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Micro Finance in Egypt

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Chapter One **Microfinance in Egypt**

1) Introduction:

Most developing countries operate under a dual monetary system: a small and often controlled or influenced organized money market with severely binding legal restrictions on nominal interest rate ceilings, catering to the special requirements of specific groups of firms with large internal savings; and a large but amorphous unorganized money market, uncontrolled, illegal often usurious, to which most low-income and poor individuals are obliged to turn to for their financial needs.

This situation may not be accepted from the equity point of view, since the deposits of commercial banks come from a wide cross-section of population, the benefit of their financing operations should also be broadly disbursed.

2) Importance of Small and Micro Finance:

Small and micro enterprises (SME's) are a dynamic force for sustained economic growth and job creation. In Egypt, the government's ambitious growth plans hinge on providing the private sector with a greater role in investment activities. Crucial to this plan is the promotion of SME's that constitute more than 99% of the private establishments in the non-agriculture sector, about 80% of value added and two thirds of the labor force.

Micro and small enterprises create a healthier climate for competition and are more conducive to the realization of greater efficiency and equity. But it must be admitted that SME's, although preferable, may not be feasible for all types of economic activities. Hence large business enterprises may also have to be allowed.

Despite the importance of SME's to economic development, agriculture and small and micro industries suffer from lack of government support, overvalued exchange rates, import subsidies and commodity aid. Most small and micro units operating in these sectors are small, unorganized, and unarticulated; and hence unable to exert any political pressure. The most crucial drawback in the development of SME's is the lack of financing facilities. This results in the vicious circle of negligence and poverty of these sectors and their inability to finance investments and improve technology.

Catherine Shaw, a researcher in the London School of Economics, Business History Unit, pointed out that: 'The recruitment of business leaders from one social class or a narrow social stratum is an ominous symptom; it suggests that society is failing to utilize its reservoir ability' ⁽¹⁾. The adoption of well organized small and micro financial systems is the only way to exploit this pool of ability and the potential contribution that the micro enterprise can make to output, employment, and income distribution.

(1) Source: Quoted by Chapra, M. Umer, "Economic Development in Muslim Countries: A Strategy for Development in the Light of Islamic Technique", Al-Azhar University, Cairo, Egypt. September 1988.

The selected committee on hunger stated that: ‘The provision of small amounts of credit to micro enterprises in the informal sector economy of developing countries can significantly raise the living standards of the poor, increase food security, and bring about sustainable improvement in local economies’. The committee also indicated that ‘formal financial institutions in those countries do not recognize the viability of income generating enterprises owned by the poor’⁽¹⁾.

Finally, Professor Yunus, the pioneer of micro finance and the founder of Grameen Bank in Bangladesh noted that ‘the poor are poor today because of the failure of financial institutions to support them in the past’⁽²⁾.

3) Definition of Micro Enterprise:

In June 2004 the new Small Enterprise Law was issued in Egypt. The law deals with three main issues: the identification of small and micro enterprises, the role of the social fund for development (SFD) with regard to the SME sector, and the benefits accorded to SME’s by virtue of the law.

Small enterprises are defined in the law as those with a paid up capital between fifteen thousand and one million pounds, and less than fifty employees; whereas micro enterprises are those with a paid up capital of less than fifty thousand pounds, irrespective of the number of employees. Perhaps more importantly, SME’s as defined in the law are companies or sole proprietorships.

As both forms are legally registered, the definition of SME’s in the law excludes informal business altogether. SME’s, which qualify, will be able to register with the SFD and obtain a national identification number.

As regards to the role of SFD, the law states that it shall be responsible for ‘planning, coordinating, and promoting the spreading of SME’s and assisting them in obtaining financing and services’. The law in effect institutes the SFD as the body in charge of overall coordination and planning for the SME sector, and providing the necessary basis for allowing it to collect the data relevant to such coordination from various entities involved. The law, however, does not go as far as making the SDF a regulator or licensor of SME finance.

Also, it may be noticed that the law is unclear what limitations and opportunities it creates for microfinance.

(1) Source: Quoted by Chapra, M. Umer, “Economic Development in Muslim Countries: A Strategy for Development in the Light of Islamic Technique”, op.cit. P:50

(2) Source: Yunus, Muhammad, “Group-based Savings and Credit for the rural poor”. Dhaka: Grmeen Bank, 184, P.4.

The micro enterprise from the point of view of Micro Finance Institutions MFI's in Egypt is defined as an enterprise that has passed a year of establishment, employs fewer than 10 workers, and has a capital turnover rate of LE15000, with the owner being the main bread winner in the household. MFI's provide financial services to micro enterprises regardless their legal entity, and whether they belong to the formal sector or not ⁽¹⁾.

4) Supply and Demand for Microfinance Service:

Microfinance services provided in Egypt are mostly limited to credit and, to a lesser extent, saving products. Micro lending in Egypt is provided through two main channels. The first is through private and public banks, which are regulated by the Central Bank of Egypt and operate under Law No. 88 of 2003. the second is through nongovernmental organizations (NGO's), which are regulated by the Ministry of Social Affairs and governed under Law No. 84 of 2002 on Non-Governmental Societies and Organizations.

The gap between actual demand for micro enterprises and the supply of microfinance services is significant, it has been estimated that at least 90% of demand is unmet. There is an active need in the market for outstanding credit of around LE8.5 billion. To reach such an amount through traditional loans would require banks to disburse around LE25 billion a year; however, due to high loan turnover in MSE's, this could be reached by disbursing LE17 billion in a year. This amount can be easily provided through banks funds that exceed over LE300 billion in addition to their ability to attract deposits that can be profitably regenerated into microfinance. Conditions necessary to meet current demand for microfinance services include a) having a significant institutional presence in Egypt's governorates, b) instituting procedures whereby the lending institution accesses clients and not the other way around (bank to the poor), c) the adoption of international best practices in the design and provision of microfinance programs, and d) a conducive, supporting legal and regulatory environment ⁽²⁾.

5) The future of Public and Private Banks in Microfinance:

Commercial banks in Egypt have approximately 1645 branches of which 1200 belong to public or former public owned banks distributed among Egypt's governorates. It may be noticed that although collectively the banks have penetrated all 26 of Egypt's governorates, covering 95% of all of Egypt's districts, no bank has been independently able to access the entire country. Banks are less able to provide microfinance in areas where they do not have branches. One solution to overcome the challenge of penetration was for banks to outsource their loan disbursement service to other agents in order to have a wider outreach to clients in geographical areas where the bank has no branches. The agents may have a comparative advantage in areas that the bank wants to target where it lacks branches.

(1) Source: Bahaa-el-Din, Ziad, "Environmental Quality International", June 2004 PP1-2

(2) Source: Environmental Quality International, "How to Best Utilize Banks in Microfinance", United Nations Capital Development Fund, Special Unit for Microfinance, (UNCDF/SUM), September 2004. PP2-3.

There are only four banks in Egypt that are currently engaged with micro lending programs. These consist of three state-owned banks: Banque Du Caire, Banque Misr, and Principal Bank for Development and agricultural Credit (PBDAC); and a single private bank: The National Bank for Development (NBD). Apart from PBDAC's program, which provides loans to rural women and farmers, all banks offer financing of working capital – short term assets – largely to commercial trade and service micro enterprises. Lending and collecting methodology may differ from one bank to another, but, in general, all adopt the so called 'Step Lending Methodology' traditionally applied by the NGO's. The National Bank for Development (NBD) was the first bank to start engaging with microfinance by the establishment of Small and Micro enterprises Division within the bank in 1987 under a project funded by the USAID. PBDAC started its rural microfinance programs in 1993, while Banque Du Caire and Banque Misr initiated their operations more recently in July 2001 and September 2003, respectively.

