



Microfinance Index of Market Outreach and Saturation

Kyrgyzstan

August 2017

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The microfinance sector in Kyrgyzstan is at normal penetration level, with a MIMOSA score of 3. The slowdown in lending that followed a large currency depreciation during 2015-16 has been a key factor in lowering the MIMOSA score from a score of 4 (moderately saturated) in the 2015 MIMOSA report. The presence of strong regulation, low levels of foreign-currency lending by MFIs, little multiple borrowing and moderate competition all contribute to a strong foundation for future growth. However, the convergence of bank and microfinance lending, and growth in clients' religious aversion to debt both pose new challenges and opportunities.

Regulation is generally strong. While the overall strength of regulation is judged relatively poorly by EIU Microscope (48/100), the specific elements most relevant to sustainable growth, including prevention of overindebtedness, appropriate collections, and quality of credit reporting remain positive. Moreover, the sector's largely successful weathering of the large and fairly rapid currency depreciation during 2015-16 and accompanying economic shocks suggest that the quality of regulation in Kyrgyzstan is well above the level assessed by the Microscope methodology (see Special Discussion).

From the perspective of client protection and overindebtedness, the risks are modest. Concern over inability to pay was only infrequently cited as reason for avoiding debt (4%) in our field surveys.¹ When asked about known collections practices, a large majority (59%) mentioned that defaulting on a loan would result in seizure of assets or home, or being taken to court (presumably in order to seize assets); 14% said that lenders would pressure guarantors to pay, with 20% specifically mentioning group guarantee for small loans; 6% said borrowers who default can run away. A third (33%) of respondents said they knew of people who had experienced one or more

Category	Rating	Indicator	2014	2016
Saturation	3	Loan penetration over capacity	+ 4.6%	+ 3.2%
	n/a	Credit card penetration	+ 1.7%	n/a
Regulation		Overall quality of regulation	43/100	48/100
		Prevention of overindebtedness	3/3	2/2
		Appropriate collections	1/2	1/2
		Quality of credit bureau & credit reporting	75/100	75/100
Competition / overheating*		Level of competition (HHI)	1882	2600
		% Borrowers with 3+ loans	2.3%	1.1%
		Loan portfolio CAGR in value past 3 years	24%	2%
		Loan portfolio growth in value expected next 12 months	12%	18.2%
Maturity of microfinance institutions*		% clients at MFIs <10y or >20y old	26% <10y old	48% >20y old
		Experienced crisis in past 15 years	no	partial
Transparency		Composite transparency score	4/4	4/4
		% leading MFIs with ratings in past 2 years	20%	60%
Other risks		FX exposure	<5%	<5%

* includes current members of AMFI and former member Bai-Tushum

¹ Survey of market vendors in trading areas in/around Jalal-Abad, Uzgen, Tokmok and Bishkek.

instances where lenders sought to collect on unpaid loans, while a few mentioned learning about collateral repossession from newspaper ads for “repossessed property.” None of the collections practices mentioned in the survey suggest anything inappropriate or inconsistent with loan contracts.

The credit bureau is strong, encompassing all significant lenders in the country. Its transparency and support for market analysis is an important contributor to a sustainable credit market. In field surveys, awareness of credit reporting is very high at 84%, and those who mentioned that they didn’t know about credit reporting were quickly corrected by friends or relatives nearby. In short, awareness of credit reporting is effectively universal.

