Planet Rating
TRANSPARENCY FOR MICROFINANCE DEVELOPMENT

Constanta Foundation
Georgia – November 2003

Rating scales and formulas may be found on the following page.

Global Rating

B+
Trend: Stable

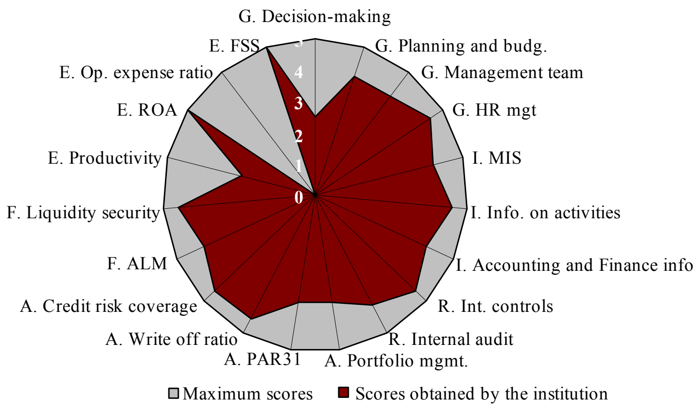
Launched by Save the Children, Constanta was first registered as a Georgian Association in 1997 and then reregistered as a Georgian Foundation in 1999. Initial funding was provided by UNHCR and subsequently USAID. Constanta Foundation serves numerous regions throughout Georgia via a network of branches, outlets, and service points. Constanta has a portfolio of over 2.5 million EUR to over 17,500 borrowers in group loans and, since 2001, individual loans. The clients are 70% women.

Rating Plus Summary

Environment	Sluggish economy; unfavorable legal environment
Maturity	**Young:** 6 years of operations
Scale	**Medium:** Portfolio of 2.5 million EUR
Target market	**Broad:** Avg. out. loan 22% of GNP per capita

Area Scores

G overnance and decision making	**b**
I nformation management and systems	**a**
R isk Management	**a**
A ctivities: products and services	**b**
F inancing and liquidity	**a**
E fficiency and profitability	**c**



		2000	2001	2002	Sept. 2003
ACTIVITIES					
Total assets	(K EUR)	1,809	2,712	3,431	3,941
	(K GEL)	3,274	5,169	7,492	9,655
Outstanding loans	(K EUR)	728	1,615	2,818	2,529
Active borrowers		9,733	13,202	16,134	17,535
Active clients (borrowers + savers)		9,733	13,202	16,134	17,535
Annual effective interest rate(b)			See notes		
PAR 30 days		1.4%	1.5%	3.0%	4.2%
Risk coverage ratio		73.1%	31.3%	111.3%	106.7%
Write-off ratio		2.3%	0.6%	0.2%	0.9%
GROWTH					
Portfolio growth		176.1%	133.9%	99.8%	0.7%
Asset growth		130.0%	57.9%	44.9%	28.9%

	2000	2001	2002	Sept. 2003(a)
PERFORMANCE				
Staff productivity	139	133	111	86
ROA*	1.5%	13.9%	22.1%	12.4%
AROA*	(7.9)%	5.9%	13.3%	3.2%
ROE*	1.5%	13.9%	22.1%	12.6%
AROE*	(7.9)%	5.9%	13.3%	3.3%
Portfolio yield*	90.5%	93.7%	85.5%	82.4%
Operating expense ratio*	97.0%	69.2%	49.8%	58.1%
Operational self sufficiency	104.4%	146.5%	160.2%	137.6%
Financial self sufficiency	81.7%	115.7%	129.3%	115.0%
FINANCING				
Commercial loans / Assets(b)	0%	0%	0%	0%
Leverage	0.1%	0.1%	0.0%	2.9%
Exchange Rate GEL/EUR	1.81	1.91	2.18	2.45

(a) Ratios with an (*) are annualized for 2003 by a factor of 12/9 for ease of comparison. Actual results for 2003 may vary from these estimations, however estimations of the increased profit tax liability have been included.

(b) Constanta offers two loan products with very different effective interest rates. The group loan product has an effective interest rate of between 76% and 100%. The individual loan product has an effective interest rate of between 24% and 36%.

Constanta Foundation – Ms. Tamar Lebanidze, Executive Director
115 Tsinamdzgvrishvili, 380064 Tblisi, Georgia
head_office@constanta.ge www.constanta.ge
Tel: (995 32) 953 020 Fax: (995 32) 951 731

Planet Rating
76 rue Fbg Saint Denis 75010 Paris France
Tel: 33 1 53 24 31 31 Fax: 33 1 53 24 11 57
rating@planetfinance.org www.planetrating.org Ref: KM/270104

Rating Scale

The rating method includes 19 factors that are rated using the system described below from "0" (lowest score) to "5" (highest score). A weighting system applied to these scores produces a rating for each of the six GIRAFE domains as well as the overall rating.

Area Rating	Global Rating	Explanation
a	A+ A A-	**Excellent** The institution excels in the evaluation area and is a model for the sector. There is a long-term vision for continual improvement. There are no risks in the short and medium term for operations. Long-term risks are well managed and monitored.
b	B+ B B-	**Good** Procedures are well developed, effective, and incorporate a long-term perspective. Some improvements could be made. Long-term risks are identified in the strategic plan.
c	C+ C C-	**Minimum required** Procedures are functional but with certain failings. There are minor risks in the medium term for operations, but these risks are being managed and monitored.
d	D	**Insufficient** Procedures are in place, but with failings, and certain problems are only partially addressed. There are medium-term risks for operations.
e	E	**Immediate risk of default or very insufficient** There are immediate or underlying risks for operations or an unacceptable under performance.

Rating Plus: MicroBanking Bulletin categories for ECA (Eastern Europe and Central Asia)

Scale (Outstanding portfolio USD)	**Target Clientele** (Avg. out. loan / GNP per capita)	**Maturity** (Years of operation)
Large: > 8 million	Low-end: < 20% OR avg. out. loan ≤ 150 USD	New: 1 to 3 years
Medium: 2 to 8 million	Broad: 20% to 149%	Young: 4 to 7 years
Small: < 2 million	High-end: 150% to 249%	Mature: over 7 years
	Small Business: 250 %	

Ratio Formulas

Personnel productivity	Active borrowers / Total personnel (end of period)
Loan officer productivity	Active borrowers / Total Loan Officers (end of period)
Return on assets	ROA: Net operating income before donations / Average assets
Adjusted return on assets	AROA: Adjusted net operating income before donations / Average assets
Return on equity	ROE: Net operating income before donations / Average equity
Adjusted return on equity	AROE: Adjusted net operating income before donations / Average equity
Leverage	Debt (savings + debts) / equity (end of period)
Portfolio yield	Portfolio revenue / 13-month average gross outstanding portfolio
Operating expense ratio	Operating expense / 13-month average gross outstanding portfolio
Funding expense ratio	Interest and fees paid on funding liabilities / 13-month average gross outstanding portfolio
Cost of funds ratio	Interest and fees paid on funding liabilities / Average funding liabilities (deposits + borrowings)
Loan loss expense ratio	Net loan loss expense / 13-month average gross outstanding portfolio
Adjustment expense ratio	Total adjustments / 13-month average gross outstanding portfolio
Net portfolio as a % of assets	Net outstanding portfolio / total assets (end of period)
Operational self-sufficiency	Revenue from operations / (Financial expense + Loan loss expense + Operating expense)
Financial self-sufficiency	Revenue from operations / (Financial expense + Loan loss expense + Operating expense + Adjustments)
Risk coverage ratio	Loan loss reserves / Portfolio at risk (31-365 days)
Write-off ratio	Loans written off / 13-month average gross outstanding portfolio

Executive Summary

The Georgian microfinance sector began in the mid-1990's and currently includes several non-profit Foundations, a dedicated microfinance bank, and several credit unions. These credit unions have recently come under supervision of the Central Bank, reducing their numbers. Through an EBRD program, several local banks have developed distinct microfinance/SME programs as well. These institutions are operating in an environment with very slow economic growth, minimal production, and political instability.

The sector will benefit from the new Georgia Microfinance Stabilization and Enhancement Project, a four-year 10 million USD initiative funded by USAID and lead by Chemonics. The project will provide up to 5 million USD in financing for microfinance institutions and the remaining funds will be used to provide technical assistance and to improve the operating environment, notably the unfavorable legal framework for microfinance.

Launched by Save the Children, Constanta was first registered as a Georgian Association in 1997 and then reregistered as a Georgian Foundation in 1999. Initial funding was provided by UNHCR and subsequently USAID. Constanta Foundation serves numerous regions throughout Georgia via a network of branches, outlets, and service points. Constanta has a portfolio of over 2.5 million EUR to over 17,500 borrowers in group loans and, since 2001, individual loans. The clients are 70% women.

Constanta Foundation received a final rating of B+ with a stable trend.

Governance and decision making received the rating **b:**

- Constanta combines its mission of providing financial services for Georgian microentrepreneurs, predominantly low-end clients, with profitability.
- The current governance bodies do not provide sufficient structural checks and balances as the Executive Director also holds the position of Board Chairman. Constanta plans to change its charter to separate the two functions. Furthermore, the Board remains overly confident in the work of the current management team.
- The latest strategic plan under development using a "bottom-up" approach takes account of the major operational risks that Constanta faces. They seek to develop markets where there are existing offices and fully integrate cash handling into their operations in addition to launching new products. The plan contains ambitious goals for market penetration and expansion with individual loans (from 20% of the portfolio to 40% by the end of 2006).
- The competent management team works effectively together, serving to reduce key person risk. The team lacks business experience but is working to upgrade its technical skills via microfinance trainings and degree programs in business.
- Constanta is working to further develop its human resource management which is already strong with a dedicated RH department, a culture of staff investment, and an incentive pay system.

Information and systems received the rating **a:**

- Constanta's MIS is effective for operations and includes over 100 computers, a useful internally developed loan tracking system, an off-the-shelf accounting software, and monthly Excel spreadsheet templates for reporting purposes. Constanta plans to hire a second developer for the loan tracking system to limit key person risk.
- All key loan portfolio information is accurate and available monthly consolidated and by branch. Further sophistication would require analyses based on individual level data, not currently consolidated in the loan tracking system.

- Financial statements and best practice financial ratios are also accurate and available monthly consolidated and by branch. Institutional performance goals for these ratios and formal financial analysis are not yet developed.

Risk analysis received the rating **a:**
- Constanta limits operational risks with formalized and applied procedures, appropriate credit methods, and useful tools. The clear separation of duties with layers of supervision strongly limits fraud. Procedures to limit risks related to individual loans are being finalized.
- Constanta has a comprehensive approach to internal audit with a two-person team to audit both financial and operational performance. The auditor serves also as an internal consultant to assess efficiency and issue recommendations. With the recent expansion, Constanta plans to decentralize part of the internal audit work to the branch managers.

Activities: Products and Services received the rating **b:**
- Constanta is a market leader in Georgia for its group loan product, although the market position with respect to the individual loan product remains unclear.
- Loan product performance is very different between the group and individual loan products. The group product has effective client selection and delinquency management, and a manageable PAR31 of 2%. The individual loan product has undergone revisions to the credit methodology given its slow start and problems with portfolio management, the result of which is a current PAR31 of 13.3%.
- Credit risk coverage is over 100% given the increase in loan loss provisions to include a percent of the healthy group loan portfolio as well. Constanta takes collateral for the individual loans but does have difficulty with loan recovery given challenges in executing court judgements.

Funding and Liquidity received the rating **a:**
- Constanta has been financed itself entirely with donated equity (69%) and retained earnings (28%). After a planned conversion to a legal for-profit entity and after using up the existing committed grants, Constanta anticipates seeking loans from local and international sources.
- Given the excess cash on hand from grants, Constanta has not experienced liquidity problems thus far despite its considerable expansion. To ensure the safety of cash handling in an environment prone to occasional robberies, Constanta is investing in its physical infrastructure and working closely with banks for cash deliveries.

Efficiency and Profitability received the rating **c:**
- Constanta received only a “c” rating for this evaluation despite high profitability due to low overall productivity and efficiency results.
- The strong profit margin of over 30% in 2001 and 2002 is due to a very high portfolio yield (94% and 86% respectively). This profitability results in a very strong Return on Assets and Return on Equity of well over 10%. Constanta expects that the ROA will decline in the short term but will stabilize around 10% by 2006. This is due to an additional tax burden and investments in expansion and staff training.
- The operating expense ratio of 50% in 2002 and 58% annualized in 2003 (the jump being attributable to an increase in staff salary tax burden) remains high for the sector. The very low staff productivity of 86 in 2003 for a structure like Constanta is due in part to the recent staff hirings for expansion and, to a lesser extent, the currently low productivity of individual loan officers prior to full-scale launching of the product.