It may be noticed that there is a limited number of banks that are involved in microfinance, where there are more than 63 banks in Egypt, only four of them participated in micro lending. This means that the majority of private banks are still absent from availing funds to the micro sector and tend to regard micro finance either as too risky or as a development function that should be reserved to NGO's and public sector banks. This perception comes as a consequence of the fact that most of Egypt's micro finance initiatives have been donor driven programs aiming to help existing micro enterprises meet their short-term financial needs, namely financing working capital. Notably, the USAID has initiated and funded most of the microfinance activities in Egypt with estimates crediting USAID with financing roughly 70% of all activities in the sector⁽¹⁾.

5-1) Incentives for Bank Engagement in Microfinance:

There are several factors which may induce banks to engage in microfinance, among which are:

- a) The high potential for profits that this sector holds. In the experience of NBD, microfinance yields a 15% return on assets compared with the 10% return witnessed in traditional bank activities.
- b) Risk disbursement is more evenly spread with microfinance. In microfinance the risk of a LE120 million fund would be divided between more than 70,000 clients operating in three different sectors (for instance: trade, manufacturing, and services). By contrast, the same fund applied to traditional loans would risk being concentrated in a few clients operating in one or two sectors.
- c) In addition, engaging in microfinance allows banks to access a new market of clients that would otherwise have no dealings with bank institutions. This is a distinctive advantage in view of the role that brand loyalty can play in securing client accounts and encouraging them to access other banks.

(1) Source: Environmental Quality International, 'The Potential for New Microfinance Products and Services', United Nations Development Program (UNDP), January 2005, PP2-4

5-2) Constraints to Bank Engagement in Microfinance:

Microfinance in Egypt faces the following constraints:

- a) Market distortions: for one, the SFD offers loans to micro borrowers at subsidized interest rates. For another, the banking law levies a 0.6% duty on each bank loan. The duty is not a major problem at present, but it is foreseen that as competition in microfinance intensifies and as institutions attempt to decrease their prices, the duty will become more of a problem.
- b) Lack of collateral: this could be one of the determining factors discouraging banks from engaging in the microfinance sector as a whole. In reality, however, microfinance yields high rates of repayment, increasing banks' reserves and allowing them to develop zones, all without the use of credit guarantees.
- c) Concentration of the Bank Portfolio: for most banks, the concentration allotted to microfinance is minimal if measured against the bank's overall portfolio ⁽¹⁾.

5-3) Legal Obstacles to Micro Credit:

- a) Business formalization: Business that are interested in obtaining banking credit must provide proof of commercial registration, as well as operating licenses in some cases. Thus formalization becomes a prerequisite for obtaining credit. The cost, effort and overall burden associated with business formalization have been recognized as one of the obstacles to the poor entrepreneurs.
- b) Collateral Requirements: The difficulty of providing the required collateral has long been recognized as the main obstacle to bank finance. Under the new Banking Law, banks have become under increasing pressure to obtain the right tangible assets as collateral. Not only is more emphasis placed on the need to obtain the right tangible assets as collateral, but also a significant obligation is imposed on members of a bank's internal audit committee to ascertain the valuation of assets submitted as collateral.
- c) Internal procedures: internal procedures, especially within larger institutions, have tended to consume much more time than is warranted, especially when the credit in question does not necessitate such procedures. It is also a costly process, which makes credit institutions reluctant to deal with the whole category of micro borrowers.
- d) Credit history: the absence of 'credit bureaus' is one of the elements in reducing the efficiency of credit approval for microfinance within financial institutions.
- e) Judicial enforcement and criminal sanctions: lenders considering a potential credit approval are undoubtedly concerned not only about the viability of the business, but also about the possibility of foreclosure on the business and the credit collateral in case of default. The less likely are the chances for a reliable and speedy foreclosure procedure, the more concerned will the lender be, and accordingly, the more likely that additional guarantees will be required. Thus, the reliability and speed of foreclosure is not only a guarantee to the lender, but, more

(1) Source: Environmental Quality International, 'How to Best Utilize Banks in Microfinance', op.cit. P7.

importantly, the most effective incentive for greater access to microfinance and for reducing its cost⁽¹⁾.

6) Non Governmental Organizations:

Beyond lending by the formal banking sector as outlined above, financial services to small and micro enterprises are provided through lending programs by NGO's that are financed through national and international donor agencies. Activities of NGO's, including financial service activities are governed by Egypt's NGO Law 84 of 2002, which requires that they operate as not-for-profit associations, foundations, or unions.

Credit is the dominant service provided by NGO's to micro enterprises. The individual lending methodology is still dominant in Egypt, both in terms of the percentage of total micro loans and the portion of programs devoted to the methodology. The types of NGO's that are engaged in lending to small and micro enterprises can be distinguished as follows:

a) Specialized NGO's: These microfinance institutions (MFI's) are usually NGO's that are governed by people with strong business backgrounds. USAID has supported the establishment or development of several business associations in different governorates that in terms of lending volume are the largest NGO lenders in Egypt. In terms of outreach and sustainability, these specialized groups tend to be the most successful players.

b) Social development NGO's: These NGO's have a broader mission and provide a range of community based social development services, of which micro credit is but one. They typically have limited experience and at times low appreciation for micro credit best practices. Their results in terms of outreach and sustainability are mixed.

c) Umbrella NGO's: These NGO's serve as a nationwide grouping of community based organizations and are often closely linked to the government. They face issues similar to those of the social development NGO's.

d) Community Development Associations (CADs): These small, local, voluntary organizations tend to perform a credit retailer function for umbrella or social development NGO's. Activities are largely based on volunteers. Understanding and concern for micro credit best practices are very limited⁽²⁾.

(1) Source: Environmental Quality International, 'Review of the Legal and Regulatory Framework Affecting Microfinance', The Steering Committee, August 2004, PP5-6.

(2) Source: Environmental Quality International, 'The Potential for New Microfinance Products and Services', op.cit. PP2-3

As it is revealed from the previous discussions of the role of the two different MFI's, commercial banks and NGO's, that both of them provide credits to the poor borrowers, however they don't enjoy equal competition. Banks are governed by the banking law and supervised by the central bank, whereas NGO's are governed by the NGO law and supervised by the Ministry of Social Affairs. As a result of regulatory difference, NGO's can offer lower interest rates but can not easily raise funds through bank loans and other means. Banks can hold ample funds but pay duties that raise interest rates. In order to insure an enabling microfinance environment, it is important to have unified standards for microfinance provision irrespective of the financing institution. Once unified standards for microfinance are applied to all MFI's, free competition among these institutions would be in the best interest of the client, and eventually the MFI looking for profit will target the not yet served markets, rather than the saturated ones⁽¹⁾.

7) The National Postal Authority:

The National Postal Authority is a significant player in microfinance because it offers saving accounts with competitive interest rates and because it controls a formidable national network of facilities, thus reaching the grassroots of Egyptian society in both urban and rural areas. The postal Authority has around 10,000 outlets (3,400 post offices and 6,000 postal agencies) throughout the country. Its workforce of 45,000 individuals serves 11 million Egyptians who maintain LE22.5 billion in postal saving accounts. Some commercial banks contend that they have been hindered from engaging in micro savings because they can not compete with the high interest rates that the Postal Authority offers to its clients.

