CASE STUDY: TEACHING NOTES

Bosnia and Herzegovina

July 2017

METHOD

Though the narrative is only 3.5 pages long, this exercise includes several pages of graphs on 7 leading Bosnian institutions during the years leading up to, and following, the 2008 financial crisis. Depending on participants' levels of experience and the time you have available, you may choose to omit graphs and tables that relay similar information. For example, gross loan portfolio is expressed in both USD and EUR; because the Bosnian currency is pegged to the EUR, that curve minimizes the effects of USD-related currency fluctuations.

We recommend providing time upfront for participants to read the narrative and review the data before engaging in small group discussion. Afterward, we recommend a plenary debrief that includes summaries as well as reflections on how the dynamics in the case might apply to participants' own institutions and markets. We believe that in personalizing its application, the exercise becomes most beneficial as a learning tool.

We emphasize the following key lessons: 1) market dynamics similar to those in Bosnia during the time period highlighted can occur elsewhere and 2) well managed institutions can effectively weather crises.

We suggest reserving between 45 and 60 minutes for reading and small group discussion and an additional 45 minutes for debriefing. We have found that the exercise lends itself in richness of discussion the more senior and experienced the participants' backgrounds.

Finally, while we include sample "correct" responses in the sections below, you as the facilitator may determine the level of depth and issues to emphasize depending on your particular participants' profiles.

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PURPOSE

This exercise provides readers an opportunity to deep dive into data analysis. Accompanying the short narrative are several pages of portfolio data from the seven largest MFIs in BiH at the time of the financial crisis. After reading the case, readers are asked to draw from both the data and narrative to identify trends, hypothesize where the sector might have exercised better risk mitigation and compare how different institutions weathered challenges.

ASSIGNMENT

Using the information on the following pages, analyze the performances of the seven leading Bosnian MFIs before, during, and after the global financial crisis. Consider the following questions:

1. **What information do you derive from the data on pages 5 through 12?**

2. **At what point in the development of the sector would you have had concerns regarding a potential crisis? What advice would you have given to your institution?**

3. **Which of these institutions would seem best positioned to survive the financial crisis? (Hint: Of the institutions in this case study, only one went into receivership.)**

4. **Is this dynamic reminiscent of any market pockets your institution has seen?**

KEY LESSONS

Decisions made during a crisis will impact an institution's resiliency. For example, Partner had its managers review former microfinance crises (Bolivia, etc.) to learn how others had responded in similar situations. It also informed investors early: management foresaw the crisis 6 months in advance and wrote a letter outlining the impending problems so investors were prepared when it breached some covenants. Some institutions continued to open new branches to stay competitive, while others refocused on basic core procedures to minimize incurring further damage.

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GENERAL NARRATIVE

After the war ended (1995) the World Bank provided a loan to the BiH state government to fund MFIs and support the post war rebuilding effort. By the early 2000's there were 27 MFIs in this small market (population size 3.8 million). Bosnia's microfinance sector became a paradigm for post-war economic recovery and was touted as proof that institutions could both be profitable *and* help the poor. MFIs attracted increasing levels of donor funding (according to CGAP, was 2nd highest MIV funding recipient around 2008-09). This happened to coincide with the financial crisis at a time when many thought microfinance was recession proof.

OVERARCHING THEMES THAT MAY HAVE CONTRIBUTED TO THE CRISIS

- ***Highly fragmented market/too many players***: Per the terms of the World Bank loan, recipient MFIs were eventually supposed to consolidate into stronger institutions. This was not enforced and more joined the market. There was no succession planning for CEOs and institutions were reticent to fire staff (BiH has strict labor laws and an unemployment rate of close to 50%). There was therefore little incentive for the market to consolidate.
- ***Too much money and lack of information exchanged between MIVs***: MIVs did not coordinate the relative amounts they were contributing (i.e. there was no exchange of information between donors). While we don't know the precise MIV investment figure, as of December 31, 2008, the sector's consolidated balance sheet listed total liabilities at US$688.432 million.
- ***Loosened credit procedures***: It is difficult to know exactly how decision processes were carried out within individual institutions. However, clients became severely over-indebted, indicating that credit procedures were loosened to accommodate over-liquidity in the market.
- ***Regulator won't allow transformation***: Some hypothesize that if MFIs had been allowed to transform into commercial institutions, shareholders would have encouraged them to lend more responsibly than their NGO boards did.