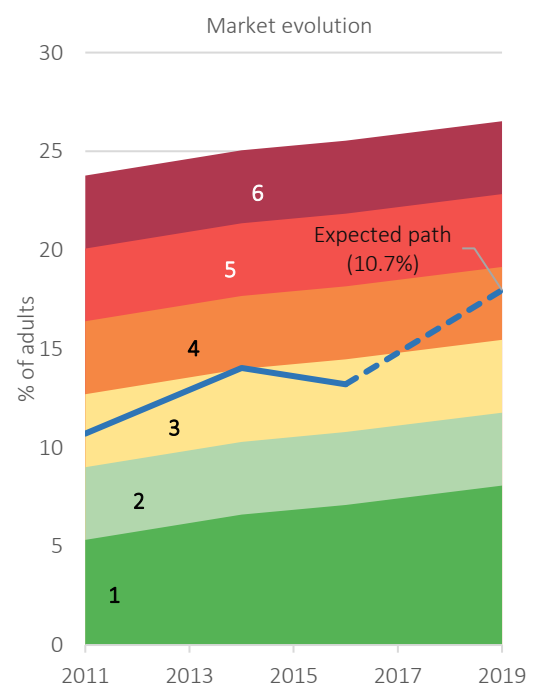
This awareness of the consequences of non-payment – both on pledged property and credit history – also suggests that the risks of default are widely understood, encouraging borrowers to maintain payment discipline and likewise avoid borrowing more than they can repay. These are important, positive attributes for healthy credit markets. But lest one forget, they also reflect the high degree of stress that many borrowers experience, and that alone should encourage conscientious lenders to continue to perfect practices that minimize the risk of overindebtedness.

The market among MFIs appears to have become somewhat less competitive since 2014, with the largest three MFIs (FINCA Bank, Kompanion Bank, and Mol Bulak) increasing their share of active borrowers to above 80% of the microfinance sector. However, this shift has been accompanied by the transformation of the leading MFIs into banks (Kompanion, FINCA, and Bai-Tushum). This has significantly reduced the distinction between bank- and non-bank credit institutions. During field surveys, 69% of borrowers named banks as their current lenders, and even excluding recently transformed MFIs, the figure remains high at 37% (e.g. borrowing from banks such as Optima, Asia, RSK, and others). Moreover, when asked to name lenders from whom they could potentially borrow, interviewees made little distinction between MFIs and banks. In short, while market segments remain, there is a lot more cross-competition between sectors that had previously been more distinct.

Concurrently with this change in competition, multiple borrowing has likewise continued to decline, with just 1.1% of borrowers holding 3+ loans from all formal financial institutions, according to data from Ishenim credit

	2011	2014	2016	2019
HDI	0.637	0.662	0.664	0.672
Population density per km ²	27.4	27.6	29.5	31.1
Credit Bureau Score	31.2	63.7	81.4	114.3
Loan capacity	9.0	10.3	10.8	11.8
Borrowers per adult	10.7	14.0	13.2	18.0
Microfinance loans per adult	12.0	11.4	12.1	16.5
MIMOSA Score	3	4	3	4
Credit card users per adult	0.4	1.7	-	-
MIMOSA CC penetration score	Normal	Normal	-	-
GDP per capita (current \$)	1,116	1,267	1,073	1,196
CAGR GDP, past 3 years (constant LCU)	2.8%	4.9%	3.8%	4.1%

* forecasts: IMF for GDP, UNDP for population; MIMOSA for others



bureau. Borrowers holding two concurrent loans is likewise very modest, at just 12.8%. The figures from a survey of market vendors are generally consistent with the credit bureau data, with 15% reporting having 2 loans and 2% reporting 3 loans or more.

The biggest and most obvious change in the past two years has been a large slowdown, and even reversal, in growth. Portfolio amounts have barely budged, even when measured by the much-depreciated local currency. The number of loans outstanding declined by 8% in the microfinance sector and 4% the financial sector overall between 2014 and 2016. The resulting lower penetration level is the primary reason for the drop in the country's MIMOSA score, down from a score of 4 in 2014. According to the MIX Barometer March 2017 survey, MFIs expect to average 18.2% growth in portfolio and 10.7% growth in borrowers over the next 12 months, which may well be optimistic. But even if met, the risk posed by such growth is modest in the context of the current low-risk environment.