The Postal Authority's impact on the microfinance sector is soon to grow. During recent efforts by the government to restructure and modernize the Postal Authority, new cash transfer services have been introduced in collaboration with Western Union to diversify the product portfolio offered to clients. In addition, the Postal Authority recently signed a cooperation protocol with the SFD to provide micro credit services to its customers. Given the Authority's extensive network of facilities, the outreach impact would very likely be profound⁽²⁾.

It may be concluded that outreach of MFI to the poor is not a problem to make available microfinance service to the low-income and poor people in Egypt. What is needed is an optimum utilization of these facilities.

(1) Source: Environmental Quality International, 'How to Best Utilize Banks in Microfinance' op.cit. PP7-8.

(2) Source: Environmental Quality International, 'The Potential for New Microfinance Products and Services', op.cit. P3.

8) The Private Sector:

The full potential of private sector engagement in the development of the economy still remains unrealized. A key constraint to such engagement is the unfulfilled potential of large businesses to provide financial facilities to micro and small enterprises. The reason for this may be attributed to three main factors; namely: existing perceptions of small scale enterprises, lack of information on the SME sector, regulatory constraints, and current business processes that are inappropriate for servicing microfinance markets.

8-1) Perception:

Private sector companies tend to view microfinance as a social rather than a commercial activity. They consider microfinance to be a donor funded development activity and view microfinance markets as small, low-margin markets that can not be served profitably and whose low production standards may seriously compromise their business. As such, private sector companies have limited interest in entering into microfinance markets.

8-2) Lack of Information:

The information nature of micro enterprises in Egypt as well as the lack of a formal microfinance market has resulted in a lack of information on the microfinance market in Egypt, the operations of micro enterprises, their performance, their financing needs, and means of servicing them. The absence of such essential data discourages financial institutions from offering tailored facilities ending to micro enterprises, micro service providers or potential investors willing to profit from emerging sectors.

8-3) Regulatory Constraints:

The current government structure of different financial markets is generally not conducive to the engagement of private sector companies in the provision of microfinance. Regulatory constraints hinder their engagement in two broad ways:

- a) Excessive regulation hinders the development and delivery of new products, or forces companies to implement inefficient business processes that are not appropriate for the delivery of microfinance services and that would make them prohibitively expensive.
- b) Various lump sum duties and taxes increase the cost of operations, often disproportionately for micro products, thereby making it difficult or impossible to provide microfinance services profitably.

8-4) Internal Infrastructure:

Business processes in place in private sector companies do not allow for the profitable delivery of microfinance services. Successful entry in this market requires a different approach with a different set of operational processes.

It may be concluded that a crucial ingredient to increased private sector engagement in microfinance markets is the creation, capturing, and dissemination of the success stories. Promising Egyptian initiatives, as well as international private sector experiences in microfinance markets, may encourage the private sector to engage in this business⁽¹⁾.

9) Current Microfinance Services Available in Egypt:

Despite the variety of financial services that could be offered to micro enterprises and consumers, credit has been the main type of microfinance product offered to the Egyptian market. These credit services have been offered in the form of micro loans that are predominantly provided through non-government organizations (NGO's).

9-1) Credit Services:

Credit services provided in Egypt are dominated by two types of products: individual loans financing short term operating costs of existing enterprises, predominantly in the retail and mercantile sectors in urban and semi-urban settings; and group lending for income generating activities of women in the lowest income categories. Other types of credit services, including asset based lending, and micro-leasing products have not been provided on a significant scale in Egypt. The products offered in Egypt can be generalized as including:

- a- Micro lending to groups, loan size of LE50 to LE500 (offered by NGO only).
- b- Micro lending to individuals, loan size of LE300 to LE1,500 (offered by NGO only).
- c- Small enterprise lending to individuals for working capital, loan size of LE1,500 to LE10,000 (offered by banks and NGO's).
- d- Medium enterprise lending to individuals, loan size LE10,000 and up (offered by banks and NGO's)

9-2) Savings/Deposits Services

Savings services are necessary because many poor households are not in a position to take advantage of credit for investing in human or physical capital to increase and diversify their incomes. Other households require additional services besides credit to manage the household budget and risks. Moreover, poor people can save in the form of human capital by improving their health, nutritional status, and education. MFI's need to recognize that this form of savings can produce real future benefits by raising productivity and speeding development.

(1) Source: Environmental Quality International, 'Interview with the Private Sector Representatives', Draft Report, Project Steering Committee, August 2004, PP17-18.

Although public and private sector banks in Egypt offer savings accounts to the general public, the National Postal Authority remains the dominant provider of micro savings due to its extensive outreach and low cost application procedures. In this regard, low income savings mechanisms are often informal. The informality is due to the unwillingness of the formal banking sector to deal with small savings due to the higher administrative costs associated. Moreover, the reluctance of entrepreneurs to deal with the banking system, which can be rather intimidating, also contributes to the informality of SME savings. It is estimated that less than 50% of SME's use formal channels for savings. The Ministry of Foreign Trade estimates that 95% of SME's do not even maintain a bank account. Consequently, on one hand large amounts of savings remain unutilized for financial intermediary, and on the other hand, neither non-bank financial institutions nor NGO's are allowed to capture savings.

9-3) Insurance Services

In addition to borrowing and savings services, the poor need insurance to protect themselves from uncertainty. In the absence of insurance, the poor avoid risky but potentially profitable economic activities and enter into informal insurance arrangements or rely on precautionary savings.

With regards to the insurance industry in Egypt, state owned companies remain the main providers of insurance services to this sector, where they account for more than 90% of the market share. While some of their products are affordable for micro enterprises and micro consumers, these follow product driven approaches neither designed nor marketed to meet the needs of the micro sector. Some microfinance programs, like that of NBD, provide life insurance to their clients to cover part of the amount lent in case of default due to death. However, these insurance packages are only provided embedded with credit packages as to reduce MFI's risk of default but not offered as a stand alone product⁽¹⁾.

The following two sections show the experience of one commercial bank in Egypt – National Bank for Development – in microfinance, Section two. Section three presents the experience of the non-governmental organizations – Alexandria Business Association – in microfinance.

(1) Source: Environmental Quality International, 'The Potential for New Microfinance Products and Services', op.cit. P4.

Chapter Two

The experience of Commercial Banks in Microfinance **The National Bank for Development**

National Bank for Development Information Sheet

Year of Establishment: 1987

Legal status: Bank

Number of branches involved: 44, divided into:

30 specialized units

14 windows

Demographic distribution: the program covers 16 of Egypt's governorates.

Products of program:

a- Short term loans 1-12 months

b- Savings accounts. Compulsory savings at 10%

c- Insurance.

d- Certificate deposits for small savers.

Total number of employees: 376, divided into:

Direct: 318

Managerial: 58

Methods and criteria of assessing clients:

Criteria of client selection:

- 1- The client (borrower) must have an active business or which s/he needs the loan.
- 2- The client must have a good reputation in terms of trade and transactions with suppliers and customers, as well as willingness to pay his/her dues.
- 3- The ability of the active business to cover the new liability that is the loan.
- 4- The credit officer's investigation about the client must be satisfactory.
- 5- The preliminary credit study conducted by the credit officer must indicate that the client will have future cash flows for loan repayment.

Conditions of loan granting:

- Collaterals:
The program does not require traditional collaterals. The borrower provides a copy of his/her ID.
- Interest (according to loan type): 16% annually
- Method and time of payment:
The loan officer collects interest from the borrower at the premise of his/her business. Also the collection of principal is made weekly or monthly by arrangement with the client, and according to his business and abilities.
- Loan types:
The program provides short term loans (1-12 months)
- Compulsory savings:
The client starts a small savers' account with at least 10% of the loans value before s/he is granted the loan.
- Installments collection methods
Through the loan officer at the premise of the borrower's business

Training Programs for Loan Officers:

Training programs are divided according to level and length into:

a- Classes

The loan officer attends lectures on the program and bank system in the training department in the bank for 2 weeks.

b- Practical training

A hands-on training experience where the loan officer opens accounts and gets involved with the collection process in one of the program's specialized units for 2 weeks.

