



GALT & TAGGART
CREATING OPPORTUNITIES



Georgia's Microfinance Sector

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Eva Bochorishvili

Head of Research | evabochorishvili@gt.ge | +995 32 2401 111 ext. 8036

Tatia Mamrikishvili

Associate | tmamrikishvili@gt.ge | +995 32 2401 111 ext. 4693

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Key findings

Status quo

- MFO market accounts for 0.2% of global economy, mostly operating in developing economies
- Global MFO market focuses on transitioning from being a pure lender to business partner
- Although faced with a bunch of regulations in recent years, Georgian MFO market looks healthy, with profitability above global average
- Georgian MFO market is skewed towards consumer lending, which is different from the classic MFO model.

Key challenges in the sector

- High FX risks and inability to issue new loans in FX. Although the majority of FX liabilities are hedged through currency swaps, some open positions still remain
- High funding and hedging costs - with no direct access to GEL resources from NBG, MFOs are mostly funded through loans from banks and IFIs, high FX borrowings lead to high hedging costs
- High funding and hedging costs leading to high interest rates on loans, limiting MSME's access to credit.

Expectations

- Law on Micro-banks expected to be approved in Feb-23
- Currently, 12 MFOs are eligible for receiving micro-bank status, though only a few of them have applied for licensing. NBG does not exclude the possibility of new entrants to the market
- Micro-bank model will probably lower funding and hedging costs for MFOs, reducing interest rates on loans and increasing MSME's access to credit
- Consolidation potential exists among the remaining MFOs, considering a number of small players on the market with poor financial performance.



Content

1. Key findings

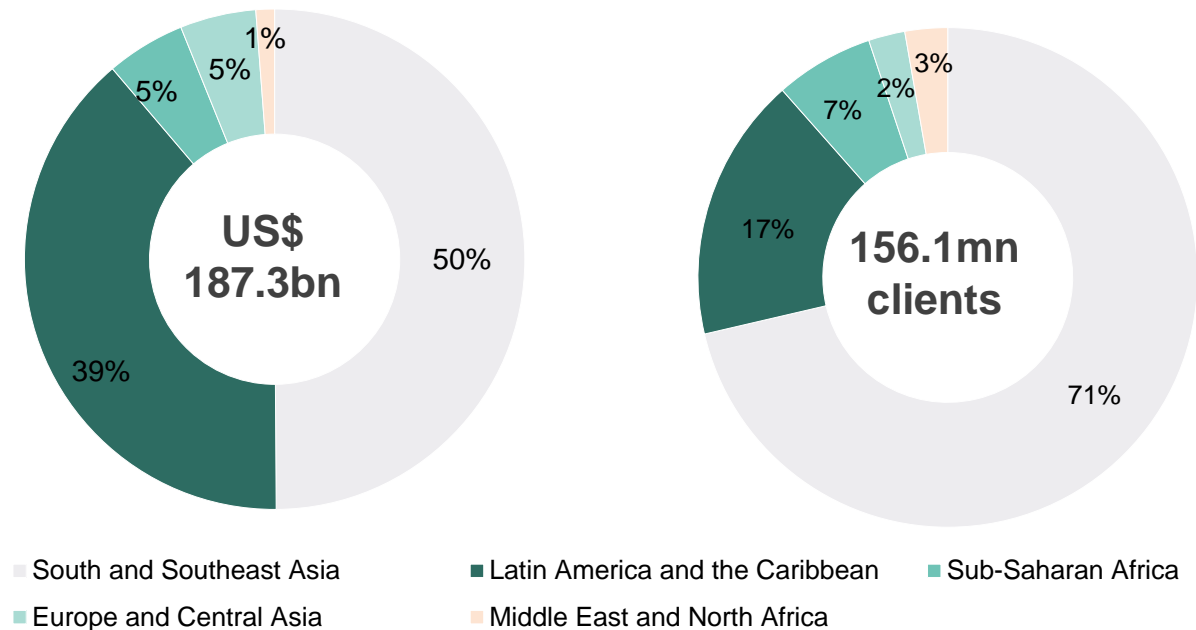
2. Global snapshot

3. Georgia's MFO sector and future outlook



Global MFO market is small, accounting for 0.2% of global economy, MFOs are mostly operating in developing countries, with underdeveloped financial infrastructure and high poverty levels

Global MFO gross loan portfolio and number of borrowers, 2021



Source: Impact Finance Barometer, 2022

Selected countries with developed MFO market

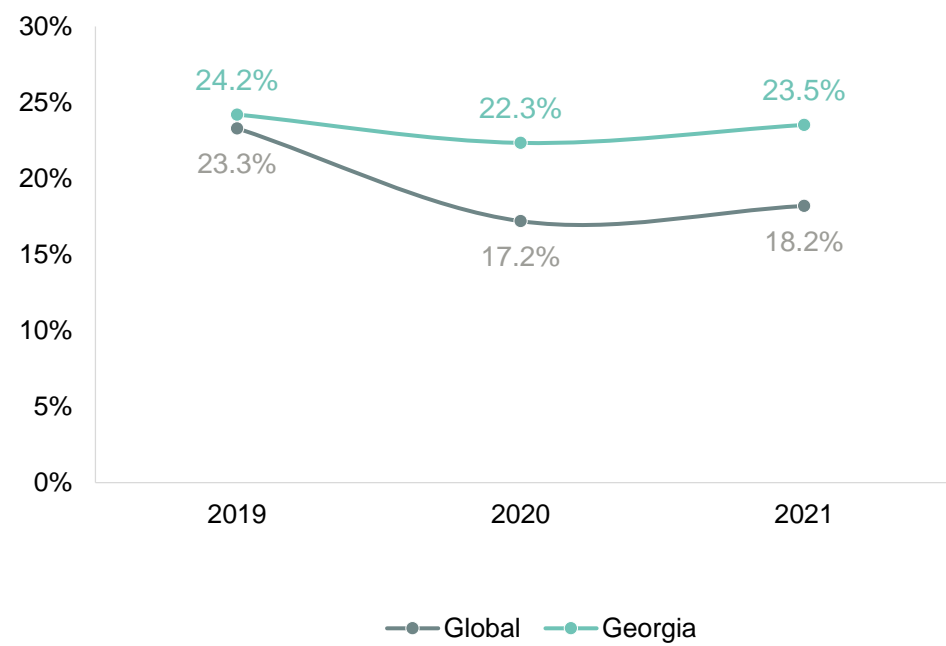
Country	Income group
India	Lower middle income
Bangladesh	Lower middle income
Cambodia	Lower middle income
Bolivia	Lower middle income
Mongolia	Lower middle income
Mexico	Upper middle income
Brazil	Upper middle income