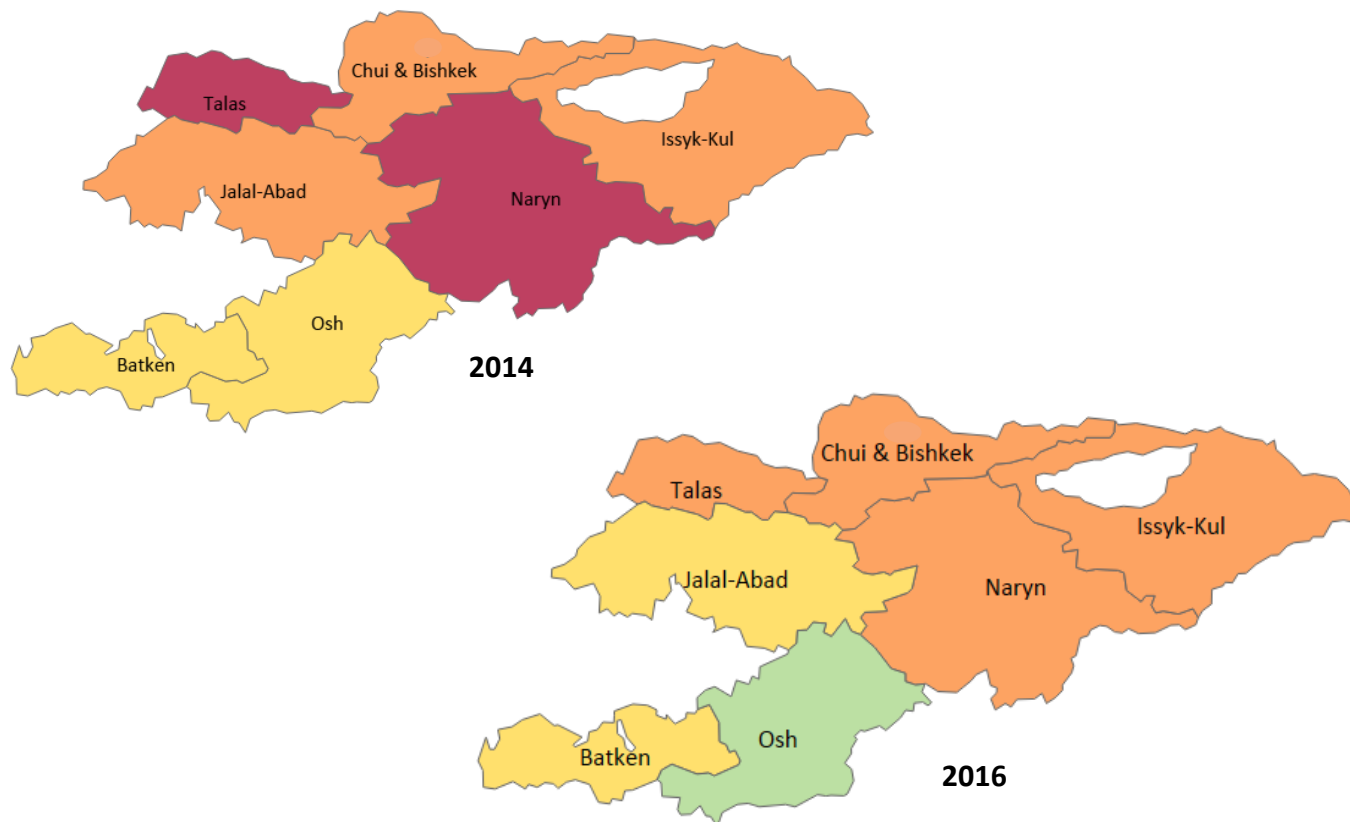
The Kyrgyz microfinance sector is approaching maturity, with 48% of microfinance clients served by MFIs founded more than 20 years ago (including recently transformed MFIs). Experience with the market downturn in 2011 and the devaluation since 2015 have also been important in tempering overly aggressive market outlook.

Market transparency has continued to grow, particularly with respect to client protection, with three of the largest five institutions having Smart Campaign certification. The positive role of the Ishenim credit bureau, to which all major lenders report, is another important support for market sustainability. Ishenim regularly publishes reasonably detailed summaries of lending activity at both national and regional level.

Foreign currency lending has been a major factor in the banking sector, comprising 58% of bank loan portfolios in January 2015. This is now down to 42% as of June 2017. However, due to regulatory prohibitions, nearly all MFIs have been prohibited from lending in foreign currency. Recent transformation of major MFIs into banks has not significantly changed that trend (see Special Discussion, below).