This is followed by training the loan officer in the unit where s/he is assigned. His/her superiors in the unit keep the trainee under observation for a month, during which the trainee learns how to prepare a simple credit study for the client as well as investigating clients, loan granting, and collection.

c- External courses

The trainee attends courses and workshops in the Egyptian Banking Institution on all banking processes.

Loans follow up method

The number of loan officer visits to the clients: 4 times a month.

Problems and difficulties that the clients face and how the program treats it:

Clients have no difficulty in getting financed by the program. However, problems may occur in case of insolvency and inability to provide timely installments. Such as...

- 1- Social problems such as death or disability. In these cases the bank terminates the loan and participates in funeral expenses.
- 2- Economic problems such as general market depression. In these cases the bank reschedules the client's installments.
- 3- Problems caused by the client him/herself such as intentionally refusing to pay installments. The treatment to such problems starts with friendly attempts by the loan officer and the head of the specialized unit. If this fails, a follow up manager may get involved in the process, and then afterwards the bank proceeds to legal procedures against the client.

1) Introduction:

The National Bank for Development (NBD) was the first commercial bank to start microfinance operations in Egypt. The NBD began micro lending operations in 1987, with financial and technical support from the USAID. By June 2005, micro lending services were being provided through 44 branches, thirty of which are specialized units. These branches cover 16 governorates or 61% of the total governorates of the country. NBD offers small and short maturities loans (3 to 11 months). Maximum loan size up to the year 2000 was LE10'000 (approximately USD3'000). The bank's management in 2000 decided to reduce the maximum loan size to LE3'000 (approximately USD500 at the exchange rate prevailing in June 2005), this decision has been made to further extend its outreach to the poor.

The bank charges a flat interest rate of 16 percent plus a number of administrative and insurance fees which take the total charges up to around 30 percent. No collateral is required or sought and loan approval is based on the viability of the enterprise and its cash flow cycle. As of 2004, the program had 25399 active borrowers and LE 47.9 million (approximately USD \$7.8 million) in outstanding loans.

2) Objectives:

The NBD's micro credit program has ambitious objectives. In the short run, the program hopes to provide access to credit to micro enterprises and small enterprises that would otherwise be ignored by conventional banks.

In the long run, it hopes not only to alleviate poverty and create jobs by extending credit, but also to help those small borrowers become clients under more conventional banking standards.

The NBD's micro credit program has several social objectives. In many cases, for example, the income from a micro enterprise represents a household's total income. Thus, in the case of sudden physical inability or death, the program writes off the loan and contributes to the funeral's expenses. Furthermore, if the borrower fails to meet his/her financial commitments to the bank because of recession, the program may consider a new repayment schedule.

The ultimate aim of the NBD program is to improve the quality of life of micro entrepreneurs while teaching them how to increase control over their financial resources. The program encourages employment generation, self employment, the preservation and

Box: 1

Name: Salah El Din

Male/Female: M

Economic Activity: Painting metals (door and window knobs).

Total Value of Loans through the Year: LE 5000

Repayment schedule: Weekly

The loan's effect on income: The beneficiary used to perform his economic activity manually. After receiving the loans, he purchased the first electric generator. Now his revenues have increased by 60%, and he has 2 generators. Also he doubled his capital and the average of his profits increased by nearly 100%. He intends to apply for more loans.

expansion of existing activities, and better accounting, book keeping, and credit management.

3) Target Groups:

The NBD's program aims to address the credit needs of small borrowers, artisans, and other entrepreneurs neglected by the conventional banks. It also extends credit to informal enterprises as well as those without proof of registration. Loan decisions are based on the following criteria:

- a) An existing enterprise, this means that the program excludes start-up or new enterprises.
- b) The potential borrower must have an outstanding reputation among his/her suppliers and clients.
- c) The economic and financial viability of the enterprise and the integrity of the borrower. The viability study of the enterprise is usually conducted by the loan officer.
- d) Bankable collateral is not required. Borrowers do, however, have to sign a promissory note obliging them to repay the loan.

The NBD focuses on financing income generating activities undertaken by individual entrepreneurs from the informal sector. Clients come from a wide range of activities in trading, production, and service sectors. Micro enterprise owners include blacksmiths, electricians, bakers, spice retailers, potters, tailors, metal painters, and shoemakers. Activities generally include light manufacturing and assembly, maintenance, transport, storage and distribution, and agricultural products processing and marketing ⁽¹⁾. Table (1) depicts loans distribution by sector based on data collected from 20 specialized units. These units are mechanized units.

Box: 2

Name: Zeinab

Male/Female: F

Economic Activity: sewing garments

Total Value of Loans through the Year: LE4000

Repayment schedule: weekly

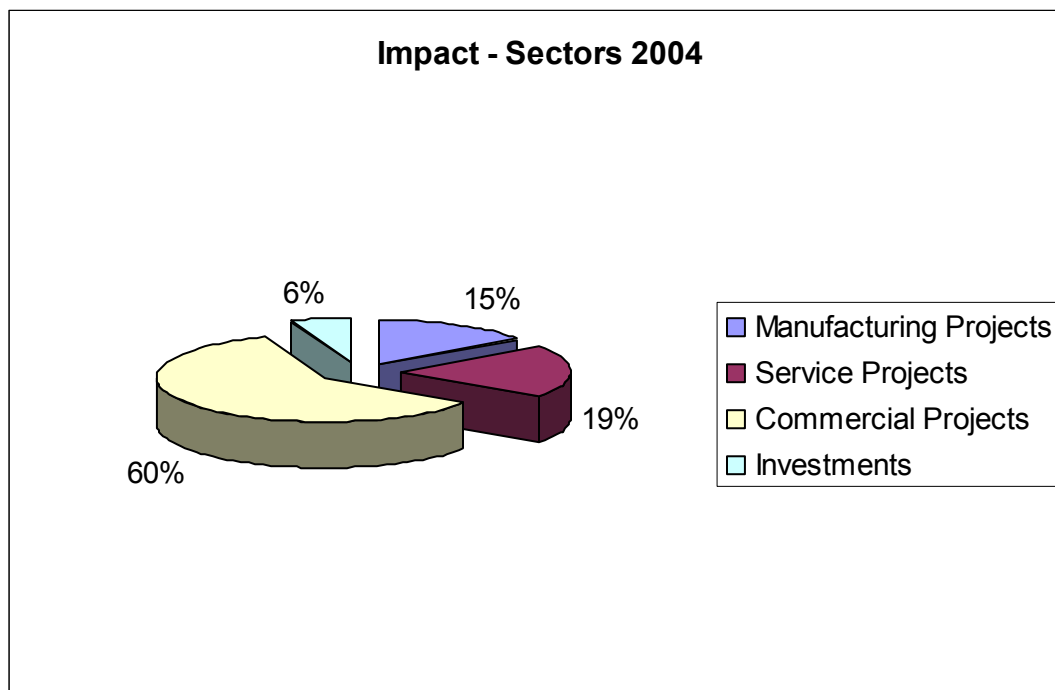
The loan's effect on income: this beneficiary did not have the ability to buy cloth for the purpose of producing in large quantities. Now, after 7 loans from the program, her production reached about 150 pieces a day. The range of profit per piece is LE3.60 to LE5.40. She used to work alone, now she has hired a number of her neighbors to work with her.