Source: World Bank



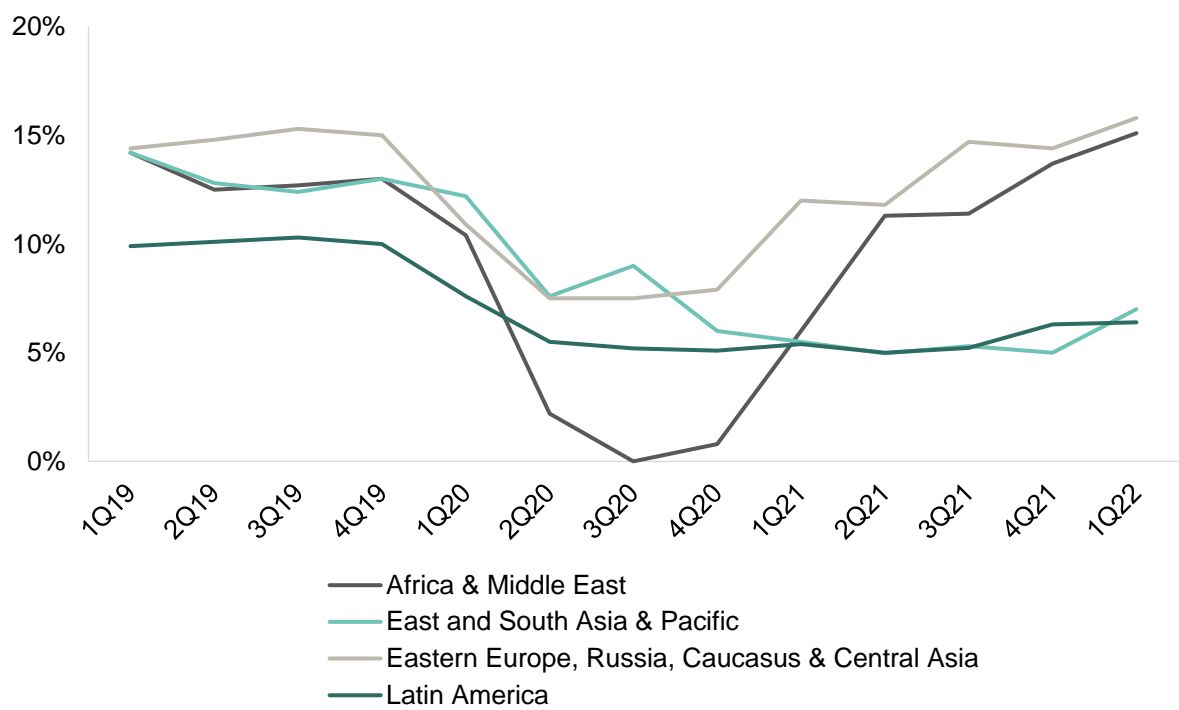
Global MFO portfolio yield averaged 18%, while ROE was hovering between 6%-16% in 2021

Average yield on gross loan portfolio



Source: Impact Finance Barometer 2022, NBG, Galt and Taggart Research

MFO return on equity by region



Source: Impact Finance Barometer 2022



MFOs globally are improving their business models, focusing to be a business partner from being a pure lender

Traditional MFO business model envisages:

- Providing access to finance to socially/economically excluded individuals
- Serving micro and small businesses for which microfinance is an additional or alternative source of funding

MFOs globally are refining their business models through:

- Providing alternative financing options like micro equity (e.g. Crystal Georgia)
- Trainings, mentoring, meetings and workshops for MSMEs, farmers and entrepreneurs (e.g. Finca Armenia, a number of European MFOs)
- Digital repositioning (e.g. partnership of Qredits – the leading MFO in Netherlands and Singlify – UK based digital transformation partner for MFOs)
- Strategic partnerships with banks and other service providers like payments and money transfers



Content

1. Key findings

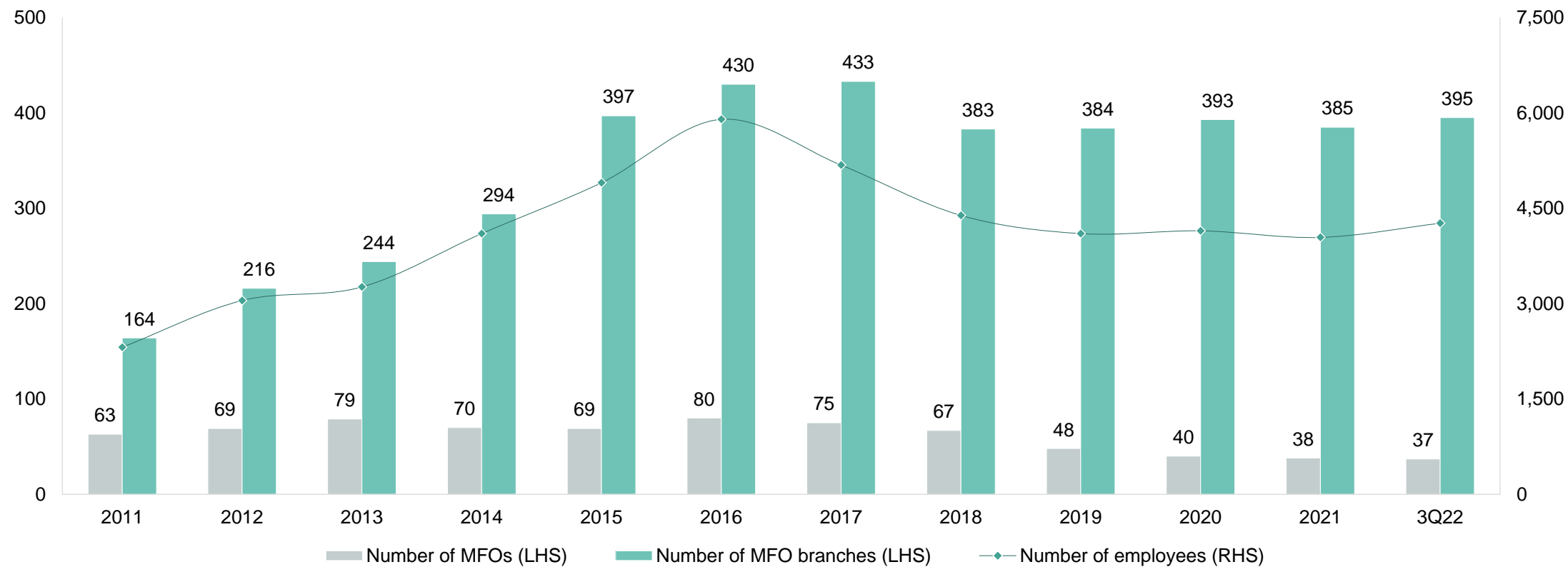
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A bunch of regulations has more than halved the number of MFOs to 37 over 2016-22, leaving qualified players on the market