MIMOSA Scores by Region

At the regional level, there are a few major shifts. The most obvious is the large decline in penetration levels in the largely rural regions of Naryn and Talas, the latter of which saw the greatest decrease, from 20.6% down to 15.0% penetration level. Other regions saw more modest declines. Notably, the region of Osh currently has the lowest penetration level of 7.8%, even though several MFIs mention it as among the most competitive markets. The distinction may largely be due to differences between the more saturated Osh city and the surrounding region, which is far less served. Given that Osh region has 4.5 times more population than Osh city, that implies plenty of opportunity for outreach in the region's more rural areas.



Column no:	1	2	3	4	5	6	7
Region	Population (000s)	HDI	Population density (km2)	MIMOSA Score	Borrowing capacity (%)	Borrowers per adult (%)	Penetration over capacity
National	5,891	0.664	29	3	10.8	13.2	2.4
Chui & Bishkek	1,903	0.716	94	4	12.2	16.1	3.9
Osh	1,453	0.593	50	2	9.6	9.5	0.0
Jalal-Abad	1,100	0.615	33	3	9.9	11.7	1.8
Issyk-Kul	463	0.685	11	4	11.1	15.6	4.5
Batken	456	0.594	27	3	9.4	9.7	0.3
Naryn	268	0.605	6	4	9.5	16.7	7.1
Talas	248	0.635	22	4	10.2	15.0	4.8

Sources: 1: The National Statistical Committee of the Kyrgyz Republic (NSCKR); 2: UNDP, NSCKR; 3: NSCKR; 4-5, 7: MIMOSA calculations; 6: Credit Bureau Ishenim

Special Discussion 1: Managing FX risk wisely

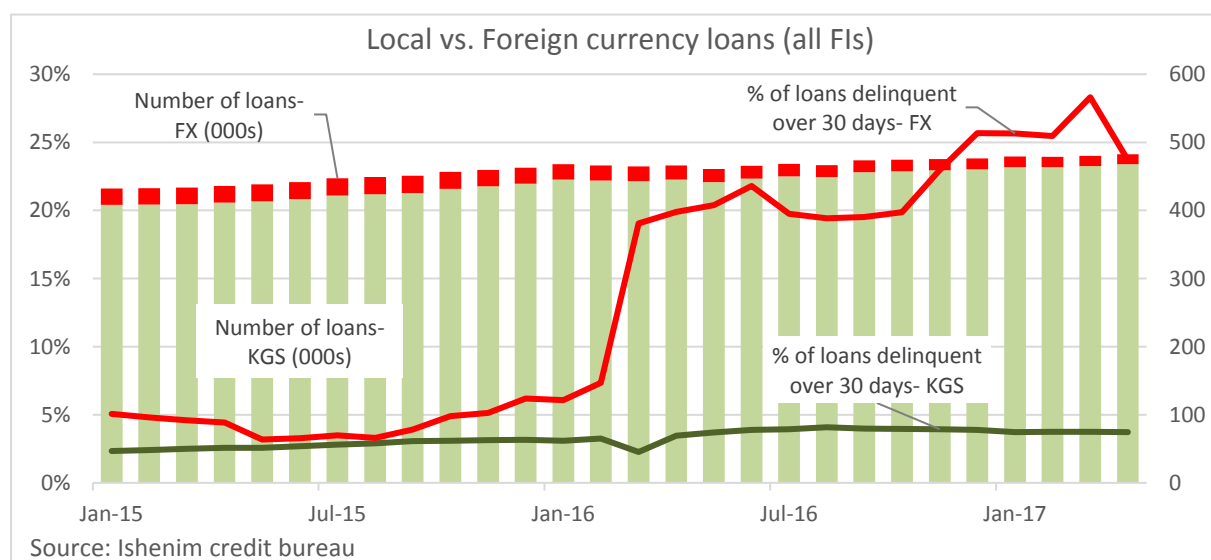
One notable aspect of the Kyrgyzstan microfinance sector in the past two years is its relationship to the economy, and particularly the large decline in the country's currency, the som, which during 2015-16 lost 25% of its value, peak-to-trough. While not as great as declines in other countries in Central Asia and the Caucasus, it nevertheless deeply affected both lenders and borrowers alike.