(1) Source: Dhumale, Rahul, Sapacanin, and William Tucker, 'Commercial Banking and Microfinance in Egypt: National Bank for Development' Study conducted by Regional Bureau of Arab States, United Nations Development in Cooperation with the Middle East and North Africa Region, World Bank 1998.

Table (1): Loans Distribution by Sector (LE 1000)

	2000	%	2001	%	2002	%	2003	%	2004	%
Manufacturing projects	9	29,0%	4	12,9%	5	16,1%	5	16,1%	8	25,8%
Service projects	12	29,3%	6	14,6%	6	14,6%	7	17,1%	10	24,4%
Commercial projects	4	5,1%	12	15,2%	15	19,0%	17	21,5%	31	39,2%
Investments (Expansion)	7	28,0%	5	20,0%	5	20,0%	5	20,0%	3	12,0%

Source: National Bank for Development, unpublished data, June 2005.



All the clients interviewed for this case study were repeat borrowers having obtained between 2 and 12 loans. Besides, those clients are in the informal sector and run their businesses from their homes. Average loan value ranges from USD330 in 1993 to USD370 in 2004. Many clients look forward to larger loans in order to produce more and hire more workers. Despite high competition, most borrowers believed there was sufficient demand for their services to warrant expansion.

Most borrowers continue borrowing because the loans provide them with the liquidity needed to keep their business running. Furthermore, most borrowers reinvest 60-80% of their generated profits. The rest is used for household needs and savings.

In summary, it may be concluded that NBD clients, who otherwise would not be considered bankable in commercial terms, depend on the program for initial and continued access to finance.

4) Credit Procedure:

- a- Loan approval: procedures are transparent and quick. The entire process generally takes less than two weeks, after the loan officer and the potential borrower agree on the maturity and the repayment schedule of the proposed credit, interest rate, fees, and savings requirements. Various documents are sent to the branch supervisor or manager for final approval. If the loan is approved, the borrower must pay the mandatory savings, and sign a promissory note before the final disbursement occurs. If the loan application is rejected, the loan officer contacts the applicant and explains why.
- b- Savings accounts: savings are mandatory because it reduces the risk exposure of the bank since borrowers often do not have bankable collateral. As a precondition to loan approval, applicants must deposit an amount equivalent to 10 percent of the value of the loan requested into an interest bearing savings account. Borrowers earn up to 8 percent on these deposits, and after the loan is settled, they are free to choose how to use their savings. Furthermore, mandatory savings will encourage the borrowers to follow better methods of managing their financial resources. Moreover, the bank believes that it makes borrowers better educated about important financial practices, which is consistent with the program's goals. Finally, mandatory savings mechanisms generally capture less savings than the outstanding micro loan portfolio. By contrast, voluntary savings captured by microfinance institutions often exceed outstanding micro loan portfolio – as has also been the experience of the NBD. In 1996 the percentage of customer deposits to loan to clients was 129 percent, it increased slightly to 130 percent in 1997.
- c- Loan monitoring: after loan disbursement, loan officers begin monitoring and collecting the periodic installments. Loan officers visit borrowers at least four times every month. The purpose of those visits is not solely to collect repayments, but they are also part of an ongoing exchange of information. Borrowers can learn about banking and saving and get advice on how to make their enterprise more efficient. This approach demonstrates NBD's commitment to borrowers' needs and its desire to promote financial discipline. Close supervision of repayments

Box: 3

Name: Mohammed

Male/Female: M

Economic Activity: Beans and falafel canteen.

Total Value of Loans through the Year: LE3744

Repayment schedule: weekly

The loan's effect on income: This beneficiary is responsible for a family of four members, of whom none work. The loans he received allowed him to increase the size of his business and reinvest

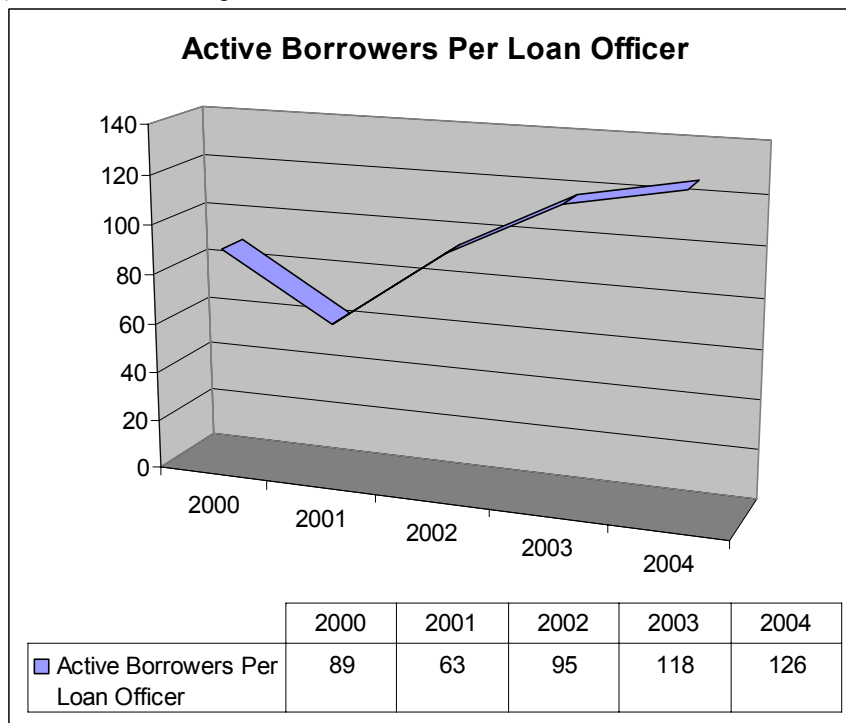
enables NBD to identify delinquent borrowers who delay. Traditional collection procedures are used to recover loans including, when necessary, legal action. Table (1) and figure (1) show the number of officers compared with the number of clients. As it appears in the table, each loan officer oversees no more than 126 clients in 2004, while it was only 63 clients per officer in the year 2001. This is due to the expansion of the project during the last three years.

Table (1): Number of Bank Officers and Clients

Years	Number of Loan Officers	Number of Active Borrowers	Active Borrowers Per Loan Officer
2000	241	21476	89
2001	227	14268	63
2002	196	18577	95
2003	196	23099	118
2004	201	25399	126

Source: National Bank for Development, unpublished data, June 2005.

Figure (1): Active borrowers per loan officer



5) Assessment of the National Development Bank Microfinance Program:

Criteria used to assess microfinance institutions can be summarized as follows:

- a) Outreach
- b) Financial sustainability
- c) Impact of the program on poor clients.

These criteria were identified to refute the following hypotheses:

Hypothesis One: Institutions can not reach the poorest because they are too costly to identify and motivate.

Hypothesis Two: If an institution does reach the poorest, it can not become self-sufficient.

Hypothesis Three: An institution that somehow reaches the very poor and becomes financially self-sufficient it will only add a debt burden to the very poor.

6- Breadth and depth of outreach:

NBD started its micro finance program in 1989 by setting up four branches with the financial support of USAID. The success made by these four branches encouraged NBD to set up 13 more branches in the greater Cairo, and three other branches outside Cairo; thus by 1993 the total number of branches engaged in micro finance reached twenty nation wide.