OUTCOME

By the time the financial crisis hit, many institutions had dramatically loosened their credit procedures. Clients were over-indebted, multiple lending was widespread, and some institutions lost money or closed entirely (like PRIZMA). Today, three strong market leaders (EKI, Partner and Mikrofin) serve about 80% of the market.

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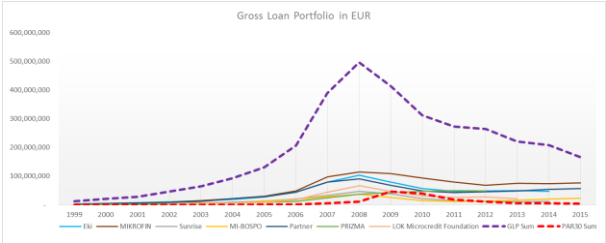
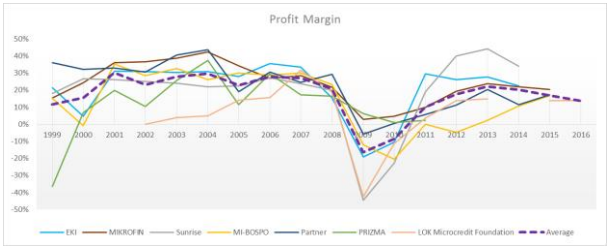
CASE QUESTIONS – SAMPLE ANSWERS AND SUPPLEMENTAL INFORMATION

1. ***What information do you derive from the data on pages 5 through 12?***

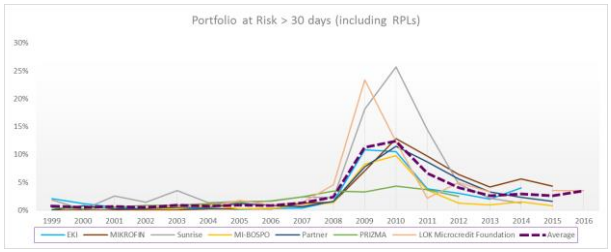
GLP graphs are included in both USD and EUR (the Bosnian Mark is tied to the Euro). Each of the 7 MFIs increased GLP every year between 1999 and 2008, often at a rate of twice that of the previous year. Following the 2008 crisis, all experienced a significant decrease with the exception of PRIZMA. In 2013, PRIZMA went into a receivership that is still active.



Between 1999 and 2008, **profit margins** for the seven largest institutions fluctuated between a low of -36% (PRIZMA in 1999) and a high of 44% (Partner in 2004). Profit margins stayed relatively high until the crisis: an average of 21% in 2008, which dropped to -16% in 2009. In 2011, institutions began to recover (average of 10%) and profit margins generally increased from then on.



Between 1999 and 2007, **PAR30** remained, on average, under 1%. In 2009, it jumped to 11% and then to 12% a year later. Sunrise and LOK had particularly bad PAR30 spikes in 2009 and 2010 (LOK was at 23% in 2009 and Sunrise at 26% in 2010).



2. ***At what point in the development of the sector would you have had concerns regarding a potential crisis? What advice would you have given to your institution?***

The rate of increase in GLP throughout the early 2000s indicates: 1) excessive growth, 2) over-liquidity in the market and 3) that management teams were preoccupied with competition and either ill-read or lacked concern for market absorption capacity. Simultaneously, there was no innovation in product development or offerings.

3. ***Which of these institutions would seem best positioned to survive the financial crisis? (Hint: Of the institutions in this case study, only one went into receivership.)***

Partner, EKI and Mikrofin emerged as market leaders after the crisis. Mikrofin completed a reverse transformation and now owns MF Banka. EKI merged with a microcredit company - effectively allowing it to become a commercial entity - but it is still not allowed to receive savings. Mikrofin's profit margins, during and after the crisis, remained above 0% (in 2009, its profit margin dropped to 3% from 22% a year earlier). EKI experienced a more dramatic drop (from 15% in 2008 to -19% in 2009) but it also recovered quickly and more robustly than others (a profit margin of -10% in 2010 grew to 29% in 2011). Partner also suffered a decline in 2009 (-6% from 29% in 2008) but Sunrise and LOK experienced more severe drops that year (-45% and -43%, respectively). In 2013, PRIZMA went into a receivership that is still active.

4. ***Is this market dynamic reminiscent of any market pockets your institution has seen?***

Answers will vary by reader.