A major reason for the lack of growth and even pullback on the part of the MFIs has been this economic malaise. During our field survey of market vendors, 78% of those who have been in business for at least two years reported a worsening of their situation following the currency depreciation. The same number (79%) mentioned having a harder time making loan repayments than before the depreciation.

Meanwhile, MFIs reported dealing with significant hedging costs and foreign exchange losses, along with reduced demand from clients. One MFI cited a large impact from declining remittances from Russia, which suffered its own devaluation. Nonetheless, few mentioned significant credit losses. All this is clear from portfolio data, in which foreign-currency loans have suffered quite high delinquency rates, while the performance of local currency loans has hardly budged. The situation was greatly mitigated by the fact that the number of such foreign-currency loans was small to begin with and continued to shrink throughout the period.

In short, the sector has weathered the shocks as well as one could reasonably expect, and is well positioned for future growth. Much of the credit for this is due to the National Bank. First, unlike countries such as Azerbaijan, the currency was never fixed, so the decline did not come in the form of a sudden devaluation. Even more importantly, regulatory limits kept foreign currency lending manageably low. As frustrating as those limits may appear to the MFIs, this is ultimately the better path. Were those limits not in place, lender exposures to foreign currency loans – along with the resulting consequences – would have been much greater.

Experience shows (including the recent case of Azerbaijan) that market forces make it extremely difficult for lenders to appropriately manage and price currency risk. Regulating foreign currency lending is critical, and Kyrgyzstan stands as one of the markets that got this right.²



² This only relates to the microfinance sector and does not address the effects of foreign currency lending on the Kyrgyz commercial banking sector, which is outside the scope of this report. We note that commercial banks held the bulk of FX lending in the lead-up to the depreciation, and continue to do so now, albeit at lower levels.

Special Discussion 2: Religion and debt

An important departure from the 2015 report has been the emergence of a new trend. One of the questions in the Mimosa field survey asks of those who were offered credit (by loan officers, marketing agents, etc.), whether they took a loan, and if not, why not. An important finding during the 2015 survey in Morocco was the large number of individuals who responded that they would not borrow due to Islamic prohibitions against debt. Until now, Morocco was the only country covered by MIMOSA where this was a significant response (in that case, ~30% of respondents). Other countries with large Muslim populations, including Kyrgyzstan, Azerbaijan, and Senegal, showed no such trends.

However, during this year's survey in Kyrgyzstan, this response began to emerge as a significant factor. In all, 15% of respondents stated this reason. Male interviewees cited religion at nearly twice the rate of female (23% vs. 13%), but another 6% of women interviewed cited close male relatives (usually husband, sometimes son) as not allowing them to borrow, often mentioning religion as the reason. Another 5% of men cited "not wanting to pay interest" as the reason, without mentioning religion specifically, while only 1.5% of women said the same.

There were also significant regional differences. We captured no such responses at all in Bishkek and just one in Osh. Meanwhile, in the town of Suzak, an outpost along the border with Uzbekistan, on the outskirts of Jalal-Abad, 53% of respondents cited this reason. The small towns on the eastern edge of Chui (Kant, Ivanovka, and Tokmok) had 16%, though Kant itself had only 4% (1 response).

This may be in part explained by the growth of religious sensibilities and Islamic schools in the country. Recent press reports suggest that Islamic schools are becoming increasingly prevalent. The free or nearly free boarding these schools provide are attractive options to families with migrant workers, who are able to leave their children in the care of trusted religious leaders.³ While it is beyond this report's scope to delve into changes in religious practice, we note that stronger adherence to Islamic principles can significantly reduce credit demand, and thus also lower the level at which market can become saturated. At the same time, it may increase opportunities for Islamic lending, but that needs to be explored further.

These findings are not yet strong enough to modify the calculated market capacity for credit (as we have done in Morocco), but this is an area that should be monitored – both for the challenges and opportunities that it presents.