Overall summary:

- **Constanta's key strengths include:** A leading market position in the group loan product with successful group loan portfolio performance; a physical presence in numerous regions of the country using a highly organized and innovative three-tiered structure (branch, outlet, service point); well-implemented procedures to limit most operational risks with an internal audit department to verify compliance; and a strong international reputation.

- **Constanta's areas for improvement include:** Structural weaknesses in governance given the relatively weak role of the current Board of Directors and the Executive Director's role as Board Chairman; stronger individual loan product (clear market position and better portfolio performance); and development of a stronger business orientation within the management team.

- **The principal risks facing Constanta include:** Continued growth in light of increasing market competition in certain regions and a lack of clear market position for the individual loan product; ability to effectively transform to a for-profit institution which will help clarify its legal status and allow easier access to loans; successful launching of new products; and country risks (slow economic growth, low levels of production, and political instability).

Funding needs:

- Per the 2004-2006 business plan, Constanta is seeking additional financing of 2.6 million EUR for the period (6.25 million GEL to complement the 3.25 million GEL in available or committed financings).
- Planet Rating believes that Constanta is a highly organized and profitable institution with strong operations and a proven track record for the group loan product that could support commercial rate debt. Funders should pay special attention to the progress of the individual loan product and country risks.

The opinions expressed within this report are valid for one year after the rating mission. Beyond one year, or in case of a major change during this period affecting the institution's performance, that change due to the institution itself or its operating environment, Planet Rating does not guarantee the validity of the opinions contained herein, and recommends that a new rating evaluation be undertaken. Planet Rating cannot be held responsible for investments/financings that are made based on this report.

Rating Plus

The GIRAFE rating evaluates the sustainability of an institution. However, it is difficult for an institution that is young, in a challenging environment, or targeting hard-to-serve populations to achieve this level of sustainability. Rating Plus serves to clarify the institution's context.

Environment

Since the collapse of the Soviet Union, Georgia has suffered a civil war and several conflicts, most recently the peaceful removal of the Shevardnadze government in November 2003. This instability along with a high level of corruption have hindered Georgia's successful transition to a market economy and efforts to attract foreign investment. The GEL has remained stable to the USD since 1999, within a band of 2 to 2.2 GEL per USD, and was forecasted to continue on this path. Recent political events have not significantly changed this exchange rate.

	Dec. 2000	Dec. 2001	Dec. 2002	Sept. 2003
Exchange rate: 1 EUR = X GEL	1.81	1.91	2.18	2.45
GNP/ capita (EUR)	719	760	751	670
Inflation	4.6%	3.4%	5.4%	5.4%*

*Annualized estimate.
Source: State Department for Statistics of Georgia; Ministry of Finance.
Note: Fluctuations in exchange rates due in part to USD/EUR fluctuations.

In the late 90's, the Russian economic crisis, drought, and interruptions of energy supply slowed down Georgia's GDP average annual growth (stable between 2-3% over the decade). The recent agricultural recovery has increased GDP growth estimations to 4.5% for the future, although the industrial base remains poor. After several years of hyperinflation following the independence, the inflation rate was only 5.4% in 2002. The country ranks 88 (out of 175 countries) in the UNDP 2003 Human Development Report.

Much of Georgia remains in poverty. Of the 4.4 million population, 56% live in rural areas, 51% live below the national poverty line (GEL 125 per month per adult, approx. 50 EUR), and 15% below the extreme poverty line (GEL 60 per month per adult, approx. 24 EUR)[1]. Unemployment is estimated at 18% of the active population.

There is a vibrant informal economy for microfinance along major roadways, but certain regions are less accessible due to political conflicts, mountainous terrain, or poor road conditions. The condition of the existing transport infrastructure is poor in the country overall, but improvement is expected with the EU-funded program to develop a corridor from Europe to Central Asia. Cellular networks have expanded rapidly and the quality of telephone lines has improved. However, electricity shortages remain a reality.[2]

Maturity and Scale

With over six years of operations and numerous grants, Constanta has achieved a portfolio size of 2.5 million EUR, placing it in the Medium category for the region per the MicroBanking Bulletin (MBB). Constanta has highly developed systems in place for overall operations, notably the group loan product. Other products are under development or being refined.

Target Clientele

Constanta has served a lower end target clientele than its regional peers while achieving strong profitability, thanks to high interest rates and increasing economies of scale.

- Average outstanding loan size is only 22% of GNP per capita, and the average disbursed loan only 34%. Constanta therefore just falls into the Broad category instead of Low End per the MBB because the average outstanding loan is greater than 20% of GNP per capita;
- Average individual loan is six times that of the group loan, increasing average loan size;
- 70% percent of Constanta clients are women and most clients work in petty trade; and
- 97% percent of clients for 80% percent of the loan portfolio are in group loan products.

[1] *Georgia: Poverty Reduction Strategy Paper,* IMF, August 2003.
[2] *Strategy for Georgia.* European Bank for Reconstruction and Development, March 2002.

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Acronyms

BTC	Baku-Tblisi-Ceyhan
CIP	Community Investment Program
EBRD	European Bank for Reconstruction and Development
EIR	Effective interest rate
EU	European Union
HR	Human Resources
IGP	Implementation Grant Program of USAID
IMF	International Monetary Fund
IPC	Internationale Projekt Consult GmbH
GEL	Georgian Lari (local currency)
GMSE	Georgia Microfinance Stabilization and Enhancement Project (funded by USAID and led by Chemonics, International)
GNP	Gross National Product
HR	Human resources
LO	Loan officer
MBA	Master's in Business Administration
MBB	MicroBanking Bulletin
MIS	Management Information System
MFC	Microfinance Center for Central and Eastern Europe and the Newly Independent States
MFI	Microfinance institution
NBG	National Bank of Georgia
PAR	Portfolio at risk
ROA	Return on assets
ROE	Return on equity
SME	Small and medium sized enterprise
USAID	United States Agency for International Development
UNHCR	United Nations High Commissioner for Refugees
VAT	Value added tax
WV	World Vision

Microfinance Environment

Several multilateral and bilateral aid programs are in place to develop the overall business and banking environment in Georgia. Major providers include the IMF, the World Bank, the International Finance Corporation (IFC), the Black Sea Trade and Development Bank (BSTDB), the European Commission through the EU Tacis program and USAID.

USAID and EBRD lead efforts to promote microfinance and SME development

USAID and the EBRD have the strongest influence on the microfinance and SME sector. EBRD has provided assistance to mainstream banks to go down market. USAID has recently launched the Georgia Microfinance Stabilization and Enhancement Project (GMSE), a four-year 10 million USD project led by Chemonics. The aim of the project is to provide up to 5 million USD in grants or loans to Georgian microfinance programs. The remaining funds will be used for technical assistance to improve the operating environment for microfinance as well as the needs of individual MFIs. In the future, the World Bank is expected to support credit unions, which have recently been required to submit to Central Bank supervision.

Banking sector

Consolidation of banking sector after massive post-independence bank licensing

Following independence, authorities liberally licensed banks such that the number reached 228 in 1994. Market pressures and a more active regulatory approach by the National Bank of Georgia (NBG) led to the liquidation of many banks, leaving less than 30 in 2003. NBG has also improved prudential regulation to bring it more in line with international standards. There is a high concentration within the ten largest banks that control approximately 80% of total assets and the gross loan portfolio. The banking sector remains thin, and credit to the SME sector is limited.

Microfinance regulatory environment[3]

Regulatory environment still unclear for microfinance

Several unclear concepts under Georgian law limit MFI funding opportunities and place MFIs at certain risks regarding their legal status and tax liability. One task of the GMSE program is to develop a more clear and favorable regulatory environment for microfinance.

- An MFI may either be for profit or non-profit, the distinction being that a non-profit may not have a commercial activity as its primary activity, but may have a commercial activity as a secondary activity to support the primary activity. This distinction between primary and secondary activity is not always clear, and a difference of opinion by a government official could jeopardize a Foundation's legal registration.
- For-profit entities may be considered banks, and thereby subject to regulation under the NBG, if they are said to provide credits as opposed to loans. There is virtually no distinction between a credit and a loan other than interpretation by a government official, who has the authority to declare the activities of an MFI illegal.
- Per civil code, loan interest must be either within a cap set by the NBG or close to the NBG interbank auction rate. The interbank auction rate is considerably lower than the rates charges by MFIs and the NBG has not set interest rate limits, resulting in a lack of clarity regarding legal interest rates.

In addition to these issues, MFIs not registered as banks are subject to other onerous legal requirements. The fees to change a charter, even for an address change, are excessive. Certain grants may be subject to taxes if used for microfinance. Collateral issues are also problematic, including the acceptance of cash as collateral and the execution of collateral by the understaffed Execution Bureau.

[3] Please refer to *Microfinance Legislation in Georgia* for FINCA Georgia, 2002 and updated research by the GMSE Project.

Heavy tax burden

Regardless of profit status, MFIs are subject to a heavy tax burden if not protected by a bilateral agreement between the MFI donor country and the Republic of Georgia. They are subject to profit taxes at a rate of 20%, real estate taxes, advertising taxes, employment taxes at a rate of 31% of salary costs and the VAT.

Microfinance Providers

Non-profits and commercial banks serving the sector

Georgia has several non-profit microfinance programs, credit unions and several commercial banks who have moved down market. Per recent surveys in the country, 70% of the approximately 43,000 microloan clients are receiving loans from non-profit MFIs, typically under 1,000 USD. However, commercial banks have considerably larger portfolios than non-profit MFIs and dominate the market for loans in the 1,000 to 10,000 USD range.[4]

The largest non-profit programs are Constanta, FINCA, and World Vision Georgia, all three started by American-based NGOs. ProCredit Bank, formerly the Microfinance Bank of Georgia, was founded to serve the microfinance and SME sector and has more recently moved downmarket, thereby competing more directly with non-profit MFIs. ProCredit and other commercial banks are experimenting with or already have reduced their collateral requirements. The sector is evolving rapidly with the increased interest of banks and the development of new products, despite the unclear legal environment.

Microfinance/SME Providers in the Republic of Georgia

Name	Region			Products offered	
	West	Tblisi	East	Group Loans	Individual Loans
MFIs					
Constanta Foundation	x	x	x	x	x
FINCA Georgia		x	x	x	x
World Vision Georgia	x	x		x	x
CHCA (Charity Humanitarian Center "Arkhazeit")	x			x	x
BAI (Business Assistance Initiative)	x				x
DRC (Danish Refugee Council)	x			x	x
Support for Development	x				x
Union of Trust	x			x	x
Oxfam Georgia	x			x	x
Banks					
ProCredit Bank	x	x			x
United Georgian Bank	x	x	x		x
TbiluniversalBank		x			x
Bank of Georgia	x	x	x		x
TBC	x	x			
Maritime Bank	x				x
Intellectbank	x		x		x
IOCC	x				x
Agrobusiness Bank			x		x

Source: Constanta Foundation 2003. Please note that not all MFIs listed operate in the same towns as Constanta and are therefore not necessarily competitors.

[4] Information obtained from the GMSE Microfinance Mapping Survey 2003, project led by Chemonics, Int. and funded by USAID.

Institutional Presentation

Legal form, supervision

Constanta started its operations in October 1997 as a local Association thanks to grants from UNHCR, and subsequently USAID IGP, both managed by Save the Children. The institution is a locally registered non-profit Foundation since 1999 and is not subject to any banking supervision but is subject to civil law and tax regulations.

Networks

Constanta is a member of the Poland-based Microfinance Centre for Central and Eastern Europe and the Newly Independent States (MFC). The Executive Director of Constanta is on the MFC Board. Constanta Foundation is a member of the MicroFinance Network since October 2003. Constanta is also a member of the Save the Children Network, which involves information and experience sharing and regular data reporting.