Number of MFOs, branches and employment



Source: NBG



Interest rate caps were among the strictest regulations

MFO regulatory pathway

• 2017

100% ceiling on annual effective rates on loans

De-dollarization program

If the number of individual investors exceeds 20, borrowed amount should be at least GEL 100k per individual

• 2020

Loosened responsible lending standards

Obligation to form a 5% loss reserve on gross loan portfolio in 1H20

• 2018

GEL 0.5mn minimum amount of supervisory capital from Jan-19 and GEL 1.0mn from Jul-19

50% ceiling on annual effective rates on loans

Responsible lending standards

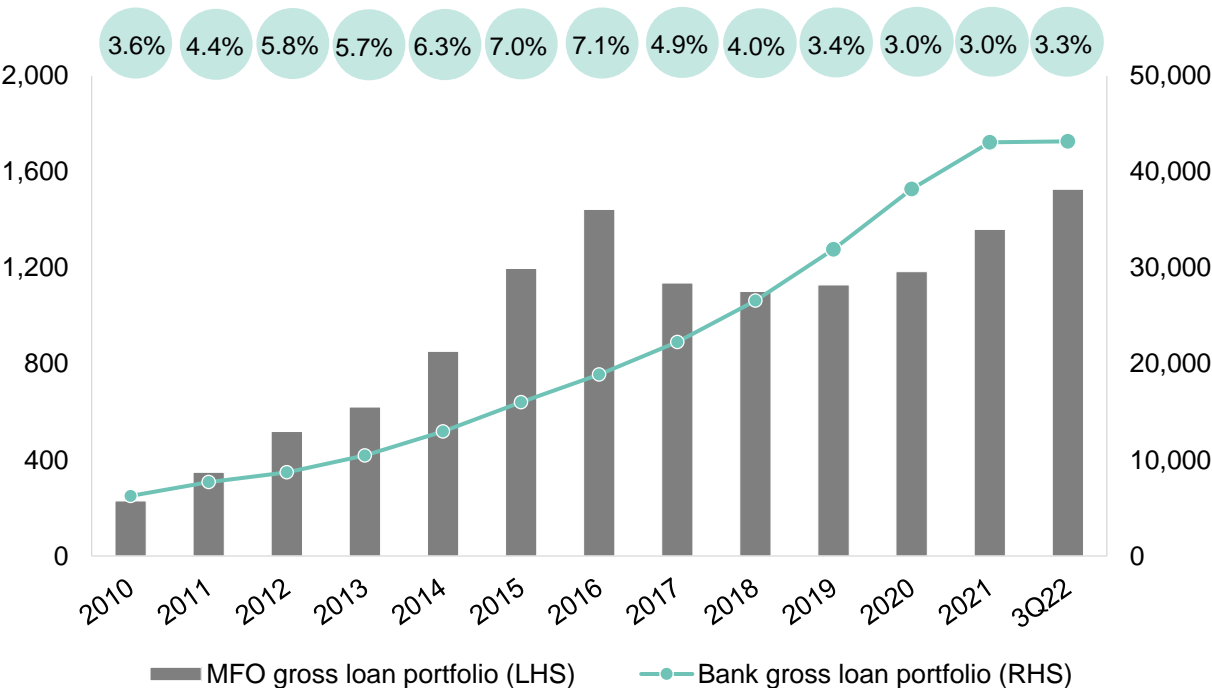
Law on adequate reserves for possible losses

Maximum amount of MFO loan to a single borrower increased from GEL 50k to GEL 100k



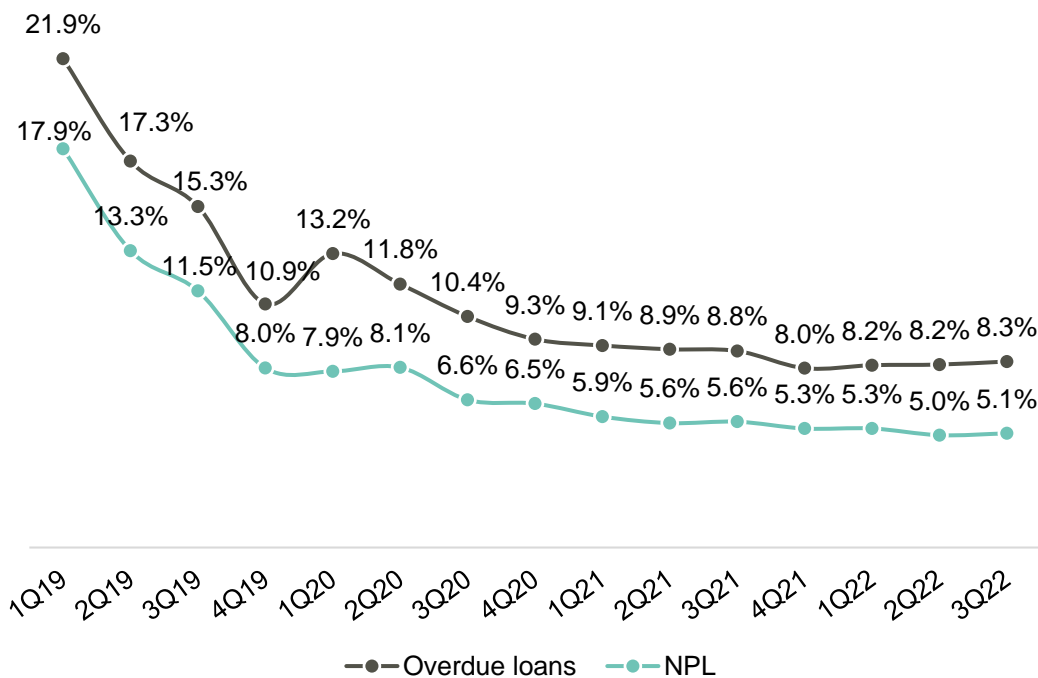
Regulations have made the sector healthier, with overdue and NPL share dropping to 8.3% and 5.1%, respectively as of 3Q22

MFO sector development trend, GEL mn



Source: NBG, Galt and Taggart Research
Note: Bank loan portfolio excludes interbank loans. Credit institutions include banks, MFOs and loan issuing entities

Overdue and NPL share in gross loan portfolio



Source: NBG, Galt and Taggart Research
Note: NPL includes loans with more than 30 days overdue



Georgian MFOs are not very active in the MSME lending segment...