By 2000, the micro lending program was implemented in 33 out of 66 NBD branches, covering poor areas in greater Cairo as well as upper and lower Egypt. Expansion has continued into 2004, with the total number of branches with micro credit lending increasing to 44 in 16 governorates, of which 30 are specialized branches and 14 operate micro credit windows of the 44 branches, 20 are donor financed [17 by USAID, and 3 by the Canadian International Development Agency (CIDA), UNICEF, and the Ford Foundation] and 24 are own financed (table 2).

Box: 4

Name: Nevine

Male/Female: F

Economic Activity: selling cosmetics (at home).

Total Value of Loans through the Year: LE1248

Repayment schedule: weekly

The loan's effect on income: This client knew about the program through the neighbors. The loans have helped her increase the size of her economic activity by increasing working capital which allowed her to increase her sales. The client did not receive loans from other sources, and her repayments are always on time.

Table (2): Program Growth

Indicator	1993	2000	2004
Number of Branches Engaged in Micro Lending	20	38	44
Number of Governorates covered	7	10	16

Source: National Bank for Development, unpublished data, June 2005.

The number of active borrowers more than doubled during 1993 to 2004 increasing from 10464 at the end of 1993 to 25399 at the end of 2004. Furthermore, the proportion of women in the total client base increased from 20% in 1993 to 33% in 2004. This suggests that NBD experienced a remarkable improvement in the breadth of its outreach. The total amount of disbursed loans has increased by 73% between the same years. (Table 3 and figure 2).

It may be noted, however, that the number of active borrowers decreased from 21476 in 2000 to 14268 in 2001, because the bank has reduced the ceiling of loan value to LE3000. The program lost clients who used to borrow up to LE5000. In March 2004, the bank increased the ceiling to LE10000, and it has been increased to LE25000 in December 2004, and therefore the number of active borrowers reached its peak by the end of the year 2004, where it was 25399 clients. Also, the number of new clients increased to 2932 instead of 670 in 2001 (table 4)

Table (3): Outreach indicators

OUTREACH						
INDEX	89-1993	2000	2001	2002	2003	2004
TOTAL NUMBER OF DISBURSED LOANS	36,769	29,981	20,117	28,406	36,189	36,329
TOTAL AMOUNT OF DISBURSED LOANS (USD)	14365782	36788021	10601348	11396896	9665119	14568966
TOTAL AMOUNT OF DISBURSED LOANS (EGP)	48,700,000	125,300,000	40,900,000	51,400,000	58,300,000	84,500,000
NUMBER OF LOANS DISBURSED TO WOMEN	n.a	5,992	4,734	7,708	10,603	11,945
SHARE OF WOMEN IN TOTAL LOANS	n.a	20%	24%	27%	29%	33%
AMOUNT OF LOANS DISBURSED TO WOMEN (USD)	n.a	5196711.69	1762571.28	2305986.7	2039124.7	2965517.241
AMOUNT OF LOANS DISBURSED TO WOMEN (EGP)	n.a	17,700,000	6,800,000	10,400,000	12,300,000	17,200,000
SHARE OF LOANS DISBURSED TO WOMEN IN TOTAL LOANS	n.a	14%	17%	20%	21%	20%
AVERAGE LOAN SIZE (USD)	324	1233	518	399	265	397
AVERAGE LOAN SIZE (EGP)	1,100	4,200	2,000	1,800	1,600	2,300
% OF AVERAGE LOANS / GDP PER CAPITA	41.6%	87.0%	40.7%	31.3%	28.1%	n.a
AVERAGE WOMEN LOAN SIZE (USD)	n.a	867	372	299	192	248
AVERAGE WOMEN LOAN SIZE (EGP)	n.a	2954	1436	1349	1160	1440
NUMBER OF ACTIVE BORROWERS	10,464	21,476	14,268	18,577	23,099	25,399
% of INCREASE ACTIVE BORROWES	/	105.2%	-33.6%	30.2%	24.3%	10.0%
LOANS OUTSTANDING (USD)	3834808	17704052	5728357	5898004	4923740	8258621
LOANS OUTSTANDING (EGP)	13,000,000	60,300,000	22,100,000	26,600,000	29,700,000	47,900,000
% change	/	363.8%	-63.3%	20.4%	11.7%	61.3%
NUMBER OF BRANCHES 2004 *	44					
STAFF MEMBERS 2004	376					
NUMBER OF LOAN OFFICERS	n.a	241	227	196	196	201
% LOAN OFFICER 2004	53.5%					
NUMBER OF ACTIVE BORROWER	10,464	21,476	14,268	18,577	23,099	25,399
% of INCREASE ACTIVE BORROWES		105%	-34%	30%	24%	10%
LOAN OFFICER PRODUCTIVITY	n.a	89	63	95	118	126

* Divided into 30 specialized units and 14 windows

Figure (2): Active borrowers

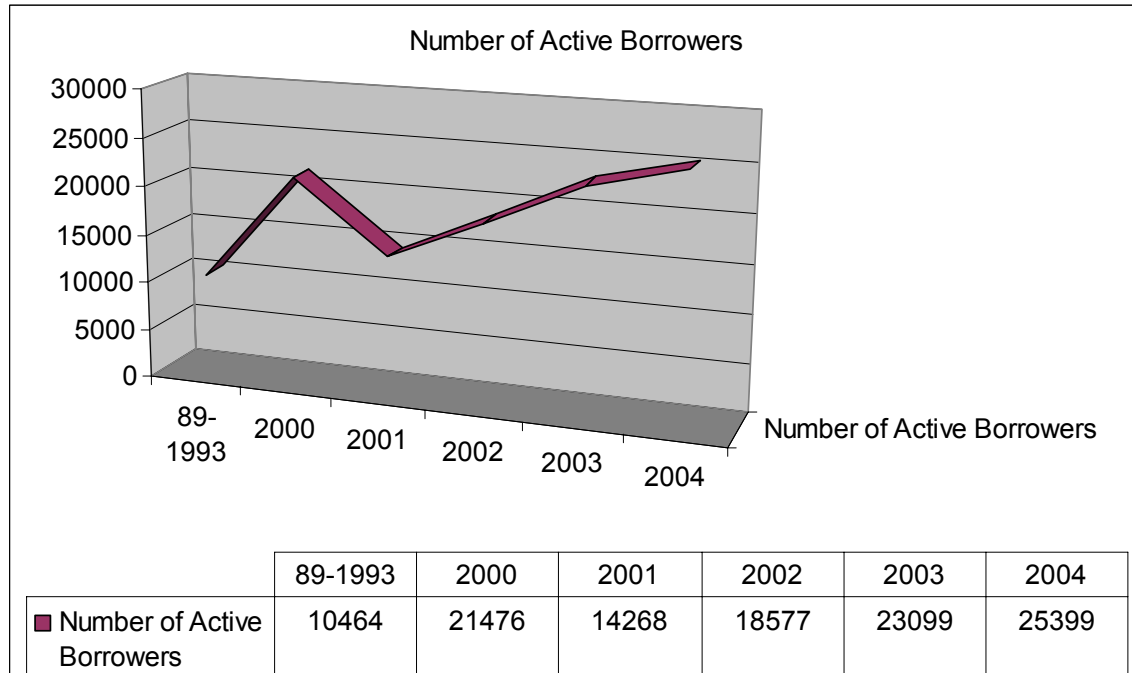


Table (4): The development of active clients in the program:

Years	89-1993	2000	2001	2002	2003	2004
Number of clients	10464	21476	14268	18577	23099	25399
Number of clients in the 20 automated units		18505	12773	16774	2017	21255
Number of new clients		2380	670	1352	2417	2932

As far the depth is concerned, depth means the bank serving more poor clients. We have examined NBD's poverty outreach from different angles, and all seem to suggest that the bank appears to have deepened its poverty outreach.