Ownership

Being a Foundation, Constanta does not have formal owners. Georgian law vests the highest authority in the founders of a Foundation. Constanta's initial founders have since definitively transferred their authority to a Governing Board (Board of Directors equivalent) via Charter amendments. Board members are all Georgian nationals and were recruited by Constanta. Board members do not have a financial claim to the dividends or assets, which upon liquidation would be taken by the State and possibly granted to another Foundation with similar purpose. The current Board members are:

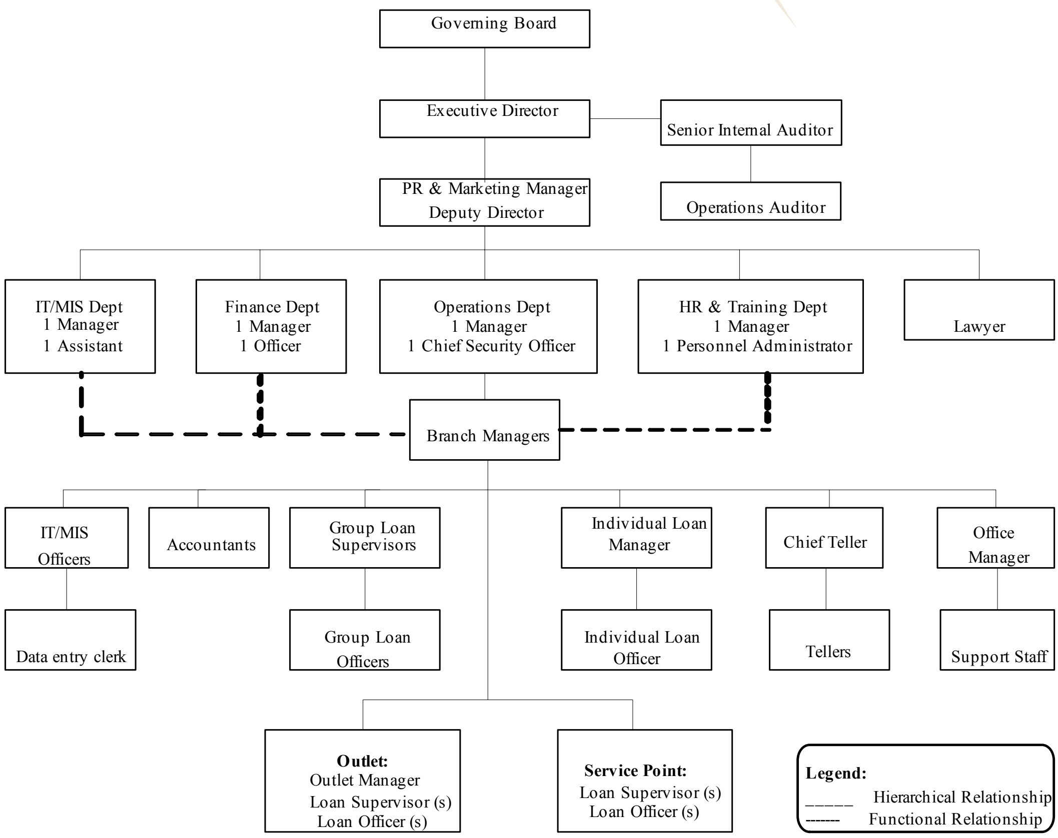
Board of Directors	Position/ Focus	Since	Profession
Tamar Lebanidze	Chairperson	Jan. 1998	Executive Director, Constanta Foundation
Natia Turnava	Economic Issues	March 2001	Deputy Minister of Economy, Industry and Trade
Maka Jakhua	Public Relations	March 2001	Journalist
Kate Bakradze	Fund Raising	March 2001	Civil Society Specialist, USAID
Tina Khidasheli	Legal Issues	Oct. 2003	Lawyer
Maka Menabde	Client Relationship	Oct. 2003	Micro-entrepreneur
Gela Vardziashvili	Business & Marketing Environment Issues	Oct. 2003	Entrepreneur

Team and structure

Constanta developed a network of 19 offices that covers the economically active areas of Georgia. The network is organized in seven, soon to be eight, regions. In each region one of the offices is set up as a branch that, in addition to its credit operations, oversees the activities of the other offices in the region (credit approval, authorization of disbursement, authorization of expenses, cash management and accounting). Branch managers are responsible for the reporting to headquarters. The other offices are either outlets or service points, depending on the market potential and the number of clients served. Small markets or new offices will be set up as service points with only loan officers and supervisors working initially on a part-time basis. These offices do not have a computing infrastructure and therefore use the closest outlet or branch for recording operations in the MIS. Constanta has developed partnerships with local banks to serve as teller windows, although these relationships are being reconsidered due to competition by banks for Constanta's clients.

Loan operations (client selection, disbursements, portfolio monitoring) are managed by loan officers who are specialized either in group or individual loans. Loan officers do not typically have cash handling duties and they are closely monitored by loan supervisors. All credit decisio

Constanta Foundation Organizational Chart



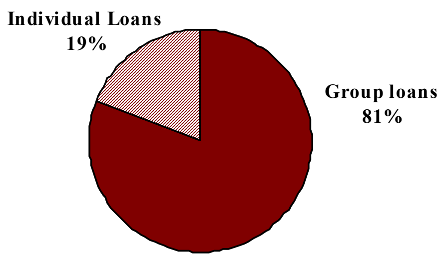
Human resources	2000	2001	2002	Sept. 2003
Number of employees	70	99	146	203
% Loan officers [a]	34%	35%	37%	37%
Turnover (exits/ period average staff)	2%	2%	2%	2%

(a) Group loan officers and individual loan officers, excluding supervisors who are 6% of personnel in September 2003.

Loan Products

The main product offered by Constanta is a classic cycle group loan product that requires no collateral. The initial loan amount ranges from 50 to 500 GEL for a three to six-month loan term, while subsequent loans may increase up to 2,000 GEL for a three to eight-month loan term. The interest rate drops from 4% to either 3.5% or to 3% per month as the client proves his repayment capability in previous cycles. This product targets solidarity groups of 4 to 15

Outstanding Portfolio by Product



members involved typically in micro-enterprises, often petty trade. Depending on the loan cycle or other parameters, that minimum number of group members may be reduced to three.

Constanta started testing a collateralized individual loan product in 2001 with gradual improvements to the methodology over time. Constanta seeks to perfect the product before beginning more intensive marketing efforts. The product targets small and micro-entrepreneurs involved in trade or services with loans up to 3,000 USD for a maximum term of 12 months. Loans under 2,000 GEL can either be denominated in GEL or USD according to clients request. Above that amount, loans may only be denominated in USD in order to limit the inflation risk for Constanta. Individual loans to employees (with a preferential interest rate of 1.5% per month) account for 23% of the individual loan portfolio.

Product Features	Group Loan	Individual Loan
Date created	1997	2001
Target clientele	Micro-entrepreneurs	Micro-entrepreneurs
Purpose	Working capital	Working capital
Minimum / Maximum loan amount	50 to 2,000 GEL	800 to 2,000 GEL and 400 to 3,000 USD
Average loan at disbursement	295 GEL	960 USD
Annual nominal interest rate	3% to 4% per month	2% to 3% per month
Flat or declining?	Flat	Declining
Fees	1% to 1.8% administrative fee	1% to 2% administrative fee depending on loan term
Savings	None	None
Repayment frequency	Weekly or bi-weekly	Monthly/ Bi-weekly
Term (without grace period)	3 to 8 months	3 to 12 months
Average loan term	4 months	N/A
Grace period	None	Possible if required by activity
Guarantees	Group solidarity	Collateral required
Effective annual interest rate	76% to 100%	24 % to 36%

External audits and reporting

In addition to completing audits for tax purposes, Constanta has been audited by two external auditors. GCG Audit Ltd, at the time a correspondent for Andersen and now an office of Ernst and Young, was hired by Constanta to audit the accounts in 2002. The firm has audited other microfinance programs and banks in Georgia. In addition, the Miller Group of Washington DC, a pre-approved auditor of USAID, performed an audit of the accounts in 2001 and 2002 as part of the IGP. Both external auditors certified the accounts without reserve.

Governance and Decision Making

Decision making

Profitability focus while serving a low-end population

Mission

Constanta's mission is to provide long-term, easily accessible and high quality financial services to micro and small entrepreneurs of Georgia with a vision of creating "opportunties for employment and self-realization." With the latest business plan, Constanta also expects to become a legal for-profit institution by 2006 to clarify its status and better access funding. Foundations in Georgia may be profitable and subject to taxes, even though their official legal status is non-profit. The profitability orientation does not preclude Constanta, which has covered operating costs since 2001, from continuing to serve a low-end population. The institutional mission and culture are commonly shared among staff. There is also a strong mission for the organization itself in terms of a positive work culture and an emphasis on staff development.

Executive Director as chairperson prevents checks and balances; Change expected soon

Decision-making process

Constanta management has considerable autonomy with regards to decision making but will inform the Board on all major initiatives for their approval (branch openings or closings, budgets, hiring or firing of the internal auditor). The Executive Director is currently the Chairperson of the Board, preventing structural checks and balances. At the time of local registration, Counsel had deemed it impractical for the Chairperson to be anyone other than the Executive Director. Bank law and commercial law do not allow such a combination of functions, although Constanta is subject to civil law, which is silent on the matter. After recent discussions with Counsel, Constanta has decided that it should transfer the role of Chairman to another Board member and anticipates doing so soon. It should be noted that other MFIs surveyed in Georgia by the GMSE suffered from a lack of fully independent Boards for various reasons.

Given that the Board delegates considerable authority to the management team, there are no constraints to timely decision-making. The different members of the management team work in tight collaboration and are fully involved in the decision-making process.

Despite dependence on donor funding, no undue donor influence

Constanta has financed its activities entirely with donor funds but has the credibility and experience to take the lead in decision making without strong external influence from donors. Constanta has refused grant opportunities for expansion in geographic areas deemed too unstable or where the conditions where not appropriate. The founder, Save the Children, has not played a role in the decision-making process since local registration, although it did actively monitor Constanta performance in compliance with the USAID IGP grant through September 2002.

Board slow to adopt strategy setting role

Skills and engagement of governance bodies

Members of the Board have been slow to adopt their role as a strategy setting body. The lack of progress is attributable to several factors despite the good intentions of several members. Because the Chairperson is the Executive Director, this removes in part responsibility from the other members. Despite two key Board workshops (2001 and 2003), turnover in the Board and the very recent addition of three new members have resulted in a team that does not have sufficient microfinance or Board-specific knowledge. The concept of a Board is somewhat unusual in the post-Soviet Georgian context. Furthermore, there are no active sub-committees or clear expectations for members with regard to Board responsibilities. Constanta continues to seek outside facilitation to improve the Board.[5]

Diverse Board lacks finance and business experience

The Board members do have diverse backgrounds with the Board, but this does not include expertise in banking, finance, or the management of a large company. Current members include a Deputy Minister, media expert, legal counsel, medium-sized business owner, microentrepreneur and development expert. Constanta management has continued to invite new Board members but has faced resistance from the banking community given their perceived conflict of interest with the activities of Constanta.

Management information

Comprehensive management information; format of information to Board could be better summarized

Constanta consolidates its management information in an extensive monthly Excel spreadsheet that contains financial and portfolio information as well as key microfinance indicators. The team also tracks closely market information, notably competitor products in the different regions. The management information submitted to the Board includes the master Excel file. Other information is provided via oral reports during Board meetings. Board members, unfamiliar with the plethora of ratios presented, have indicated that it would be useful to have more written analysis of performance and a user-friendly summary worksheet to better understand the trends.

Communication of strategic decisions

Clear communication of strategic decisions

Constanta Board, management, and employees have a common understanding of all strategic decisions, especially after the latest planning process during which all branch managers produced projections for their own branches.

Planning

Risk identification

Risks commonly understood and integrated in new business plan

Risks identified by the management team are addressed in the strategic plan, notably the unclear legal and political environment, the rising competition, recruitment outside of the capital, key person risk for the MIS, and cash handling risk. The risks associated with the expansion of the individual loan product, which experienced several delays given poor credit performance, are acknowledged.

Budgeting and projections

Transition in process from top-down to bottom-up planning

For the development of the latest business plan, 2004 to 2006, Constanta transitioned from a top-down to bottom-up process for the projections and budgeting. The business plan was not yet finalized at the time of the rating mission, but will include budgets consistent with the operational goals. All branch managers used Microfin, the Excel-based planning software, with the aid of an external facilitator. The prior business plan, 1999 to 2002, was developed with external assistance in preparation for the IGP grant. With the addition of over 1 million USD in new funds in 2003, Constanta focused on successful expansion and deferred the onset of the long-term plan until 2004. To begin the training process for budgeting, branch managers were responsible for developing their branch budgets from April through December 2003. Budgets are verified a posteriori by the Internal Auditor.