Challenges faced on MSME lending:

- Competition from banks
- Higher cost of funds (10% on average vs 6% for banks)
- Difficulty accessing long term and low-cost local currency funding
- Mandatory local currency lending
- High hedging costs due to mismatch in FX funding and local currency lending

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MFOs actually engaged in lending to small businesses and agricultural activities

0.1%

of MFO borrowers are legal entities

Loans issued to legal entities account for

1.9%

of total portfolio

Loans issued on trade & service and agriculture account for

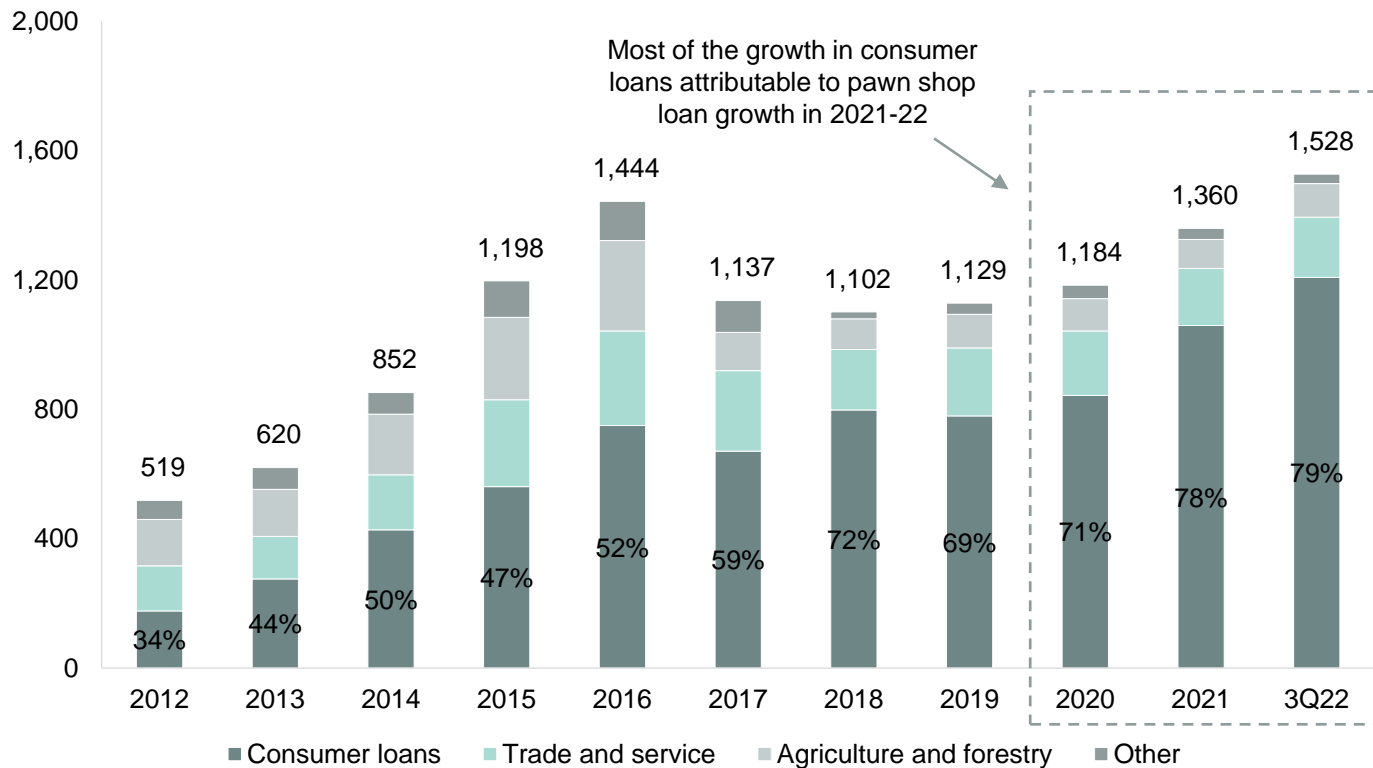
19.3%

of total portfolio



...instead focusing on loans to individuals (79% of total portfolio as of 3Q22)

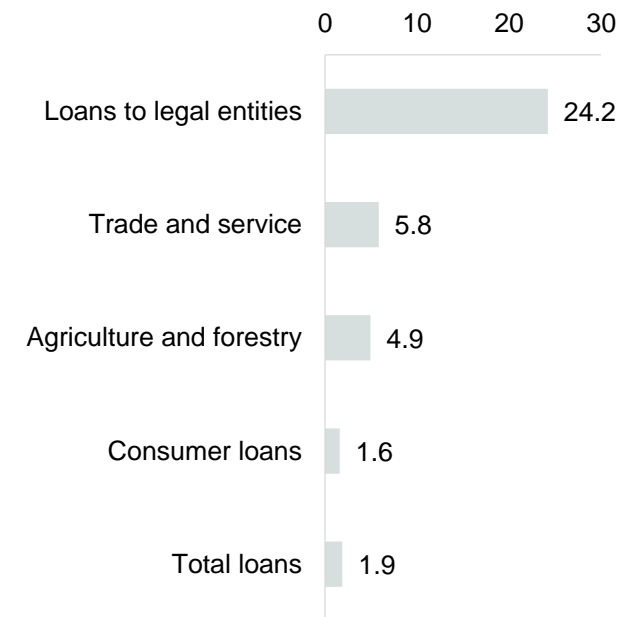
MFO gross loan portfolio by sector, GEL mn