The national average active loan balance increased by 58%, from LE1200 in 1993 to LE1900 in 2004 (table 5). It is worth to notice that the average active loan balance reached its highest level in 2000, where it was LE2800, and it decreases since then when the management of the bank decided to reach even poorer clients and set the maximum loan size at LE3000.

The nominal average active loan balance as a percentage of GDP per capita, which is arguably a better proxy measure seem to support the assertion that NBD serves the lower end of the market. Furthermore, the inflation adjusted average active loan increased above 52% from LE1127 in 1993 to LE1792 in 2004. This again supports the mentioned argument (figure 3 and table 5).

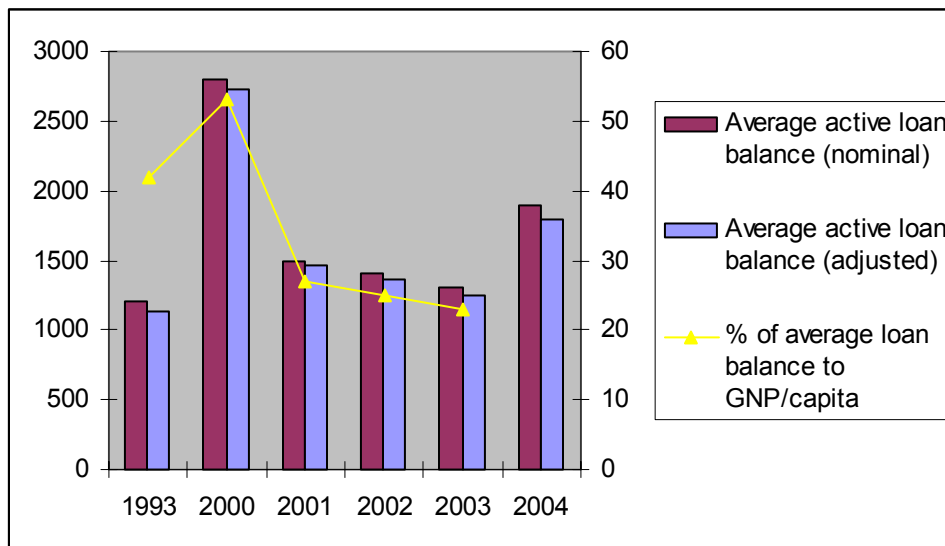
Loan size can increase not only because of inflation but also because of other factors including (a) improvement of the bank’s information base on clients over time, enabling the bank to issue bigger loans; and (b) organic growth of clients’ activities that makes larger loans necessary and possible. Dhumale, and others pointed out that the micro loans made by NBD are an important source of liquidity for working capital and running costs of the micro enterprises. Between 60-50 percent of enterprise profits is reinvested, the balance is used to support household needs and savings ⁽¹⁾.

Table (5): Average active loan balance and percentage of average loan balance to gross national product per capita

Year	Average active loan balance (nominal)	Inflation rate %	Average active loan balance (adjusted)	GNP/capita	% of average loan balance to GNP/capita
1993	1200	6.4	1127	2872	42
2000	2800	2.5	2731	5316	53
2001	1500	2.2	1468	5650	27
2002	1400	2.7	1363	5503	25
2003	1300	4	1250	5565	23
2004	1900	6	1792	n/a	n/a

Source: National Bank for Development, unpublished data, June 2005.

Figure (3): Average active loan balance and percentage of average loan balance to Gross National Product per capita



(1) Source: Dhumale, Rahul, Sapcanin, and William Tucker, ‘Commercial Bankig and Microfinance in Egypt: National Bank for Development’ op.cit.

7- Financial Sustainability:

The objectives of financial policy have changed. Initially the focus was on improving the outreach of microfinance institutions (MFI's) to the poor, that is in serving more of the poor (breadth of outreach), and more of the poorest of the poor (depth of outreach). Eventually, the objective of sustainability of financial institutions took on greater importance. Some analysts argue that increasing the depth of outreach and sustainability are compatible objectives. However, others argue that there appears to be a trade off between improving outreach and achieving financial sustainability. This trade off stems from the fact that MFI transaction costs are high for obtaining information about the credit worthiness of poor clients. Transaction costs have a large fixed cost component, so unit costs for smaller savings deposits or smaller loans are high compared with these for larger financial transactions. The law of decreasing unit transaction costs with increasing transaction size generates the trade off between improved outreach to the poor and financial sustainability, irrespective of the lending technology used ⁽¹⁾.

The previous discussion of outreach revealed that NBD has been successful in both breadth and depth of outreach.

This part of the study will examine financial sustainability of NBD, and conclude whether the two objectives of outreach and financial sustainability are compatible or there is a trade off between them.

Financial sustainability means the ability of MFI to generate enough revenue to cover its total expenses, and makes satisfactory profits which allow the MFI to continue; therefore the financial sustainability will be evaluated by analyzing the quality of the micro lending program and its profitability.

Box: 5

Name: Fatima

Male/Female: F

Economic Activity: Linens shop

Total Value of Loans through the Year: LE 6124

Repayment schedule: weekly

*The loan's effect on income:
Before this client started receiving loans, she sold linens at home to neighbors in order to be able to support her 4 children. Now she is able to rent a small shop and her sales have increased.*

She does not receive loans from any other sources, and her repayments are always on time.

(1) Source: 'The Triangle of Microfinance: Financial Sustainability, Outreach, and Impact', Edited by Zeller, Manfred and Richard L. Meyer, International Food Policy Research Institute, the Johns Hopkins University Press, Baltimore and London, 2000.

A- Portfolio Quality

Data of (table 6) indicate that portfolio at risk (PAR) over 30 days decreased from 2% in the year 2000, and 2001, to 1.4% in the following year. However the ratio reached its highest level in 2003, where it was 2.4%. This increase can be attributed to the following two reasons:

- 1- The number of active borrowers increased in 2003 by 24.3% compared to the previous year.
- 2- The total amount of disbursed loans increased by 13% during the same two years (table 3)

Finally, the ratio decreased to 1.3% in 2004.

PAR over 90 days also decreased from 5.3% in 2002 to 4.1% and 2.4% in 2003 and 2004 respectively. This ratio which is below 3% in 2004 indicates that NBD has made an impressive achievement. Furthermore, the ratios of the years 2001 to 2003 support the argument that NBD has sacrificed quality of its micro lending portfolio to achieve high growth rates of outreach.

Table (6): Portfolio at Risk (Million LE)

Y	ONE DAY	% OF OUTSTANDING PORTFOLIO	THAN 30 DAYS	OUTSTANDING PORTFOLIO	THAN 90 DAYS	OUTSTANDING PORTFOLIO
2000	11.3	9.0%	2.5	2.0%	2.8	2.2%
2001	3.1	7.6%	0.8	2.0%	4	9.8%
2002	4	7.8%	0.7	1.4%	2.7	5.3%
2003	6.8	11.7%	1.4	2.4%	2.4	4.1%
2004	9.9	11.7%	1.1	1.3%	2	2.4%

Source: National Bank for Development, unpublished data, June 2005.

B- Profitability ⁽¹⁾:

The microfinance program of NBD achieved profitability reasonably quickly. Overall operation achieved break-even and generated an overall profit in 1995, which grew by 15-17 percent in 1997 and almost 20% in 2002 (table 7). It is clear from the evolution of costs and profits of the program between 1997 and 2002 that operating expenses has risen as a proportion of total income. This probably reflects the cost of the decision in 2000 to reduce the maximum loan size. However, the cost has been absorbed adequately in the sense that profitability has risen modestly (following an initial drop in 2000/01).

e: Iqbal, Farouk and Riad, Nagwa, "Commercial Microfinance in Egypt, The Case of the National Bank for Development", op.cit.