Feasibility of current strategy

The current strategic plan appears feasible but will require improvements to existing operations to achieve the ambitious goals for individual loans (40% of the portfolio from 20% today) in

[5] Per Planet Rating's policy on transparency, it should be noted that Constanta began in 2002 to work on Board development issues with the volunteer Executive Director of PlaNet Finance UK. PlaNet Finance, which is based in France and houses Planet Rating, is a separate legal entity from PlaNet Finance UK.

light of past performance and increasing competition. Some assumptions for market penetration are also very optimistic.

Strategy feasible if Constanta vigilant with individual loans and new financings after 2004

The post-expansion strategy is to grow activities with the existing office network while investing in 2004 in staff and infrastructure (MIS, cash handling security) before converting to a for-profit entity by 2006. The addition of non-grant funds may be necessary to reach the portfolio targets as donor funding is limited to possible USAID funds in 2004 or BTC CIP program renewal in 2005. Constanta will continue to offer group and individual loans as well as other possible products including an agriculture (animal husbandry) loan, money transfers, health insurance (as a broker) and currency exchange. A new position for product analysis will assist the credit operations department in this regard.

Key Aspect	Expected Changes
Services offered and geographic coverage	❑ Expand client base from 18,000 to 26,000; ❑ Maintain existing office infrastructure with possible upgrades in status for service points or outlets depending on client volume; ❑ Individual loans up to 40% of the loan portfolio; ❑ Test and implement agriculture (animal husbandry) loan product; and ❑ Introduce non-lending products (insurance in partnership with an insurance company, money transfers, money exchanges, and micro-savings with a partner bank).
Operational methods	❑ Add cashier infrastructure in all branches given competition with partner banks; explore cash-handling partnerships with non-bank entities in remote areas; ❑ Link all offices via a Virtual Private Network; ❑ Upgrade of staff capacity, notably for individual loans; and ❑ Transform branch management into profit center management.
Structure and statutes	❑ Transform to a for-profit organization.
Supervision	❑ No changes expected.
Financing	❑ Finance the growth in the loan portfolio from 6 to 15.5 million GEL; ❑ Obtain additional financing of 2.6 million EUR (6.25 million GEL to complement the 2.5 million GEL already available in cash and the 0.75 million GEL already committed from existing grants, primarily for loan capital); ❑ Apply for available grant opportunities; and ❑ Seek debt financing once legal status changed.

Source: Business Plan 2004-2006 in process

Management Team

Skills and experience of management team

Relatively strong management team; individual loan technology and banking areas for improvement

The management team is highly educated and competent but with professional and educational experience unrelated to microfinance or business in general. The team's lack of business experience relative to some of its major competitors could be problematic in the future if not addressed. Managers are working to improve their microfinance and business knowledge with additional education and training (extensive external trainings, MBA degree programs). The relatively strong management team, known as the Executive Board, includes an Executive Director, a Deputy Director/Marketing Manager, a Finance Director, and an Operations Manager. The Management Council is a larger group including the MIS Manager, the HR Manager and, when necessary, the Senior Internal Auditor. Areas of technical competency that should be strengthened within the team include banking and individual lending methods.

Team approach reduces key person risk

The management style is highly conducive to team work, which reduces key person risk. The Executive Director effectively delegates to other team members. The Deputy Director has extensive contact with external parties and the entire management team participates in regional microfinance events.

Executive Director: Ms. Tamar Lebanidze has led Constanta since its origins as a program within the local Save the Children office in 1997. Prior to her work with Constanta. Ms. Lebanidze worked for four years in other companies and humanitarian organizations after teaching biology. She holds a Master's degree in biology and an MBA, both from Georgian universities, as well as several external trainings in microfinance, including Boulder, Colorado and the Kennedy School of Government at Harvard University.

Branch managers to take on more management role

Although they are not part of the management team, it is anticipated that the branch managers will take on a more active management role in their operations. They are now involved in budgeting and business planning. Constanta has made management training a priority, and this is being offered to branch managers. As recruitment for qualified branch managers is challenging outside of the capital, Constanta prefers to hire individuals that have the potential to be trained and remain loyal to the organization.

Definition of roles and separation of tasks

Clear and appropriate separation of tasks

Constanta has established a clear separation of tasks for each member of the management team, and each performs the functions appropriate to the position. Although there is potential for overlap between the marketing and operations functions, the managers work together to clearly delineate their responsibilities for specific projects.

Communication within management team

Open communication

Most members of the management team share the same common space office, facilitating informal exchanges. On a regular basis, at least monthly, the Management Council meets with formal minutes taken.

Human Resource Management

Skills management: recruitment, training, and internal promotion

Already appropriate skill management being further improved

Constanta has an appropriate skill management policy that is being further upgraded and professionalized with the hiring of an experienced Human Resources manager in 2003.

- The recruitment process is standardized and the various steps (external and internal announcements, written tests, several interviews) guarantee the objectivity of the choice. [6] In Tblisi, there is a sufficient number of qualified candidates. However, since educated individuals tend to move from the regions to Tblisi for employment, it is a great challenge to find appropriate staff for the offices outside the capital. The HR department dedicates considerable time to recruiting and training staff in the regions so that Constanta is able to meet its regional development plans.
- New loan officers receive two months of on-the-job training and, for those new to Constanta, a mentor is assigned.
- Employees upgrade their skills through external and internal trainings (training expenses totaled approx. 40,000 EUR in 2002 and 2003 including Georgian MBA study co-financing for managers, international trainings for top-management, several MFC trainings, etc.). The HR manager recently performed an evaluation of training needs and is building a training plan for 2004 so as to better manage the training needs of each employee. Concerted training efforts are focused on the business skills of branch managers (in anticipation of the transformation of branches into profit centers) and loan staff working on individual loans (whose business analysis skills were judged to be weak).

[6] Please note that members of the same family are employed within Constanta. The official policy is to allow any appropriate candidate to apply for a position. If a relative is selected for a non-support function, the individual must be significantly more qualified than any other candidate.

- To promote internal job promotion, Constanta opens recruitment to existing staff. Given the high education level of Constanta staff, it is possible for a cashier to climb the career ladder to branch manager.
- There is a strong culture to support and develop the employees that is highly valued by the staff. The salary structure is very competitive and the fringe benefits (health insurance, lunch, additional vacations, birthday presents) attest to this focus on employee well being.
- Salary increases and bonuses for loan officers are linked to their quantitative performance, but are only linked to seniority for the rest of the staff. An incentive system and salary grid based on quantitative performance evaluation is expected to be generalized to all staff in the near future.

Performance evaluation

Evaluation procedures for staff underway

A qualitative evaluation methodology (including downward and upward evaluations) is currently being developed and has been tested this year. Given the lack of familiarity with such evaluations, employees are hesitant to use them fully, therefore the HR department is continuing its education efforts on the matter.

Skills of human resource manager

HR manager well-qualified and has innovative approach

Constanta had an administrative HR manager prior to 2003. In May 2003, a new HR manager was hired to head the department with continued assistance from the administrative manager. The new Director has several years of experience both in HR and in management training. She brings to the department a pro-active and innovative approach towards the career development of staff.

Information Management and Systems

Management Information System (MIS) and Equipment

Extensive computing Network

Description

Constanta has an extensive computing network with appropriate software and technical support. The MIS team consists of a manager, an assistant, and an MIS coordinator for each branch who serves maintenance and, in several branches, data entry needs for the loan tracking system.

Computing Resources	
Access to internet:	All personnel in HQ (24 hour) 1 connection per branch (24 hour or dial-up)
Network:	5 stand alone servers; 10 laptops; and 92 PCs Local Area Network at HQ and in branches
Software used:	Office 2000 or XP ORIS, Georgian accounting software Internally developed software for loan tracking system, HR management, and inventory management

Well conceived loan tracking system and appropriate accounting software; Data entry managed at the branch level

ORIS is an affordable local Georgian accounting software for the general ledger. Accounting information is entirely decentralized to the branches, which handle all accounting for the branch. The accounting database is submitted to headquarters every two weeks. Constanta requested that the provider update the software so that it now permits consolidation. The software does not produce financial statements, therefore branch accountants complete a template for financial statements on a monthly basis by office which are consolidated with links in Excel.

Monthly consolidation via Excel spreadsheets

The loan tracking system was developed internally with Visual Fox Pro. The system satisfies Constanta's needs and provides appropriate reporting and information tracking. Updates to the software to adapt to new products and procedures are possible with the assistance of the on-staff developer. Update versions are easily installed in the branches. The information is managed at the branch level but not consolidated in raw data form at HQ. Headquarters does consolidate certain basic client information to serve as a database that is checked whenever a client applies for a new loan to prevent multiple loans. Summary information on loan performance by loan product type are submitted on a monthly basis in the same Excel spreadsheet as the financial information.

Security

Adequate security measures

Constanta has adopted adequate security measures for the security of electronic information. There are restricted access levels to the loan database which is accessed by several types of users (cashiers, MIS, loan officers, accountants). Backups at headquarters and in the branches is expected to be performed daily by the MIS manager. Every two weeks accounting data is sent to headquarters. After a data loss this year resulting from lax back-up in one branch, monthly loan tracking backups are recorded to CD and sent to headquarters. There are generators at branches in the event of electricity outages but there is no substitute manual system in the event of an extended outage.

Ease of system use

Although non-integrated, system user-friendly

Users find the system easy to use despite the lack of automatic consolidation of the loan tracking data. The monthly transfer of information to Excel is not time consuming and the multiple checks within the spreadsheet identify quickly probable data entry errors. The users are familiar with all of the procedures and do not have any notable problems with the hardware or software.

MIS plan to be formalized

MIS plan and future improvements

Until now, there has been no formal MIS plan with a strict timetable. The MIS plan is therefore being formalized in the new business plan. MIS improvements expected include: infrastructure upgrades to branches without continual internet access, a Virtual Private Network to link the entire network of offices, the transition to an SQL client-server platform, and the hiring of another MIS specialist. According to the preliminary budget, these upgrades are not expected to have a negative impact on profitability.

Internal skills for software development and maintenance; key person risk to address

Skills of MIS managers

The existing MIS manager has the requisite skills to ensure appropriate software development and maintenance for Constanta's needs and is supported by an MIS officer in each branch. The hiring of the new MIS specialist will help reduce the key person risk associated with the current director who is the only person to program the existing loan tracking system.

Information on Activities

Regular, accurate, and detailed portfolio information

Information quality

The portfolio information is regular, accurate, and detailed and allows loan officers to effectively monitor client performance. The reports produced track monthly the number of loans and amounts (disbursed, outstanding, in arrears, at risk, and written off) by loan product and office. This information is accurate and consistent with the accounting data.

Consolidation of individual level loan data could improve analysis

Although several aspects of the loan data are regularly analyzed, a consolidation at headquarters of individual level loan data would allow for more sophisticated analysis for marketing and audit purposes. This could include analyses by cycle and type of activity, but the data is currently only available at the branch level.

Information dissemination

The master Excel spreadsheet by branch is on the shared network and available for all management staff to consult for their own needs. The information is not sent between branches but discussed at meetings among branch managers that take place at least every quarter.

Financial and Accounting Information

Accurate monthly financial statements consolidated and by branch

Quality of information

The accounting information is accurate and provided on a monthly basis by office and in consolidated form. The high quality of the accounting information was noted by the local external auditor. Daily reconciliations with cash and the loan tracking system enable Constanta to identify and resolve any discrepencies immediately. For branches working with partner banks as teller windows, there are occassional differences in amounts recorded that are resolved same-day or soon thereafter. On a monthly basis, accountants calculate loan loss reserves and complete all accrual accounting. The loan tracking system provides the data on interest and penalty accruals for input to the financial statements.

Financial team diligent with accounting

Financial management and skills of finance department

The Finance and Planning Department performs diligently and accurately the accounting work. Although not all the branch accountants have an accounting background, they are highly educated and learn quickly how to perform their duties. The Finance Director is also a trainer for the MFC. The Finance Department has not yet developed formal policies with respect to investments or asset liability management but plans to do so.