Source: NBG

Note: Consumer loans include pawn shop loans, online loans and installments

Average loan size as of 3Q22, GEL '000



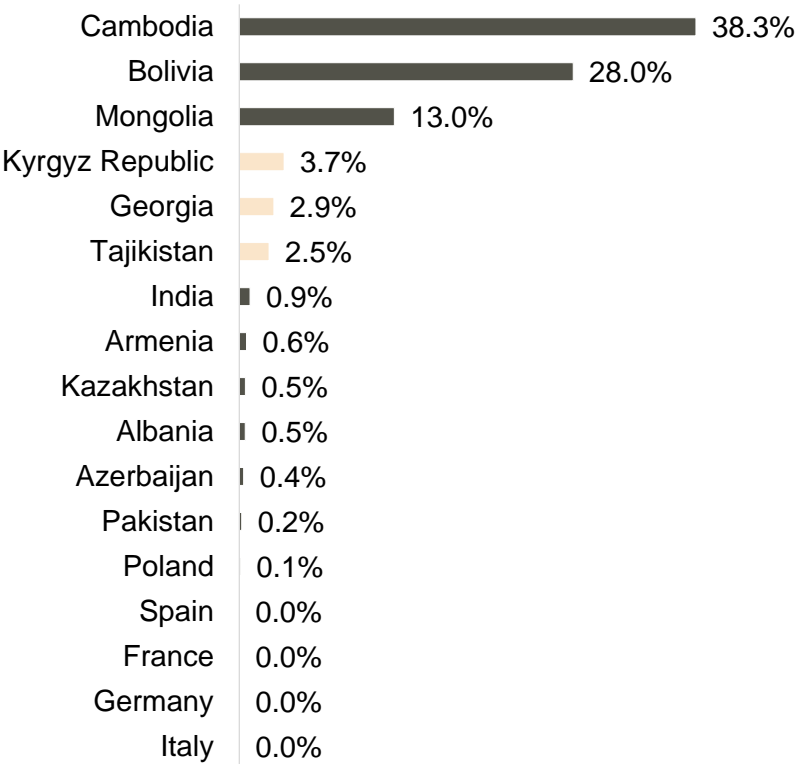
Source: NBG

Note: Consumer loans include pawn shop loans, online loans and installments



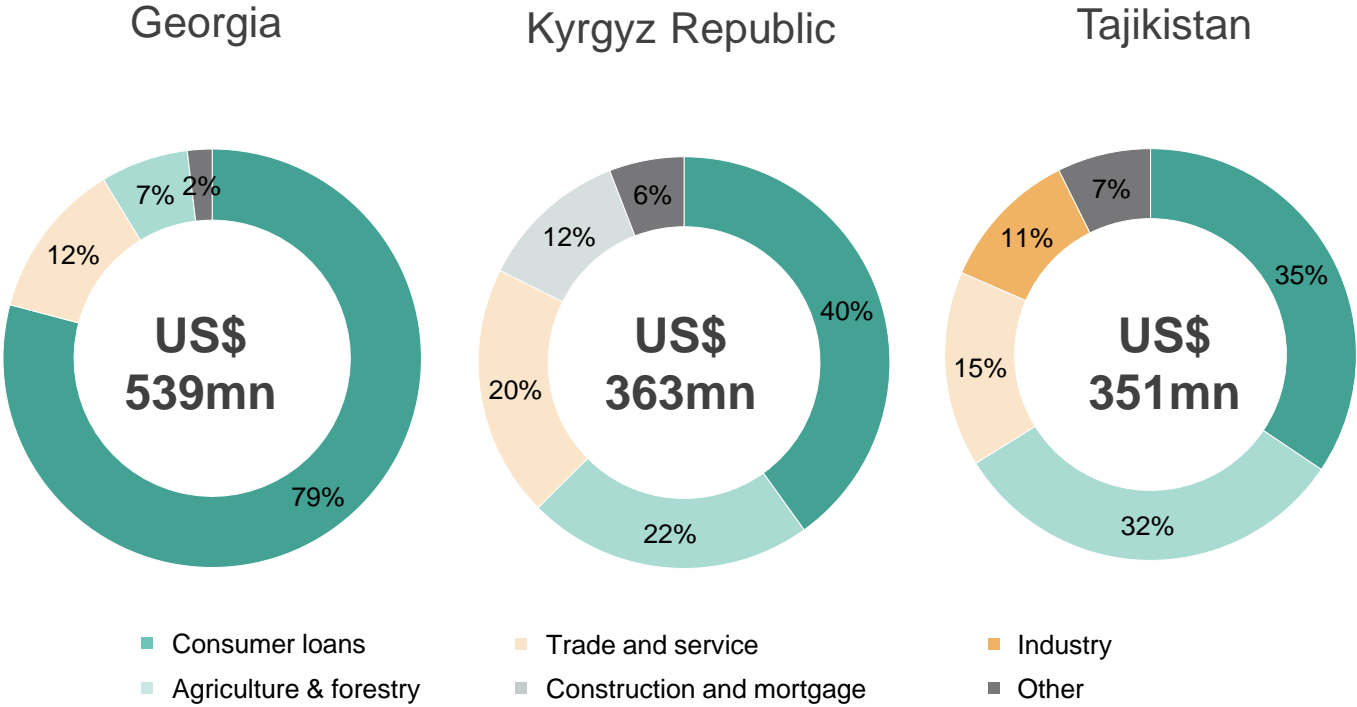
Consumer loans range between 35-40% of total MFO loan portfolio in peer countries vs. 79% in Georgia

MFO gross loan portfolio to GDP by country, 2020-22



Source: World Bank, Galt and Taggart Research
Note: Data for Georgia and Tajikistan as of 3Q22, Kyrgyz Republic as of 2021, others as of 2020

MFO gross loan portfolio distribution by country, 3Q22

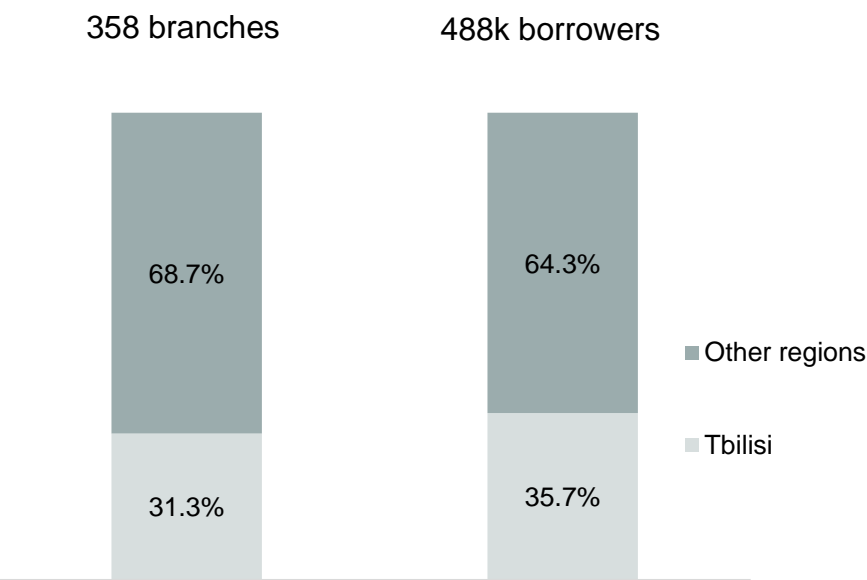


Source: National banks of respective countries, Galt and Taggart Research
Note: Data for Tajikistan as of Nov-22