³ Nastoyaschoe Vremya, 5 Oct 2015: www.currenttime.tv/a/27283336.html

User Guide

This is an abbreviated guide. For explanation of the methodology behind the penetration and capacity values, please consult the MIMOSA whitepaper.

The MIMOSA index consists of several measures. The primary score evaluates the degree to which the level of penetration exceeds estimated market capacity. The score levels and their interpretation is shown in the below table.

MIMOSA Score	Penetration over/ under capacity		
	Percentage points	Standard Deviations	Market status
6	>11.1%	3+	Saturated
5	7.4-11.1%	2 to 3	
4	3.7-7.4%	1 to 2	
3	0-3.7%	0 to 1	Normal
2	-3.7 - 0%	-1 to 0	
1	< -3.7%	< -1	Underserved

In addition to the score, we include the component metrics underlying the capacity and penetration calculations:

Human Development Index (HDI): developed by UNDP to assess the level of development, comprising GNI per capita, life expectancy, and education metrics. The scale ranges from 0-1.

Population density per km²: standard measure retrieved from country statistical bureaus.

Credit Bureau Score: derived from the Getting Credit measures in the World Bank Doing Business report. We include the level of coverage, and amount of information (both repayment history and debt outstanding) provided. The scale ranges from 0-400.

Borrowing Capacity: % of adults expected to be active borrowers, based on the MIMOSA model.

Borrowers per adult: derived from multiple sources, including the World Bank Findex survey, central bank reports, credit bureaus, and MIMOSA field surveys.

Microfinance borrowers (% of loans): number of active loans of microfinance institutions. Usually defined either by institutional registration with the regulator or membership in the microfinance association. Multiple loans held with the same institution are counted once.

Credit card borrowers (% of adults): number of adults with an outstanding credit card balance. Figure from Global Findex.

Credit card score: level of penetration vs. capacity. Graded on a three-point scale, indicating a market whose credit card demand is under-served, appropriately served, or over-saturated.

GDP 3-year CAGR (current \$): three year cumulative growth rate of GDP. Figure from IMF WEO.

GDP per capita (constant LCU): figure from IMF WEO.

In addition, we include a list of indicators that serve as additional risks or mitigants that in aggregate may increase or reduce the country's ability to manage increased levels of penetration:

Category	Indicator	Indicator	Mitigant 	Neutral 	Risk 
Regulation	Overall quality of regulation	Overall microscope score (0-100)	≥ 75	50-75	< 50
	Consumer protection (OID)	Microscope score 4.2.1	3	2	0 or 1
	Consumer protection (Collections)	Microscope score 11.3.2	2	1	0
	Credit bureau, credit reporting	Microscope score 10	≥ 75	50-75	< 50
Competition / overheating	Level of competition	Herfindahl-Hirschman Index	$HHI > 3,000$	$1,500 < HHI < 3,000$	$HHI < 1,500$
	Multiple borrowing	% borrowers with 3+ loans	$< 5\%$	5-15%	$> 15\%$
	Prior growth	Loan portfolio 3-year CAGR	$< 2x$ GDP growth	2-3x GDP growth	$\geq 3x$ GDP growth
	Future growth	Loan portfolio 12-mth growth expectations	$< 2x$ GDP growth forecast	2-3x GDP growth forecast	$\geq 3x$ GDP growth forecast
Maturity of microfinance institutions	Age of FIs	% clients of MFIs $> 20y$ or $< 10y$ old	$> 65\%$ of the borrowers are clients of MFIs > 20 years old	Other	$> 65\%$ of the borrowers clients of MFIs < 10 years old
	Prior crisis experience	Date of previous crisis	Market experienced crisis in past 15 years	no crisis experience	
Transparency	Composite score	See Transparency worksheet	≥ 3		< 1.5
	Ratings	% leading MFIs rated in past 2 years	≥ 75	50-75	< 50
Other risks	FX exposure	% of loans in foreign currency	< 10	10-25	≥ 25
	Interest rate level	Average Full APR, weighed by number of borrowers	$< 30\%$	30-60%	$> 60\%$