Constanta tracks all the internationally recognized microfinance indicators but does not perform in-depth financial analysis to improve performance. The team is aware of the

Financial ratios could be better analyzed to improve performance

performance ratios, but Constanta has not in the past had specific targets for such ratios. In 2004 it is expected that there will be greater attention paid to the comparison of targets to actual performance. Although Constanta remains profitable, strategies to reduce the high operating costs could be more carefully studied. As Constanta transitions to more profit-centered branches, this financial analysis will be increasingly delegated to the branch managers. The use of Microfin in the current business planning process is educating the team on these ratios.

Risk Management

Procedures and Internal Controls

Formalized procedures with appropriate methods and tools

Quality of procedures to limit risks
Procedures are defined to limit operational risks and are well known by all staff members. To ensure standardization, Constanta uses procedure manuals (for credit, cash handling, human resources, and certain accounting policies), useful loan processing and administrative forms, on-the-job trainings and day-to-day monitoring by supervisors. These procedures are standardized even in the most recently opened offices. Constanta's effective monitoring system is reinforced by multiple layers of supervision (loan supervisors, branch managers, operations manager, internal and external auditors) and effective tools (MIS assisted loan approval flow, high quality information). There are specific procedures to limit risks for the outlets and service points where there is less staff (no accountant in outlets, no supervisor or office manager full-time in service points, etc).

Clear separation of duties to limit fraud

Procedures for loan activities are very precise and strict. They include all necessary separation of duties and double checks to limit the risks of fictitious clients or fraud related to cash handling, loan assessment and loan approval.

- Supervisors monitor each group by attending at least one meeting and visiting the businesses. Branch managers randomly check a small sample of client files each month. At least two Constanta staff attend all disbursements.
- The limits in loan amount per cycle implicitly limit the authority of the loan officers and supervisors.
- In most offices, loans are disbursed by check and clients make repayments at the bank. In branches with teller windows, cash is collected at the end of each day by banks and the amount left each night in the safe is capped at approximately 2,000 EUR.
- Constanta does not rotate loan officers as management considers that the relationship of confidence between loan officers and clients is key to ensure good portfolio quality. The higher risk of collusion between clients and loan officers is nevertheless controlled by the procedures described above.

Procedures to limit individual loan credit risk being refined

- Constanta experienced numerous difficulties in the design and implementation of adequate procedures to control credit risk for individual loans. These procedures, as well as the accompanying methodological tools and documents, are now being finalized.
- The procedures limit the financial incentive for an employee to want to commit fraud, and any suspected cases have involved small sums.

Administrative procedures strictly limit expenses of the various branches (approx. 400 EUR for a single purchase). The quality of the MIS allows managers and auditors to monitor from headquarters important issues such as expenses, financial results, portfolio quality per office or loan officer, etc.

Systematic control of procedures and performances

Systematic controls
Constanta has developed systematic controls to ensure compliance with procedures and to incite staff performance. Branch managers monitor the loan granting process and check that all procedures have been properly followed before signing the loan contract. The individual performance of loan officers (level of activity, quality of portfolio) is tracked and used to compute their monthly bonus.

Internal Audit

Internal audit procedures

Comprehensive approach to internal audit

The department has a comprehensive approach to internal audit, which has improved subsequent to an IPC evaluation in 2001. The team of one manager and one assistant performs both operational and financial audits, at the pace of one audit per branch per quarter. Their visits of between five and ten days cover the branch office and a sample of the related outlets or service points. The operational audit procedures aim to monitor the effectiveness of internal controls and include documents and procedures checks, some visits to clients, and interviews with staff members. Financial audits are designed to check and reconcile, if necessary, financial information.

The visits follow a schedule submitted only to the Executive Director. If there is an exceptional event, such as suspicion of fraud or problems with portfolio quality in a branch, the auditors may perform additional visits.

The internal audit will gradually be decentralized to the branches as the structure grows. Branch managers are being prepared for that change and have started performing random spot checks, including verification of procedures, client visits and regular visits to audit other branches.

Audits of headquarters underdeveloped

Systems and procedures to monitor headquarters is underdeveloped. In theory, the internal audit reports to the Board and the Executive Director. However, the Board has not been sufficiently implicated to work directly with the internal auditor or to critically monitor performance. Headquarters is not subject to systematic audits, although the internal auditor does have conversations with other department managers when problems arise.

Quality of internal audit

Internal audit effectively checks procedures and serves as "internal consultant"

The internal audit department produces good summary reports that highlight the most important findings in terms of procedure compliance. The internal auditor also serves as an internal consultant and assesses the efficiency of the structure, issuing recommendations regarding management and operations. The recommendations of these reports trigger corrective measures, either at the branch level or headquarters. The branch managers or internal auditors are responsible for monitoring the implementation of recommendations. The reports are shared with all staff of the audited branch and the relevant people in other departments. There does not yet exist a standard audit report format, but the internal auditor is working on a template.

External actors complement the work of the internal auditor. The financial statements of Constanta have been subject to rigorous external audits in 2001 and 2002 by two different firms. In addition to certifying the quality of the financial information, they provide recommendations on accounting methods and legal issues.

Approach to risk management and internal controls

General risk awareness

The entire staff is generally aware of major risks (credit operations, fraud, competition, legal environment). The internal auditor continually tries to improve the quality of procedures to manage risks. The information gathered during audit missions and analyses of financial and portfolio information are used to anticipate potential problems. The auditor is also involved in the design of new products (individual loan, agricultural loan) to ensure that the procedures are adapted to the new risks that might arise.

Activities: Products and Services

Portfolio Management

Market, competition, and competitive advantages

Developing expertise on market information

Constanta has developed a very good knowledge of its market environment including market size estimates and a list of providers. The existence of a Marketing Manager illustrates how important these matters are to the institution given the increasing competition in many regions where Constanta operates.

Constanta a leader despite strong competition on group loans

On group loans, Constanta has a leading market position, even though the institution does not have any notable competitive advantages, apart from national coverage, as the interest rates and loan sizes are similar to competitors. All the major urban markets are now covered by Constanta. The service point methodology has allowed Constanta to also target very small markets (less than 1,000 potential clients for 8 of the service points). Market conditions for group loans vary considerably from region to region. Tblisi is a dynamic market and also very competitive as most MFIs of the country offer their services in the capital. While some other important regional markets also experience strong competition with at least two or three major MFIs (Kakheti, Adjara), in some areas Constanta is the only provider. Loan officers are actively involved in marketing activities.

The group loan market segment is the largest in terms of number of currently served microfinance clients but is only one segment of the larger potential microfinance market. The development of new products such as individual loans or loans for other business activities is thus key to the development of Constanta, as these markets are currently underserved.

Unclear market position for individual loans

Constanta is still building its expertise, reputation, and image for the individual loan segment. There are no notable competitive advantages so far. The methodology was only recently stabilized. The individual loan clients tend to be new clients to Constanta and not former group clients, as initially anticipated. The competition on individual loans is even more developed than that for group loans as in addition to MFIs there are traditional banks and banks specialized in microfinance competing for this clientele who have extensive branch networks.

Client selection, portfolio monitoring and delinquency management

Effective group client selection, individual client selection still being refined

Constanta has developed a strong group loan methology that limits the credit risks and promotes a strong repayment culture.

- During the client selection process (five meetings and client visits), the loan officers ensure that the members of the group know each other well and all have a sustainable business. The quality of the loan officer evaluation is systematically checked by the supervisor and sometimes by the branch manager.
- Constanta chose to allow a limited number of family members within a group if the individuals have separate businesses. Constanta deemed that the stronger solidarity among family members outweighed the risk of insolvency for a family.

Swift and strict delinquency management; ongoing visits for on-time clients

- Loan officers regularly visit their existing clients, especially those in their first cycle, even though no visit is formally planned to check loan use.
- The delinquency management is swift and strict and facilitated by the efficiency of the MIS. Loan officers are immediately aware of late clients so as to call them within a day. The pressure to repay gradually increases over time through group meetings, warning letters, visits to the family, etc. If all measures fail after the fourth week, the case will be referred to court.

Updated individual selection process will have to prove itself in the coming months

The individual loan methodology has been finalized but still needs to prove itself in the coming months. The major weaknesses in the past were attributable to problems with collateral and inadequate business assessments that did not effectively limit credit risk. The assessment now relies more on historical performance than projections made by the clients, which should prove more prudent as Constanta plans to invest a greater percent of the portfolio in individual loans. The procedures of client monitoring and delinquency management follow the same pattern as the group loans.

Loan officer skills

Quality group loan officers via on-the-job training; inadequacies with individual loan officers being addressed

All loan officers are highly educated, with an education level at a Master's degree or higher, but all need microfinance-specific on-the-job training upon hire. The internal training efficiently educates all loan officers to Constanta's tools and methods for the group loans. The internal auditor frequently notes weaknesses in business analysis skills, which do not prove too problematic for group loan officers, but are key to the success of individual loan officers. Constanta has tried to address this problem by co-financing MBA courses for individual loan officers.

Strong financial incentive for performance

The loan officers show a high level of motivation and dedication that might be partly fostered by the incentive system. The bonus is based on portfolio quality and volume and can go up to three or four times the base salary each month, and typically doubles a loan officers salary. Penalties may also be deducted from the salary, up to 10% of the base salary, if the loan officer's portfolio is too small. If the loan officer does not follow certain procedures regarding late clients, he or she may become financially responsible for the client's debt.

Portfolio diversification policies

No formal policies but geographic diversity

Constanta's portfolio is concentrated almost exclusively in trade but geographically diversified within Georgia. Most commercial regions of Georgia are covered including urban areas, small towns, coastal and mountain regions, resorts, major international roadways and pipeline routes. A sector diversification is expected to increase in the near future since Constanta will market more aggressively the individual loan product, attracting more service providers, and has plans to expand slowly into agriculture (animal husbandry).

Portfolio at risk
Write-off ratio

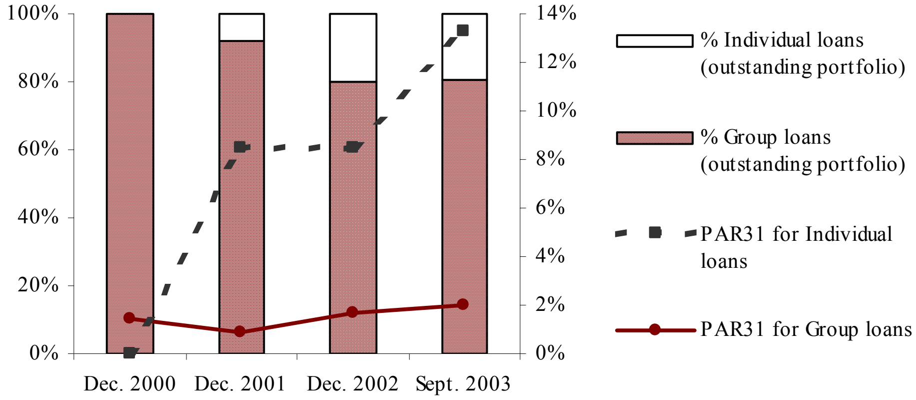
EUR (unless otherwise stated)	Dec. 2000	Dec. 2001	Dec. 2002	Sept. 2003
Number of active borrowers	9,733	13,202	16,134	17,5345
% Change	--	36%	22%	9%
Outstanding portfolio (end of period)	727,565	1,615,247	2,818,022	2,528,563
GEL	1,316,310	3,079,145	6,152,587	6,194,505
% Change	--	134%	100%	1%
Average outstanding portfolio	445,518	951,468	1,962,885	2,377,512
Average loan at disbursement	124	170	244	225
% of GNP/capita	17%	22%	32%	34%
Average outstanding loan	75	122	175	144
% of GNP/capita	10%	16%	23%	22%
PAR >31 [(a), (b)]	1.4%	1.5%	3.0%	4.2%
Write-off ratio	2.3%	0.6%	0.2%	0.9%

(a) This amount may include some loans over 365 days, since the write-off procedure is to write off loans one year after the loan term date. This procedure is done on a daily basis.

(b) Constanta reschedules loans on a limited basis. They are tracked separately in the MIS, but are not automatically included in the PAR. In September 2003 all restructured loans (except for one) are still late and are thus included in the PAR. The amount of rescheduled loans at that time was less than 8,000 GEL.