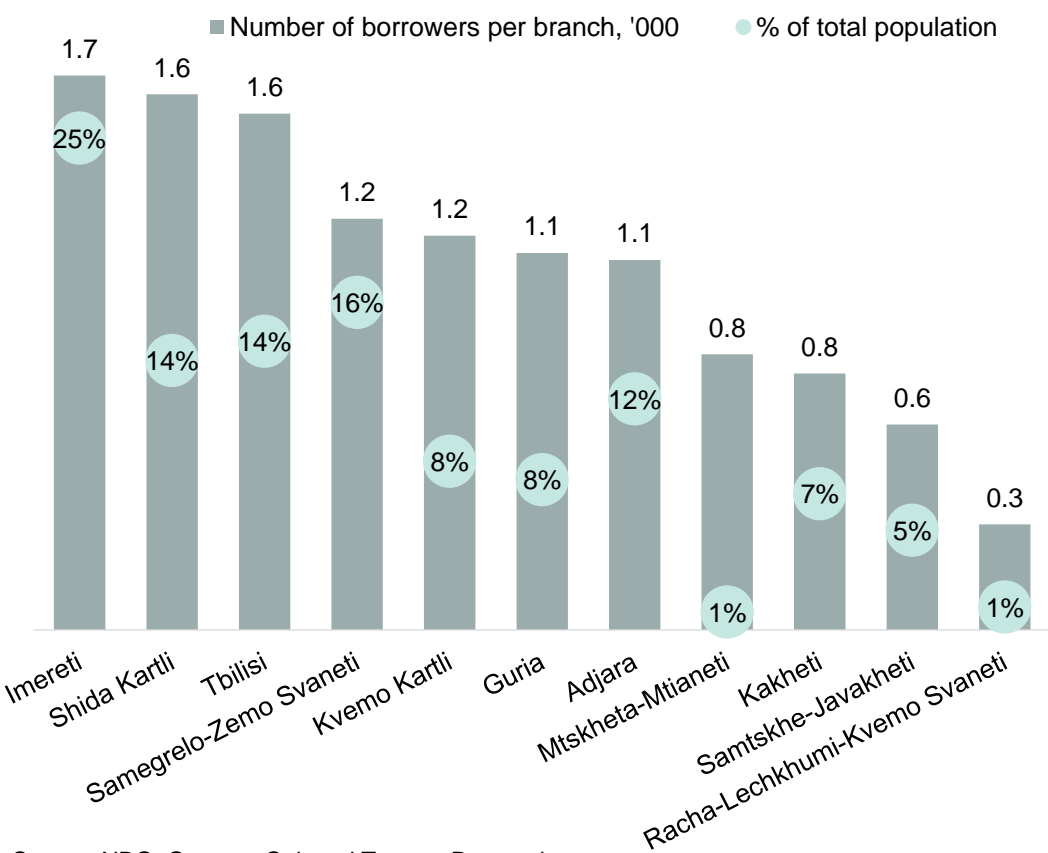


MFOs target unbanked and underbanked populations mostly in the regions, with regional borrowers accounting for 64.3% of total as of 3Q22

Regional distribution of MFO branches and borrowers, 3Q22



Number of MFO borrowers per branch, 3Q22



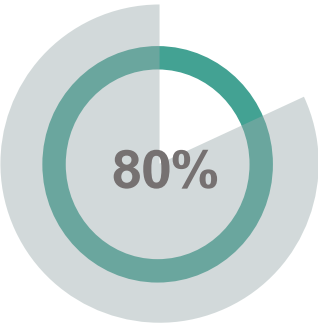
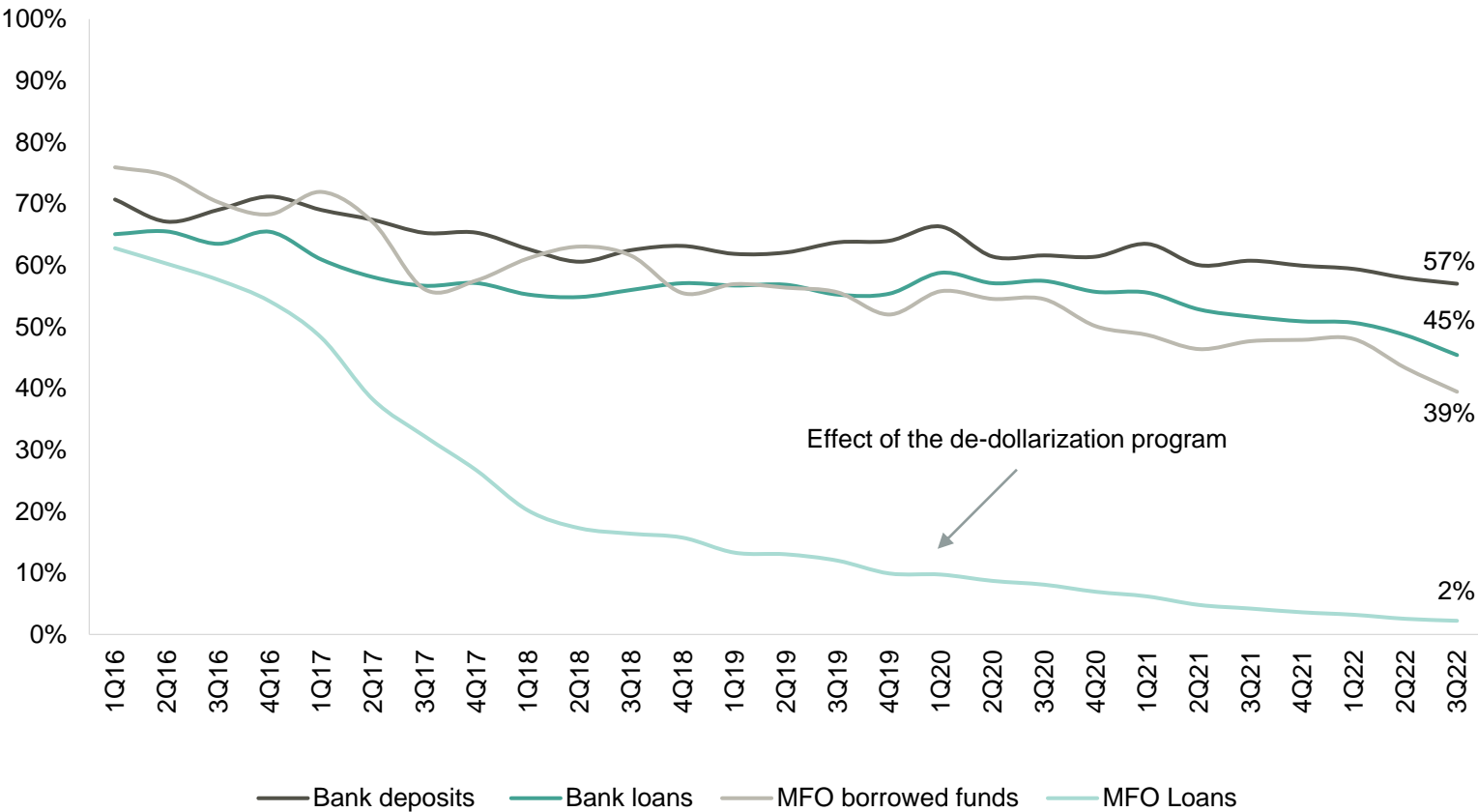
Source: NBG

Source: NBG, Geostat, Galt and Taggart Research



MFOs are subject to high FX risks, as 39% of total borrowings are in FX while entire loan portfolio is in GEL

FX share in Bank loan and deposit portfolio vs MFO loan portfolio and borrowed funds



