Organizations and Clients

The organizations eligible for participation in MicroStart Egypt will be those that are already engaged in microfinance activities. They should represent a range of institutional types (NGOs, private and/or public banks) with different client foci and delivery methodologies. In addition, those selected should be representative of the different levels of professionalism demonstrated by microfinance organizations--from non-professional to professional. This will help to examine the range of possibilities for future investment in the sector and to compare the progress and success rates of the different institutional arrangements. It will also ensure that the participating organizations can learn from and support each other and contribute to the strengthening of the sector as a whole. The suggested criteria for selection of organizations or bank credit windows are as follows:

- Have the poor as the target group
- Have a need for technical and/or financial assistance
- Have the capacity to absorb and utilize the assistance
- Have a legal status
- Have a regular growth in number of clients, with the intention and potential to reach a significant volume
- Have the intention and potential to attain self-sufficiency through the setting of sustainable interest rates
- Preference will be given to those organizations, which are already working in or willing and able to work in the areas selected by UNDP and the Social Fund

Clients will be poor adults in both rural and urban areas. They will have either existing or start-up activities in any productive sector, which includes agriculture, livestock raising, fishing, petty trade, artisanel activities, transformation of products, services, etc. Clients may be existing or new clients of microfinance service providing organizations. Selection of clients/members is the jurisdiction of the individual organizations. In selecting the participating organizations, however, the ITSP and LTSP will review each institution's selection criteria to ensure that they are compatible with the objectives and target group of MicroStart.

The premise of MicroStart is that providing small loans--with repeated access to increasingly larger loans--to the economically active poor can help them break out of their cycle of low investment and low returns. The design of the financial products and the methodologies used will play a role in ensuring appropriate self-targeting of clients. The current loan range of 100 to 5000 LE practiced by local organizations seems appropriate for MicroStart, given the types of investments made by the desired target group. The loan duration for MicroStart should be 12 months or less, although research may be done during the period on developing medium-term financial products, which has been identified as a need in the sector. Repayment will be in regular (usually monthly) installments of interest and principal. Alternatives to collateral will continue to be encouraged to ensure that the poor are able to access to loans. The ITSP and LTSP will work with participating organizations to ensure that they have suitable selection criteria, appropriate financial products, and good systems of monitoring to ensure that they are reaching the intended target clientele.

G. Risks and Special Considerations

The following list indicates some of the risks and special considerations that should be taken into account in implementing MicroStart in Egypt.

Nature of NGOs

The Charity focus of many NGOs in Egypt and their general lack of managerial accountability and clear lines of authority may make it extremely difficult to build up strong institutions with a vision and mission supportive of microcredit. If MicroStart is to be successful in transforming these institutions there must be a commitment at all levels to vesting these NGOs with the necessary authority to manage their microcredit activities and to take responsibility for the quality of their programming as well as the clients that they service. At an operational level, this will mean making NGOs responsible and ultimately accountable for the quality and management of their micro portfolio as well as for strategies to increase their outreach and grow as an institution.

Targeting Clients vs. Supporting Institutions

Targeting of project beneficiaries is often viewed as a necessary and effective way to ensure that the truly needy are benefitting from development interventions. However, microfinance is not a traditional development tool, where local organizations act as disbursement mechanisms and project managers for donor money. Rather the success of microfinance interventions is dependent on the existence of healthy institutions with a clear vision and commitment to serving the target population (i.e. poor communities) through the provision of financial services. Therefore, attempts to predetermine or select microcredit recipients for the organizations will greatly undermine ownership and accountability of the organization for its programming. Market surveys can be used by the organizations to identify the target population and ensure that their products are designed in such a way as to meet their financial needs. If done properly the result will be a self-selection process, whereby the neediest will be served.

Underepresentation of Women

Many of the most successful microfinance programs in the world work primarily or exclusively with women, who make up the majority of the world's poor and face the greatest barriers in accessing formal financial services. One of the most successful methodologies for reaching women has been through peer or solidarity group lending methodologies. The social benefits derived from these groups are often viewed to be more important than the credit itself as they result in networks of exchange and support previously unavailable to women with restricted mobility. In Egypt, however, there is reluctance among microfinance providers to use group lending methodologies, which are seen to be incompatible with the more individualistic way of doing business and managing financial affairs in Egypt. This is evidenced by the preponderance of individual microcredit lending schemes that are being offered throughout the country. The result has been an overwhelming disparity in the number of men and women benefiting from microfinance services in the country. Unofficial estimates show that women make up only 12% of all the current clients of microcredit programs in the country.

While some organizations have experimented with solidarity group lending in Egypt (e.g. UNICEF, Save the Children and CRS) the success to date has been limited and outreach to women is often limited to special women only projects. In order to achieve greater gender equity in the microfinance sector in Egypt, one of the major objectives of MicroStart, it will be necessary to examine the compatibility of group lending methodologies in Egypt as well as to explore other appropriate mechanisms for increasing outreach to women clients. The ITSP and the LTSP should help participating organizations identify and implement innovative and effective ways of reaching women and ensuring that they benefit equally from this intervention.