High level of PAR in individual loans due to inadequate business analysis

The steady increase of the PAR31 over the past three years (from 1.4% in 2000 to 4.2% in September 2003) is largely due to the poor performance of the individual loan product (PAR of 13.3% in September 2003). The first credit methodology used by Constanta rapidly proved problematic as the product represented only 8% of the portfolio, but was already responsible for 46% of the total PAR31 by 2001. It now represents 20% of the portfolio and 61% of the PAR31. The larger loan size of this product compared to the group loans also increases the impact of each bad loan on the portfolio quality. The improvements to the credit methodology are not yet visible in the global performance of individual loans.



Good overall portfolio quality for group loans, despite regional problems

The PAR31 for group loans is only 2% overall. For 11 of the 19 offices, which represent 30% of the loan portfolio, the PAR31 is 0%. However, the average PAR increased over the period from 1.4% in 2000 to 2% in September 2003 given both the natural aging of the portfolio and regional economic problems.

- Group solidarity becomes less efficient as the loan amounts increase.
- The Kakhetie region (Lagodekhi, Tsnori, Sagarejo, Dedoplistskaro) did not have the support of a full-time branch manager until October 2003 due to the challenges recruiting qualified staff outside Tblisi. The lack of appropriate management resulted in poor portfolio monitoring.
- The region of Kobuleti, a resort town on the Black Sea coast, experienced a bad 2003 summer season followed by a bad citrus production due to weather conditions that resulted in a very high PAR31 at 32.1%.

Group loans	% of the portfolio	PAR_{31}
Kobuleti	1%	32.1%
Sagarejo	1%	8.4%
Tsnori	2%	6.9%
Isani	20%	2.6%
Tbilissi	31%	2.1%
Batumi	10%	2.0%
Marneuli	3%	0.9%
Lagodekhi	1%	0.4%
All other offices	30%	0.0%

Cross indebtedness to monitor

The intensification of competition and the consequent potential for cross-indebtedness may also have an effect on the quality of the portfolio. By policy, Constanta accepts clients with loans elsewhere if the debt capacity analysis supports the decision. There is a clear risk for this in the Kakhetie region with FINCA, the Adjara region with WV Georgia, and with all competitors in Tblisi. There is no credit bureau in Georgia, although Constanta informally shares information about delinquent clients with at least one other major competitor.

Low level of write-offs

The write-off ratio follows the same trend as that of the PAR, with a slight increase in 2003 from 0.2% in 2002 to 0.9% in September 2003. Given that the overall portfolio is of good quality, the ratio remains low. Constanta began writing off loans in 2000, which explains the higher ratio for that year. Constanta writes off loans on a daily basis, one year after the final term date of the loan. This is an accounting procedure and does not stop efforts for loan recovery.

Credit risk coverage

Portfolio at risk covered over 100% by provisions

Coverage by provisions

Constanta's new policy of provisioning 1.5% of the healthy group loan portfolio results in a very high coverage ratio for loans already at risk (>100%). This policy also serves in the event of other portfolio risks.

Provisions	Group loans	Individual loans
Healthy portfolio	1.5%	--
PAR 8 – 30	10%	10%
PAR 31 – 60	30%	25%
PAR 61 – 90	60%	50%
PAR 91 – 270	80%	75%
PAR > 270	100%	100%

Loans are written off on a daily basis one year after the final term date of the loan.

	Dec. 2000	Dec. 2001	Dec. 2002	Sept. 2003
Risk coverage ratio	73%	31%	111%	107%
PAR > 30 days net of loan loss provision/ equity	0.2%	0.6%	0%	0%

Collateral required for individual loans but difficult to execute

Coverage by guarantees

The only guarantee taken on group loans is group solidarity and is considered by loan officers as efficient for small loan amounts. Constanta takes several forms of collateral for individual loans to cover the interest and principal portion of a loan, but does allow the borrower to maintain possession of the objects (vehicle, home, household goods, etc). Gold is an exception to this rule. There are special challenges regarding vehicles as collateral because most cars are not actually sold but leased in Georgia given the tax regime.

Two on-staff lawyers review collateral agreements and take cases to court. Efforts are made to minimize the cost of collateral to borrowers by avoiding a notary for smaller loan amounts. Although the legal environment for collateral is well established, corruption and other problems with the court system hinder the execution of such collateral even when the judgment is in Constanta's favor. Although going to court is costly, Constanta still prefers to maintain its serious reputation against delinquency with clients.

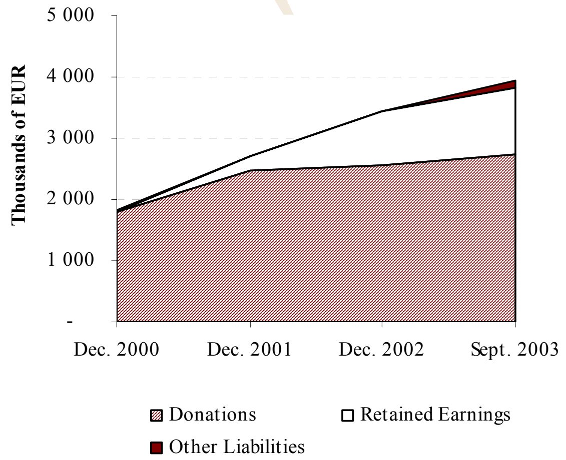
Funding and Liquidity

Asset Liability Management and Financing Strategy

Financing via donor funds and retained earning; Foundations prohibited from savings mobilization

Description of capital structure

Constanta has financed its portfolio predominantly with donor funds, 69%, and the positive retained earnings generated since 2001, 28%. As a Foundation, Constanta is prohibited from mobilizing client savings as a financing source but is not expressly prohibited by law from borrowing funds.



Below is a table of grant amounts allocated to Constanta by major donors, initially UNHCR and USAID, with additional funds in 2003 from the BTC Community Investment Program. Note that of the almost 4 million USD allocated to Constanta in these major grants, 350,000 USD has not yet been received.

Grants	Amount Granted (USD)	Comments
BTC Community Investment Program	682 722	Funding for loan capital and operating expenses via consortiums lead by Care and Mercy Corps through end of 2005
CARE (USAID)	400 370	Funding for loan capital and operating expenses through September 2004
Shorebank Advisory Services (USAID)	355 000	Funding for loan capital; grant ended August 2002
USAID IGP	885 710	Funding for loan capital, operating subsidies, and technical assistance via Save the Children Final transfer of assets to Constanta completed
UNHCR	1 583 727	Funding for loan capital, operating subsidies with technical assistance from Save the Children on the initial grants Final transfer of assets to Constanta in process
Other grants	54 065	50 000 USD from CGAP for Innovations program to develop Service Points in rural areas; grant ended December 2001 4 065 USD from Save the Children to monitor a small microfinance program; grant ended July 2003
Total	3 961 594	

No formal procedures; exchange rates stable but risk should be monitored

Asset/liability management procedures

Constanta has a simple capital structure limiting the need for sophisticated asset/liability management. With entirely long-term and fixed rate funding, there are no maturity or interest rate gaps. In the future, when Constanta takes on debt, these procedures will need to be clarified. Constanta is exposed to exchange rate risk both in terms of the loss in value of the donations received in dollars as well as the individual loans disbursed and repaid in dollars. Fortunately for Constanta, the exchange rate to the USD has remained stable since the Russian fiscal crisis in 1999 and is forecasted to remain within a band of 2.0 to 2.2 GEL per USD for the next couple of years. Given that individual loans are longer term, the strategy of USD loans is in part to manage inflation risk. Approximately 58% of the cash on hand and 19% of the outstanding loan portfolio is in USD accounts. Accounts are held in seven different banks to serve Constanta offices located throughout the country and to manage concentration risk in any particular bank.

Financing strategy

2.6 million EUR needed to finance portfolio growth

Constanta has been able to satisfy its financing needs using donor funds and retained earnings. By 2006, Constanta will need to obtain an additional 2.6 million EUR to finance its activities. The goal is to grow the portfolio by 9.5 million GEL, which requires 6.25 million GEL above and beyond the 2.5 million GEL in cash and investments and the 0.75 million GEL already committed from other sources.

Goal of debt financing after conversion to for-profit entity

Given the somewhat unclear legal environment for microfinance, Constanta has also preferred not to borrow funds to avoid drawing public attention to its microfinance activities. These activities are of a commercial nature and permitted as a secondary activity for a Foundation. (Please refer to the section Microfinance in Georgia for further explanation of the legal environment.) Another local MFI had experienced legal problems upon borrowing funds, although there are currently other MFIs with loans in the form of a line of credit from local sources. Other international funds have contacted Constanta about lending opportunities but they are hesitant to lend while Constanta is a Foundation. Therefore, the transition to a for-profit institution by 2006 and greater clarity in the regulatory framework should facilitate considerably Constanta's access to debt.

Liquidity Management

Physical security of liquidity

Internalization of cash handling to be accompanied by security measures to manage risk appropriately

Physical security of liquidity is a clear and present risk in Georgia, as MFIs have been the victim of armed robbery, but Constanta has taken measures to manage well this risk. Initially Constanta used in many locations the teller windows of partner banks. Given perceived competition, Constanta has chosen to revise this strategy and has begun internalizing cash handling in such areas. Constanta estimates that the commissions paid to banks could cover the cost of hiring additional cashiers internally. It is anticipated in the business plan to make important infrastructure investments to branches that will handle cash (bullet proof cashier windows and security systems) in addition to the hiring of security personnel. Cash transport risk is also taken seriously, as branches use nearby banks but either do not transport the entire sum in one trip or the bank takes responsibility for cash transport. Overnight safe limits are only 2,000 EUR.

Cash flow projections

Sophisticated cash flow planning not yet a necessity

Given the available funding, Constanta has not needed to develop sophisticated cash flow planning and therefore does basic planning as part of the new business plan. There have been no periods of major funding gaps over the past several years. Branches have a two-week liquidity planning worksheet to identify if they will have too much or too little cash in their local bank accounts necessitating a bank transfer between headquarters and the branch. Such transfers are very easily executed. The margin is a bracket of between 5% and 10% of the outstanding loan portfolio plus or minus 5,000 GEL.

Prudential norms and security margins

No prudential norms required

Constanta is not regulated by banking authorities and the law on Foundations does not stipulate any specific prudential norms. There are no internal rules regarding a security margin.

Efficiency and Profitability

Ratio	Dec. 2000	Dec. 2001	Dec. 2002	Sept. 2003 [(a)]	Formula
Productivity					
Staff productivity	139	133	111	86	Active borrowers / Number of personnel (end of period)
Loan officer productivity	406	374	299	234	Active borrowers / Number of loan officers (end of period)
Profitability					
ROA	1.5%	13.9%	22.1%	12.4%	Net operating income before donations / Average assets
Adjusted	(7.9)%	5.9%	13.3%	3.2%	ROA after adjustments to net income
ROE	1.5%	13.9%	22.1%	12.6%	Net operating income before donations / Average equity
Adjusted	(7.9)%	5.9%	13.3%	3.3%	ROE after adjustments to net income
Liabilities/Equity	0.1%	0.1%	0.0%	2.9%	Total liabilities (savings + borrowings) / equity (end of period)
Portfolio Yield	90.5%	93.7%	85.5%	82.4%	Portfolio revenue / 13-month average gross outstanding portfolio
Without accrued interest	90.5%	92.8%	85.0%	81.7%	
Operating expenses					
Over outstanding loans	97.0%	69.2%	49.8%	58.1%	Operating expense / 13-month average gross outstanding portfolio
Over total assets	33.3%	29.7%	33.7%	39.5%	Operating expense/ Average assets
Funding expense ratio	0.0%	0.0%	0.0%	0.0%	Interest and fees paid on funding liabilities / 13-month average gross outstanding portfolio
Loan Loss Provision expense ratio	1.8%	0.5%	4.7%	2.6%	Net loan loss expense / 13-month average gross outstanding portfolio
Adjustment expense ratio	27.5%	18.6%	13.0%	9.0%	Total adjustments / 13-month average gross outstanding portfolio
Outstanding Loan Portfolio / Assets	40.2%	59.6%	82.1%	64.2%	Net portfolio / Total assets
Operational self-sufficiency	104.4%	146.5%	160.2%	137.6%	Revenue from operations / (Financial expense + Loan loss expense + Operating expense).
Financial self-sufficiency	81.7%	115.7%	129.3%	115.0%	Operating self-sufficiency after adjustments to expenses

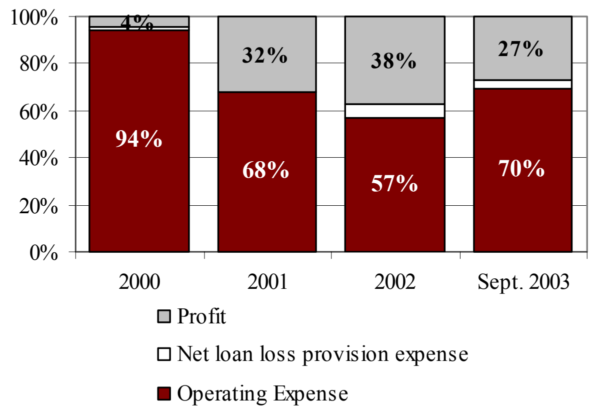
(a) For ease of comparison with prior full year periods, the relevant profitability ratios were annualized by a factor of 12/9 for results through September 2003. Actual results for 2003 may vary from these estimations, however estimations of the increased profit tax liability have been included.