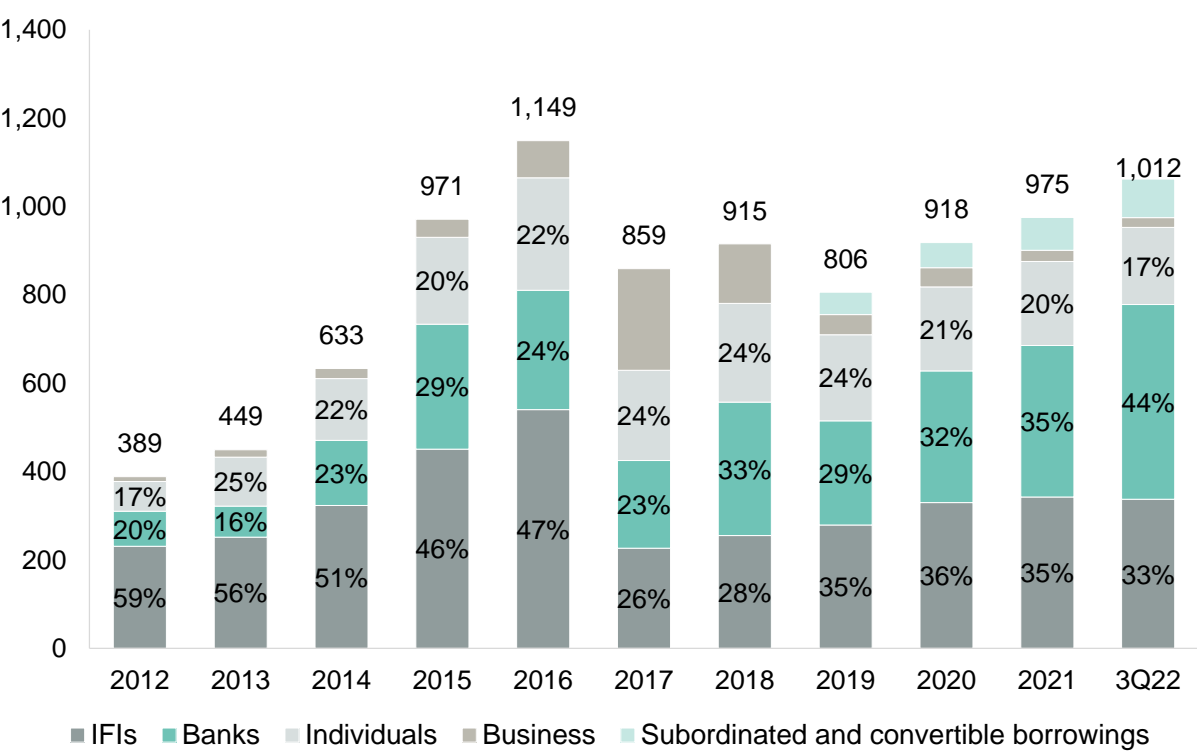
Notably, 80% of MFO FX liabilities are hedged through currency swaps as of 3Q22 (GEL 334mn)

Source: NBG, Galt and Taggart Research



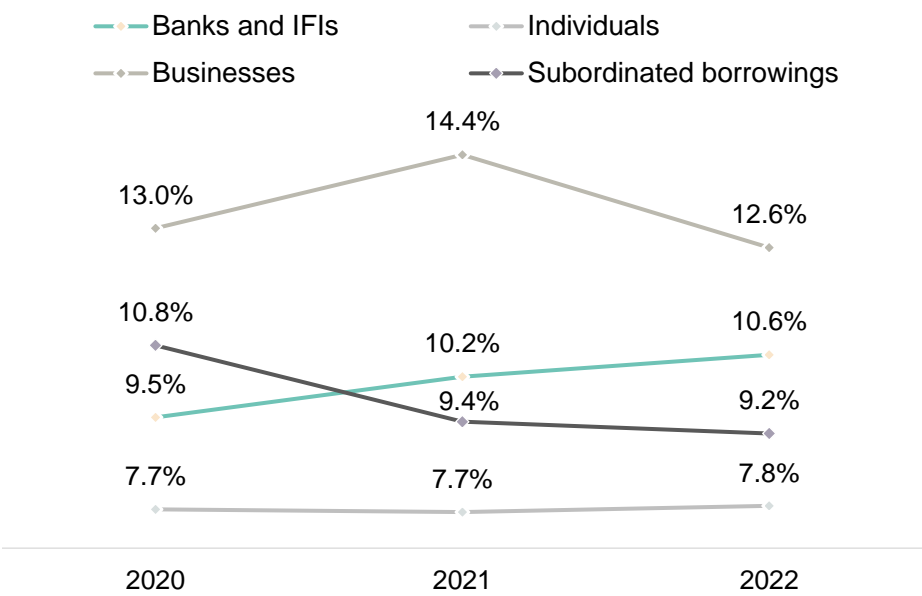
MFOs have no direct access to GEL resources and are mostly funded through loans from banks and IFIs...