Table (7) also contains a comparison of the micro lending program with the overall performance of NBD in 1997 and 2002; three aspects of this comparison are worth noting here. First, as expected, the operating expenses ratio is higher for the microfinance program than for the bank as a whole. Second, despite the higher operating expenses share, the profit rate is higher for the microfinance than for the bank as a whole. Indeed, interviews with NBD staff suggest that the microfinance program, while it accounts for only 5% of the portfolio (by value), generating almost 30% of the overall profits. Third, this may be due in part to the fact that the cost of funds for the micro lending component is lower than that for the bank as a whole, since some of the funds that the NBD still recycles were made available to it as a grant from donors.

C- Interest Rate and Repayment Rate:

The characteristics of the micro enterprise may explain the high repayment rates despite the high interest rate. These characteristics are (a) most of these enterprises produce basic needs goods and services, therefore the income elasticity of demand for such products is low, and this will not change the level of demand for them during recession periods. (b) The value of invested capital is very small, therefore total cost of production is low, and (c) total wages is also very low because the enterprise is run by the family members, whose reservation wage (opportunity wage) is low. And this will further reduce the cost of production (table 8).

With low income elasticity of demand and low cost of production, micro enterprises are less risky than small and medium enterprises, or maybe even risk free.

D- Return on Assets:

Return on Assets (ROA) may be a good financial indicator of financial sustainability. ROA reached 8.1 % in 2000 and decreased to 9.1 in 2004.

This is because of reduction of loan ceiling to LE3000, as mentioned before, and therefore the profits has been decreased from LE 15.6 million in 2000 to LE 5.7 million in 2003, and then it increases to LE8 million in 2004 when the bank decided to increase the loan to LE10'000 million in March 2004. (Table 9 and figure 4)

Table (7): Profitability of NBD and its micro credit program

	1997		2002	
	Entire Bank	micro lending program	Entire Bank	micro lending program
INCOME	100.0%	100.0%	100.0%	100.0%
C (ESTIMATED)	66.6%	34.8%	72.2%	18.7%
OPERATING	17.5%	28.5%	12.8%	44.5%
LOAN LOSS	8.6%	10.0%	6.5%	17.2%
OVERHEAD (ESTIMATED)*		10 - 12%		
PRETAX PROFIT	7.3%	14.7-16.7%	8.5%	19.6%

* For 2002, overhead expenses are included in operating expenses

Source: Iqbal Farouk and Nagwa Riad, "Commercial Microfinance in Egypt, the Case of National Bank for Development", World Bank, 2004.

Table (8): Interest Rate and Repayment Rate

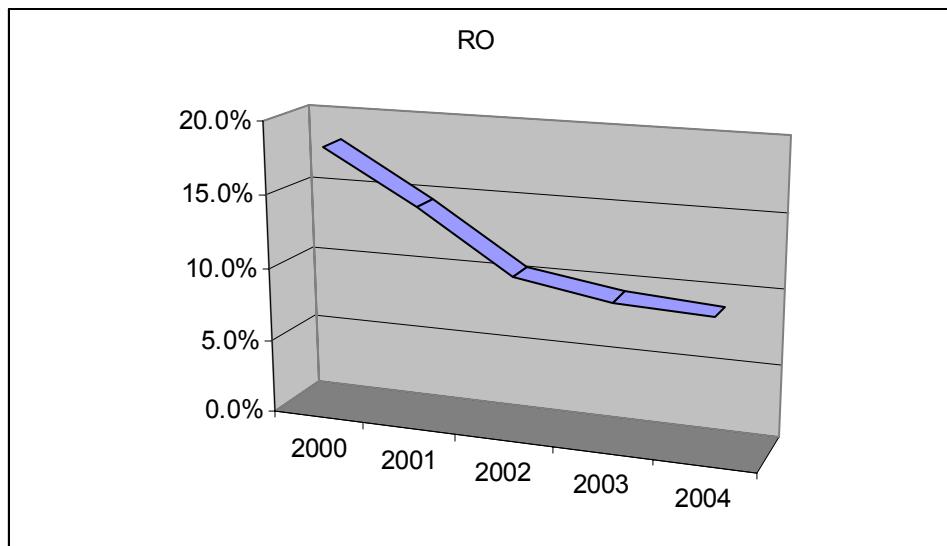
FINANCIAL SUSTAINABILITY			
INDEX	description	1998	2003
ACTIVITY			
INTEREST RATE	A nominal flat annual interest rate is 16% and a flat 3% annual transportation cost. For a six month loan, the equivalent annual percentage rate of these two fees is 31.88%. Payments of interest and fees are spread equally over time to maturity and then paid weekly. principal installments are paid according to the activity of the borrower.		
REPAYMENT RATE ON DISBURSED LOANS		99.2%	99.5%

Table (9): Return on Assets

Year	Net Profit (LE Million)	Total Assets (LE Million)	ROA%
2000	15.6	86.1	18.1%
2001	9.5	65.5	14.5%
2002	6.2	59.1	10.5%
2003	5.7	60.4	9.4%
2004	8	87.8	9.1%

Source: National Bank for Development, unpublished data, June 2005.

Figure (4): Return on Assets



7- Impact:

The impact of the micro lending program on poverty alleviation can be measured by the effect of the program on improving the standard of living of the poor recipients. To date, no systematic and statistically sound quantitative assessment of the impact of the NBD's micro credit program on the livelihood of its beneficiaries has been conducted. Some indicative evidence is available however, from data gathered from a selected sample of borrowers, 30% reported having increased the number of permanent employees in their enterprise and 20% having increased their temporary employees. In terms of income changes, over 60% reported that their incomes had increased by more than 50%, 11% by less than 50%, and 24% reported no changes. About 9% reported that they had bought their own shops and 5% that they had increased the size of their shops ⁽¹⁾.

An informal interview with 5 borrowers revealed that most of the borrowers had been clients with the NBD for several years and have taken several loans. Initial loan size

ranged between LE1248 and LE6124. For most, these loans provided an important source of liquidity to finance working capital. Loans are mostly used to sustain operations of the micro enterprise, in the most successful case they also contribute to the expansion of activity. All borrowers reported increases in incomes from credit supported activities. Part of this income is used to finance household expenses, but most of it is reinvested in the enterprise (Boxes 1-5).

8- Conclusion:

The experience of NBD has been used to test the following three hypotheses, a) institutions can not reach the poorest because they are too costly to identify and motivate, b) if an institution does reach the poorest, it can not become self sufficient; and c) an institution that somehow reaches the very poor and becomes financially self sufficient will only add a debt burden to the very poor. Based on the discussions and arguments indicated above it may be concluded that these hypotheses should be rejected.

Furthermore, a growing number of MFI's elsewhere has shown that poor people are bankable and that banking with the poor can be profitable and sustainable. The poor are willing to pay high interest rates associated with microfinance in return for quick, convenient, and continued access to well designed financial services. Therefore, the gap between the supply of and demand for microfinance services can be filled only through a sustainable increase in the number of sustainable and profitable microfinance institutions⁽¹⁾.

(1) Source: Brandsma, Judith and Laurence Hart, 'Making Microfinance Work in the Middle East and North Africa', Private and Financial Sector Development Group, Middle East and North Africa Region, World Bank, Washington, DC, 2000.