Operational self-sufficiency despite high operating costs thanks to high interest rate

Operational self-sufficiency

Constanta has succeeded in covering costs for several years despite very high operating expenses. This is due to the high effective interest rate, portfolio quality (albeit with a degradation of late), inexistent financing costs, and an exemption from tax liabilities (that ended in 2002). As illustrated to the right, Constanta has a healthy profit margin of on average 30% over last three years, which exceeds considerably that of its peer group at 5.9%.[7] The increase in operating costs from 57% to 70% of revenues between 2002 and 2003 (simple annualization) is due almost entirely to a greater salary tax obligation (18% of operating expenses).

Expenses and Profit as a % of Revenue



[7] Constanta is in the MicroBanking Bulletin ECA (Eastern Europe and Central Asia) Medium peer group. This group includes MI-BOSPO, Prizma, and Sunrise in Bosnia, KEP in Kosovo, NOA in Croatia, PSHM in Albania, XAC in Mongolia, and FINCA-Kyrgyzstan.

Return on assets (ROA) and Return on equity (ROE)

High return on assets; Activities financed entirely by equity

The remarkable return on assets, over 10% since 2001, is attributable to this strong profitability. Given that Constanta is financed entirely with equity, consequently, the funding expense ratio is also 0%. There is no leverage effect, therefore the return on equity is essentially the same as the return on assets.

Portfolio yield and effective interest rate

Portfolio yield trending downward with the addition of individual loans

The portfolio yield has trended downward over time from 91% in 2000 to 82% in 2003 (annualized). This is due to an aging of the group loan portfolio into a somewhat lower interest rate, as the effective interest rate for the group loan products ranges from 76% to 100%, and the addition of individual loans with a considerably lower effective interest rate, ranging from 24 to 36%. The mild deterioration in portfolio quality therefore has a lesser impact on these ratios, and penalty fees typically contribute 1% to 2% of portfolio revenue. Increasing competition will also apply downward pressure on interest rates charged for group loans by other MFIs and individual loans offered by both MFIs and banks.

Operating expense ratio

Operating expense ratio improving but still very high

Although the operating expense ratio has declined considerably over the past years, from 97% in 2000 to 50% in 2002 with an increase in 2003 to 58% (annualized), this ratio remains very high. As mentioned above, the increase in 2003 is due to a large extent to the greater tax liability and to the massive expansion efforts. The latest MBB, measuring this ratio in slightly different terms, shows an operating expense ratio of 46% for Constanta in 2002 while the comparables in the Europe Central Asia category are 34% and for all MFIs 29%. Operating expenses are divided among the following major categories:

- In 2003, staff salaries and benefits are 48% of operational expenses with an additional 4% on internal and external training expenses. This is down from 61% and 4.4% respectively in 2002. There is a drop in the share of operating costs to personnel, despite the staff hirings in 2003, due to the increased tax burden. Overall, staff costs are up 24% from 2002 to 2003 given these hirings (annualized).

End of tax shelter from bilateral agreement results in high salary tax burden (31%)

- Taxes, aside from the profit tax which is not included in the operating expenses, have jumped from less than 1% of operating expenses in 2002 to 18% in 2003. With the official transfer of assets from USAID, Constanta is no longer protected by the tax shelter of the bilateral agreement between Georgia and the United States. The salary taxes total 31% of salary expenses.
- Rent, utilities, and other basic operating expenses account for the remaining amounts, approximately 30% of operating expenses, the highest of which are rent at 4.9% and the depreciation expense at 4.5%.

Jump in loan loss expense in 2002 due to additional provisions for healthy portfolio

Loan loss provision expense ratio (cost of risk)

The loan loss provision expense ratio has jumped from 1.8% in 2000 to 4.7% in 2002 because Constanta added in 2002 a general risk provision of 1.5% to the healthy loan portfolio. The 2.6% loan loss ratio for 2003 is therefore due mainly to the deterioration in portfolio quality.

Adjustment expense ratio and financial self-sufficiency

Financially self-sufficient after adjustments (mainly cost of funds and inflation)

According to Planet Rating's adjustment methodology, Constanta has achieved financial self-sufficiency since 2001. The adjustment expense ratio of 9% annualized in 2003 is attributable to the standard adjustments of: the cost of funds, inflation, loan loss provisions, and in-kind donations. The cost of funds adjustment accounts for 66% and the inflation adjustment 29% of these adjustment expenses. Please refer to the annex for further details on these adjustments.

Management of non-portfolio productive assets

Asset mix to be more profitable in future

Given constraints of grant agreements and a lack of formal investment policy, Constanta has not been able to maximize the investment of non-portfolio productive assets. In September 2003 there is a significant amount of non-portfolio assets, with 19% in cash, 7% in short-term investments, and 10% in fixed assets. These amounts are higher than usual given the receipt of grant funds in anticipation of expansion activities. After asset transfer from donors, some of these short-term investments were in Treasury Notes paying very high interest rates, up to 50% annualized, although these can be risky instruments. Expected portfolio growth will have two positive effects: a greater percentage of assets will be invested in the more profitable portfolio and fixed assets will become a smaller percentage of total assets.

Personnel productivity

Productivity trending downward with continued expansion

The productivity of all staff and loan officers has experienced a notable trend downward between 2000 and 2003, from 139 to 86 and 406 to 234 respectively. These averages mask wildly different productivity among loan officers. In one exceptional region, there are officers temporarily with over 1,000 clients, while there are individual loan officers with over a year of experience who have only a handful of clients while the product is being finalized. The goal is for a group loan caseload of 500 and an individual loan caseload of 50 in 2004 and 100 in 2005. Loan officers with a client caseload comprise only 37% of staff, therefore the weight of "non-productive" staff brings down these productivity averages. Staff productivity is below that of its peer group in ECA at 100, despite the preponderance of group loan clients at Constanta, given the major expansion efforts and the low productivity of many individual loan officers.

Profitability outlook

Profitability peaked in 2002, stabilization of ROA at 10% expected in 2005

Constanta's return on assets and operational self-sufficiency peaked in 2002 at 22% and 160% respectively. This strong profitability will not be possible to preserve over the long term. Constanta currently anticipates a minimum ROA of 7% in 2004 and 8% in 2005 before reaching 10% again in 2006.

Primary factors expected to increase profitability:

Economies of scale and productivity gains expected

- There are considerable economies of scale to be achieved in several of the offices, notably those opened in the last year, and with the organization overall. This will contribute to the expected decline in the operating expense ratio. Constanta's preliminary projections are to reduce the operating expense ratio from over 58% to approximately 30% by 2006;
- In addition to better utilisation of the general network infrastructure, the productivity is expected to increase for many group loan officers under capacity, who in total could absorb several thousand more clients; and
- As Constanta increases the investment of assets from 60% to 95% in the loan portfolio, the asset allocation will become more profitable.

Primary factors expected to decrease profitability:

Portfolio yield decline and tax burden to have a negative impact on profitability

- On the revenue side, the portfolio yield will trend downward significantly over the next three years as the portfolio becomes increasingly concentrated in individual loans and competitive pressures increase. Currently the individual loan portfolio is only 20% of the total portfolio, but it is expected that this percentage will grow to 40% by the end of 2006. This could bring the portfolio yield down considerably to as low as 60%;
- The increased tax liability is a major additional cost that will considerably reduce profitability (31% salary taxes and 20% profit taxes);
- Operating costs are expected to increase temporarily over the next couple of years in absolute terms, but should decrease as a percent of the portfolio as Constanta adds staff to the newly opened offices; and
- Although the individual loan officers are significantly under capacity, the changes in credit approach may not lead to significant improvements in profitability. The current individual loans outstanding are of a considerably higher average loan size (approximately 2,000 EUR) than what is expected in the future. The average disbursed loan is projected at approximately 900 EUR for experienced loan officers and 300 EUR for new loan officers. Therefore, the average outstanding loan will be considerably less than it is currently.

Appendices

Financial Statements and Notes

Constanta Foundation Balance Sheet	Notes	GEL				EUR				% Change		
		Dec. 2000	Dec. 2001	Dec. 2002	Sept. 2003	Dec. 2000	Dec. 2001	Dec. 2002	Sept. 2003	Y2 / Y1	Y3 / Y2	Y4/Y3
ASSETS		**3 273 689**	**5 169 465**	**7 491 941**	**9 655 061**	**1 809 468**	**2 711 779**	**3 431 476**	**3 941 143**	**58%**	**45%**	**29%**
Short Term Assets		**2 834 197**	**4 410 975**	**6 610 749**	**8 668 106**	**1 566 547**	**2 313 893**	**3 027 870**	**3 538 274**	**56%**	**50%**	**31%**
Cash and Bank Deposits		1 322 420	399 679	486 127	1 832 017	730 942	209 662	222 657	747 819	(70)%	22%	277%
Net Short Term Financial Assets	1		806 196		681 399		422 912		278 143		(100)%	
Net Short Term Loan Portfolio		1 302 811	3 064 777	5 944 692	5 917 272	720 103	1 607 710	2 722 801	2 415 398	135%	94%	(0)%
Gross Short Term Loan Portfolio	2	1 316 310	3 079 145	6 152 587	6 194 505	727 565	1 615 247	2 818 022	2 528 563	134%	100%	1%
(Loan Loss Reserve)	3	13 499	14 368	207 895	277 234	7 462	7 537	95 221	113 165	6%	1347%	33%
Interest Receivable	4		15 961	21 803	30 451		8 373	9 986	12 430		37%	40%
Other Short Term Assets	5	208 966	124 362	158 127	206 968	115 502	65 237	72 426	84 483	(40)%	27%	31%
Long term assets		**439 492**	**758 490**	**881 191**	**986 955**	**242 921**	**397 886**	**403 605**	**402 870**	**73%**	**16%**	**12%**
Net Long Term Financial Assets												
Gross Long Term Loan Portfolio												
Net Fixed Assets		439 492	758 490	881 191	986 955	242 921	397 886	403 605	402 870	73%	16%	12%
Other Long Term Assets												
LIABILITIES AND EQUITY		**3 273 689**	**5 169 465**	**7 491 941**	**9 655 061**	**1 809 468**	**2 711 780**	**3 431 476**	**3 941 144**	**58%**	**45%**	**29%**
Liabilities		**2 042**	**4 370**	**1 244**	**273 704**	**1 129**	**2 293**	**570**	**111 724**	**114%**	**(72)%**	**na**
Short term liabilities		**2 042**	**1 574**	**1 244**	**273 704**	**1 129**	**826**	**570**	**111 724**	**(23)%**	**(21)%**	**na**
Demand Deposits												
Short Term Deposits												
Short Term Borrowings												
Other Short Term Liabilities	6	2 042	1 574	1 244	273 704	1 129	826	570	111 724	(23)%	(21)%	na
Long term liabilities			**2 796**				**1 467**				**(100)%**	
Long Term Deposits												
Long Term Borrowings												
Other Long Term Liabilities			2 796				1 467				(100)%	
Equity		**3 271 647**	**5 165 095**	**7 490 697**	**9 381 357**	**1 808 339**	**2 709 487**	**3 430 906**	**3 829 419**	**58%**	**45%**	**25%**
Paid-In Capital									-			
Donated equity		3 378 343	4 683 352	5 610 640	6 704 631	1 867 313	2 456 776	2 569 798	2 736 794	39%	20%	19%
Retained earnings without donations	7	(106 696)	481 744	1 880 056	2 676 727	(58 974)	252 711	861 108	1 092 625	na	290%	42%
Current year		(9 223)	588 440	1 398 274	796 670	(5 098)	308 681	640 440	325 197	na	138%	(43)%
Previous year		(97 473)	(106 696)	481 744	1 880 056	(53 876)	(55 970)	220 649	767 429	9%	na	290%