MFO total borrowings by funding source, GEL mn



Source: NBG

Cost of funds by funding source

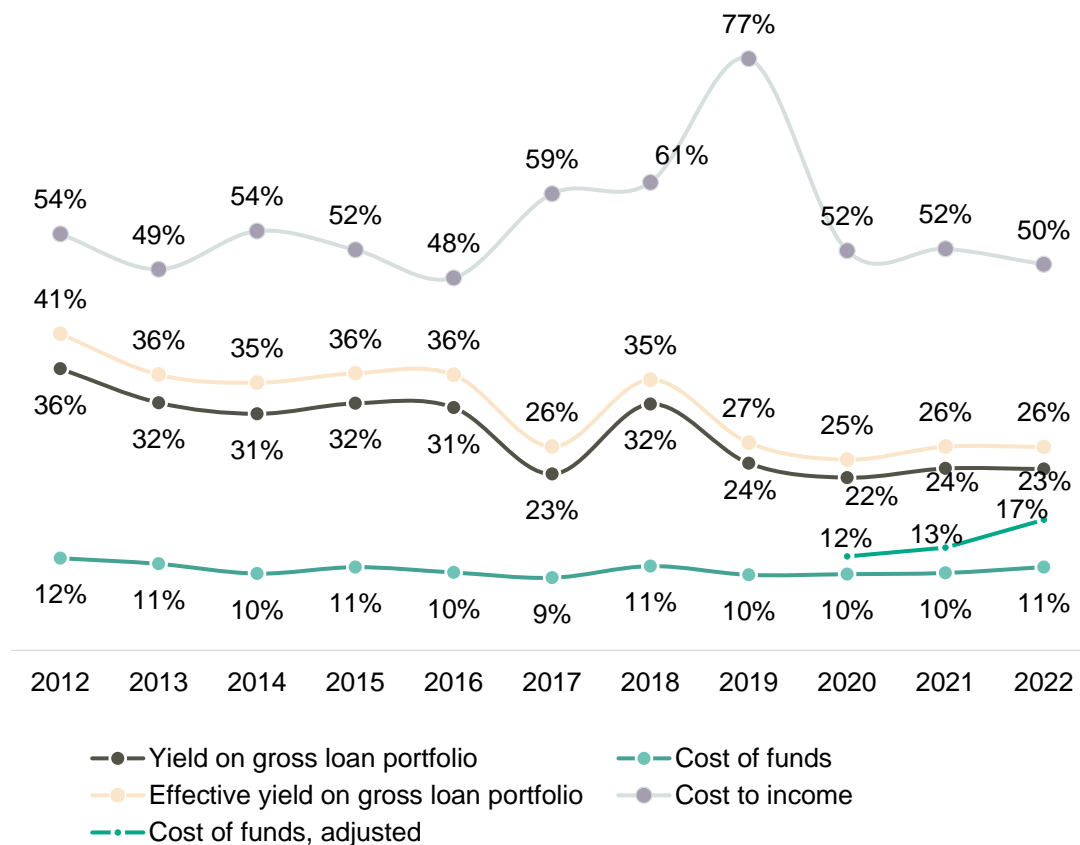


Source: NBG, Galt and Taggart Research
Note: Numbers do not include hedging costs (i.e. swap fees etc.)



...resulting into high funding and hedging costs

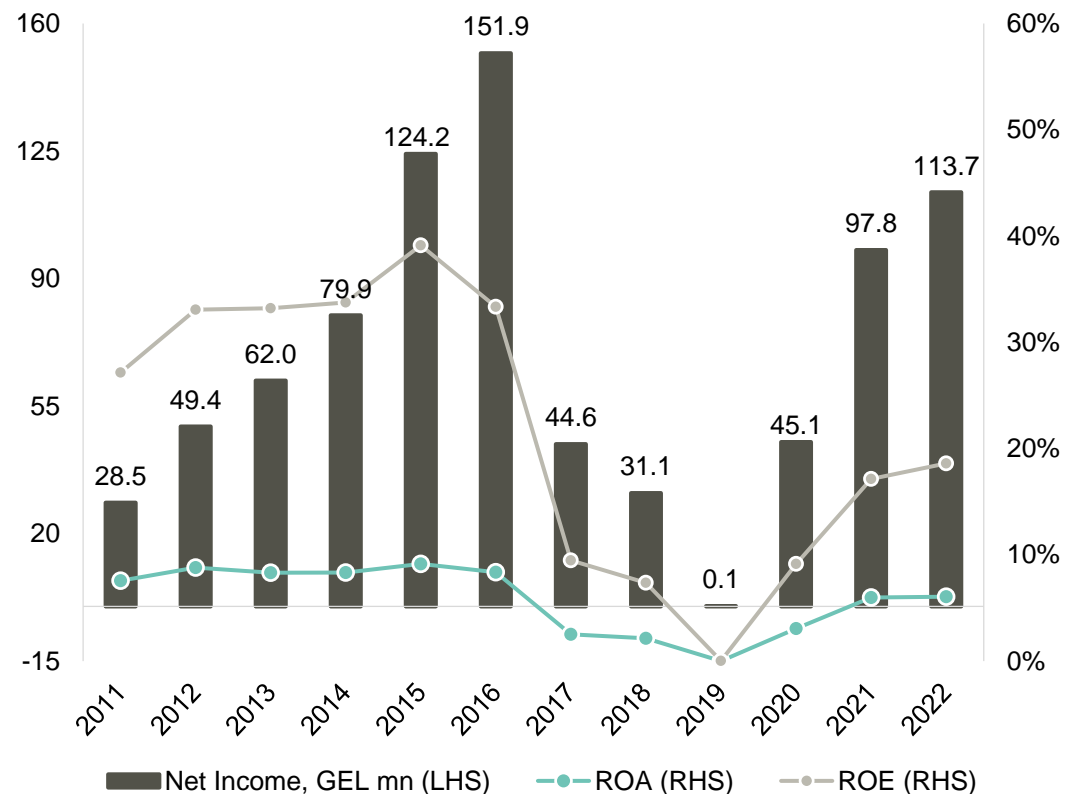
Microfinance sector profitability indicators



Source: NBG, Galt and Taggart Research

Note: Adjusted cost of funds includes estimated swap expenses, Effective yield includes net fee and commission income, Cost to income = operating expenses / interest income

Microfinance sector net profit, GEL mn



Source: NBG, Galt and Taggart Research



NBG's proposed micro-bank model expected to reduce funding and hedging costs. Resulting lower interest rates will likely increase MSME's access to credit

Proposed new structure in the micro lending sector

Aim

- To support entrepreneurship and agro-sector development, mostly in the regions
(which fall out of the bank interests due to high operational costs)

Benefits vs MFOs

- Ability to take deposits
- Ability to open client accounts and earn commission income
- Direct access on NBG GEL resources
- Reduced funding and hedging costs

Requirements

- GEL 1mn cap on lending to a single borrower/group of borrowers
- Mandatory lending in GEL
- Single micro-bank assets below 2% of total financial sector assets
- Enhanced supervision and control (capital, liquidity and leverage requirements per Basel framework)
- Min. 50% of loan portfolio to be directed to small businesses and agro-sector (70% 2 years after receiving micro-bank license)

Expected outcome

- Increased access to financial products/financial inclusion in the regions
- Reduced interest rates on loans due to improved funding and hedging costs
- Increased interest from international investors
- MSME development and related indirect benefits (i.e. job creation etc.)



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Head of Research

Eva Bochorishvili | evabochorishvili@gt.ge

Head of Macroeconomic Analysis and Forecasting

Lasha Kavtaradze | lashakavtaradze@gt.ge

Head of Analytics

Giorgi Iremashvili | giremashvili@gt.ge

Head of Sector Research

Bachana Shengelia | bshengelia@gt.ge

Senior Associate

Mariam Chakhvashvili | mchakhvashvili@gt.ge

Address: 3 A. Pushkin street, Tbilisi 0105, Georgia

Tel: + (995) 32 2401 111

Email: research@gt.ge

Senior Associate

Kakhaber Samkurashvili | ksamkurashvili@gt.ge

Associate

Tatia Mamrikishvili | tmamrikishvili@gt.ge

Associate

Nino Peranidze | ninoperanidze@gt.ge

Analyst

Giga Nozadze | gnozadze@gt.ge

Analyst

Giorgi Tskitishvili | gtskitishvili@gt.ge

Analyst

Zurab Tavkelishvili | ztavkelishvili@gt.ge