Constanta Foundation Income Statement	Notes	GEL Dec. 2000	GEL Dec. 2001	GEL Dec. 2002	GEL Sept. 2003	EUR Dec. 2000	EUR Dec. 2001	EUR Dec. 2002	EUR Sept. 2003	% Change Y2 / Y1	% Change Y3 / Y2	% Change Y4 / Y3
Financial revenue (a)		**830 097**	**1 852 638**	**3 739 193**	**3 642 506**	**458 820**	**971 850**	**1 712 634**	**1 486 851**	**123%**	**102%**	**30%**
Revenue from portfolio		729 695	1 699 651	3 664 056	3 601 204	403 325	891 597	1 678 219	1 469 992	133%	116%	31%
Interest received on loans		664 194	1 558 202	3 342 552	3 316 911	367 120	817 396	1 530 963	1 353 945	135%	115%	32%
Fees and commissions received on loans		49 468	115 613	269 148	224 434	27 342	60 648	123 276	91 613	134%	133%	11%
Penalty revenue on loans		16 033	25 836	52 356	59 860	8 862	13 553	23 980	24 434	61%	103%	52%
Revenue from other financial	8	82 823	76 808	66 640	38 815	45 779	40 292	30 523	15 844	(7)%	(13)%	(22)%
Other revenue from financial	9	17 579	76 179	8 497	2 487	9 717	39 962	3 892	1 015	333%	(89)%	(61)%
Financial Expense (b)									-			
Interest paid on borrowings												
Interest paid on deposits												
Other expenses related to												
Financial income [c=a-b]		**830 097**	**1 852 638**	**3 739 193**	**3 642 506**	**458 820**	**971 850**	**1 712 634**	**1 486 851**	**123%**	**102%**	**30%**
Operating expense (d)		**781 792**	**1 255 558**	**2 132 443**	**2 537 711**	**432 120**	**658 636**	**976 706**	**1 035 880**	**61%**	**70%**	**59%**
Staff expense (includes fringe)	10	556 651	862 785	1 303 454	1 207 542	307 678	452 597	597 011	492 912	55%	51%	24%
Non-staff operating expense (administrative expenses)		225 141	392 773	828 989	1 330 169	124 442	206 039	379 695	542 968	74%	111%	114%
Depreciation and amortization		17 155	54 589	138 689	113 610	9 482	28 636	63 523	46 375	218%	154%	9%
Consulting, auditing and rating		5 404	2 499	16 708	78 184	2 987	1 311	7 653	31 914	(54)%	569%	524%
Rent, utilities, office supplies and others	10	202 582	335 685	673 592	1 138 376	111 973	176 092	308 520	464 679	66%	101%	125%
Operational Income Before Provision [e=c-d]		**48 305**	**597 081**	**1 606 750**	**1 104 795**	**26 700**	**313 214**	**735 927**	**450 971**	**na**	**169%**	**(8)%**
Net Loan Loss provision expense (f)		13 023	8 641	202 087	108 954	7 198	4 533	92 560	44 474	(34)%	2239%	(28)%
Loan loss provision expense and write off		14 602	9 759	203 194	113 549	8 071	5 119	93 068	46 350	(33)%	1982%	(25)%
Recovery from loans written off		1 578	1 118	1 108	4 595	872	586	507	1 876	(29)%	(1)%	453%
Net operating income before taxes and donations [g=e-f]		**35 282**	**588 440**	**1 404 664**	**995 840**	**19 501**	**308 681**	**643 367**	**406 497**	**na**	**139%**	**(5)%**
Income Taxes (h)	11			6 390	199 170			2 927	81 300			4056%
Net Operating Income Before Donations [i=g-h]		**35 282**	**588 440**	**1 398 274**	**796 670**	**19 501**	**308 681**	**640 440**	**325 197**	**1568%**	**138%**	**(24)%**
Non-operating revenue (j)												
Non-operating expense (including related taxes) (k)	12	44 505				24 599				(100)%		
Net Income Before Donations [l=i+j-k]		**(9 223)**	**588 440**	**1 398 274**	**796 670**	**(5 098)**	**308 681**	**640 440**	**325 197**	**na**	**138%**	**(24)%**
Revenue From Donations (m)	13	2 138 256	1 305 008	927 289	1 093 991	1 181 879	684 577	424 719	446 561	(39)%	(29)%	57%
Net Income		**2 129 033**	**1 893 448**	**2 325 562**	**1 890 661**	**1 176 781**	**993 258**	**1 065 159**	**771 758**	**(11)%**	**23%**	**8%**

(a) Percents annualized for ease of comparison by a factor of 4/3.

General notes to financial statements per CGAP Disclosure Guidelines

1. The financial statements presented include a balance sheet, income statement, and accompanying notes.
2. The financial statements provided include 3.5 years of data.
3. Constanta Foundation is not considered a multi-service institution.
4. Portfolio reporting
   (1) The loan loss reserve is shown as a negative asset in the balance sheet. It is calculated monthly and additional amounts added to the reserve are expensed in the income statement through a separate account. The schedule of provisions by age category is presented in the section Credit Risk Coverage.
   (2) Loans are written off as a matter of accounting practice daily when a loan is overdue 365 days after the final term date.
   (3) Constanta Foundation accrues interest until the loan is written off. Reversing accrued interest prior to loan write-off is not permitted under Georgian tax regulations.
5. Portfolio quality
   (1) Portfolio quality and the calculations of such are displayed in the tables in Section A and the calculations are based on standard portfolio at risk calculation of: (outstanding loan principal for loans in arrears over X days)/(total portfolio outstanding).
   (2) Constanta has rescheduled loans on a limited basis. They are tracked separately in the MIS, but are not automatically included in the PAR. However, all restructured loans (except for one) are still late and are thus included in the PAR. In September 2003, the amount of restructured loans was less thatn8,000 GEL. Constanta does not refinance loans.
   (3) Constanta employees are eligible for individual loans and these loans are included in the overall portfolio figures. Individual loans to employees (with a preferential interest rate of 1.5%) account for 23% of the individual loan portfolio or approximately 274 000 GEL or 112 000 EUR. Loans to employees are formalized in a contract and are repaid directly by the employee to Constanta as they are not withheld from the salary.
6. Donations
   (1) Revenue from donations is shown separately in the income statement.
   (2) Please refer to Section F for a table of donations received to date.
   (3) All grant revenue is passed through the income statement.
   (4) Please refer to the appendix on Adjustments for details on in-kind donations.
   (5) These financial statements segregate the equity received from donations from the equity earned from profits since the beginning of operations.

7. Details of liabilities
   (1) Constanta has no funding liabilities.
   (2) Constanta has no savings collection.

8. Other significant Accounting Policies
   (1) Constanta's accounting is performed on an accrual basis.
   (2) The depreciation of fixed assets on a flat basis using the following schedule:
   (3) Exchange gains and losses on accounts denominated in foreign currencies are recorded in the monthly income statement.

Asset Class	Useful Life in Years
Buildings	20
Fixtures and fittings	5
Office Equipment	5
Vehicles	5
Other	12

Specific notes to the financial statements

These financial statements are based on unaudited figures for consistency of presentation across the four periods. The audited figures form the Miller Group are in USD. The figures from the GCG Audit are in Georgian Lari. Both auditors are reputable and certified the accounts without reserve. There are only slight differences between the unaudited figures presented and the GCG audited figures for 2002.

Balance Sheet

1. In 2001, term deposits per grant agreement. In 2003, term deposits as well as Treasury Notes, with final terms not exceeding 6 months.
2. Individual loans to employees account for 23% of the individual loan portfolio for approximately 274 000 GEL or 112 000 EUR.
3. Constanta added a general risk provision of 1.5% of the healthy group loan portfolio, which drives the significant increase in the loan loss reserve between 2001 and 2002.
4. This amount includes accrued penalty, interest and administrative fees. The amount is not reversed until the loan is written off given local tax regulations. No interest or penalty fees were accrued in 2000.
5. Other Assets includes accounts receivable as well as the VAT tax offset classified internally by Constanta as a negative liability. The cash return of VAT is highly unlikely, therefore Constanta has calculated the offset to future VAT expenses. These amounts are 24,164 GEL in 2000, 55,172 in 2001, 105,380 in 2002, and 89,247 in 2003.
6. In 2001 and 2002 this includes payables to employees and taxes payable other than VAT. In 2003, this category also includes amounts payable to suppliers and future income on Treasury Bills.
7. Minor reevaluation in 2002 of the retained earnings from previous years between 2001 and 2002 of 39 GEL.

Income Statement

8. Time or demand deposits of between 9% and 12% and in 2003 the addition of Treasury Notes at approximately 50% with maximum duration less than six months.
9. This category is principally exchange gains.
10. In 2003, Constanta became subject to additional taxes, including a tax of 31% of total salary costs. This amount is classified under "other" and not staff expenses. This amount also includes 4,111 GEL in 2003 classified by Constanta as non-operating expenses.
11. Constanta become subject to a 20% income tax at the end of 2002. The income tax is paid quarterly based on the obligations of the prior year. In 2002, Constanta paid a small amount of income tax, 6,390 GEL, because not all the income was subject to taxation. By the end of September 2003, Constanta estimates its tax liability of 199,170 GEL. Although not yet paid to tax authorities given that quarterly payments are based on prior year payments and not the actual tax liability, Planet Rating has included this estimate so as to make more realistic the profitability ratios discussed in this report.
12. This amount was related to a UNHCR grant that was recorded on Constanta's Income Statement. The amount of 44,505 was attributable to non-operational expenses because it included salaries of SC staff financed by UNHCR that passed through Constanta’s accounts before being transferred to Save the Children.
13. All donations received in cash, including those for loan capital and fixed assets.

Adjustments

Adjustments Constanta Foundation	GEL 2000	2001	2002	Sept. 03
Adjustment for the cost of funds = A * F - G	**96,724**	**198,527**	**393,816**	**349,904**
A. Funding needs = (b - c)	806,031	1,654,389	3,281,801	3,887,826
b. Avg monthly difference between portfolio and savings	806,031	1,813,784	4,285,566	5,824,458
% savings that may be on lent	0%	0%	0%	0%
c. Equity that used to finance the portfolio= d * e	-	159,395	1,003,765	1,936,633
d. Avg equity, net of donations	-	187,524	1,180,900	2,278,392
e. % of equity that may be on lent	85%	85%	85%	85%
F. Shadow price of borrowings	12.0%	12.0%	12.0%	9.0%
G. Interest expense on borrowings	-	-	-	-
Adjustment for inflation = (H + I -A - L) * N	**55,764**	**66,810**	**120,218**	**146,372**
H. Avg. equity net of donations	-	187,524	1,180,900	2,278,392
I. Average donated equity	2,255,867	4,030,847	5,146,996	6,157,635
M. Average fixed assets	237,584	598,991	819,841	934,073
N. Inflation rate	4.6%	3.4%	5.4%	4.1%
Adjustment for in-kind donations	**54,276**	**57,189**	**43,666**	**-**
a. Staff and technical assistance[a]	54,276	57,189	43,666	-
b. Other	-	-	-	-
Adjustments for provisions	**14,624**	**15,156**	**-**	**25,742**
Loan losses	14,624	15,156	-	25,742
Other risks	-	-	-	-
Other adjustments	**-**	**-**	**-**	**-**
Total adjustments	**221,388**	**337,681**	**557,700**	**522,018**
Net income before donations	35,282	588,440	1,398,274	796,670
Adjusted net income before donations	**(186,106)**	**250,759**	**840,574**	**274,652**

(a) This includes technical assistance provided by Save the Children in the context of the USAID IGP. Please note that these amounts are considerably less than the actual dollar amounts spent.

Planet Rating performs the following adjustments for the calculation of financial self-sufficiency:

- Inflation adjustment: to account for the net effect of inflation on equity and fixed assets;
- Cost of funds adjustment: to estimate the cost that the institution would have paid if it financed itself at market rates. This adjustment accounts for the cost savings received from donated funds or concessional loans;
- In-kind donations: to account for the hidden cost of resources received that do not appear on financial statements, such as free consulting services, trainings, or use of property; and
- Loan loss provision adjustment: to standardize loan loss provision adjustments to the international standards similar to those used in the MicroBanking Bulletin.