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Scaling Up Microfinance to Increase Access to Financial Services in Serbia

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Abstract

Social and financial issues of microfinancing are equally important. It is not possible to fulfill the social mission on the long term if microfinance providers are not financially self-sustainable. Scaling-up in Serbia would contribute to increasing access to financial services of client's, but also to increasing the access to capital by MFIs. Although specific microfinance legislation would lead to a greater provision of microfinance, it is possible to use the existing legislative framework and FFIs to scale-up and operate microfinance in Serbia. However, increased access to financial services through microfinance would require amendments to the legislation, primarily in the fields of tax and banking laws.

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I. Introduction

Microfinance[1] is not regulated in Serbia. Today there are only three Microfinance organizations[2] (MFIs) covering the population of 8 million. For comparison, in Bosnia, on the population of 3.5 million, there are 42 MFIs. The existing MFIs have covered around 6.000 clients whereas the demand is much larger since more than one third of the population in Serbia lives on the verge of poverty. Thus, there are 2.5 million potential clients for microcredits.

In parallel, several banks have been involved in issuing microcredits, both downscaled and Greenfield microfinance banks. Nevertheless, they have not included all potential clients and there is vast space for attracting the traditional MCO clients, which are unbankable, that is unemployed, with no collateral etc.

The explanation of the microcredit demand lies in the previous decade. The Serbian economy has been devastated during the last decade of the 20th century. Officially 33% of the population is unemployed, but in reality, this figure is even larger[3]. Due to the ongoing process of economic restructuring and privatization of previously state owned companies, there is a continuous downsizing of labor force, which will even more increase the unemployment rate and lead to further impoverishment. Ideally, this labor force would find their employment within the small and medium-sized enterprises sector or within micro-enterprises. The above parameters point out to the importance of micro financing in Serbia, not only for the economic, but also for the social and political development in Serbia.

It is important to say that ten years ago, one third of the population did not live in poverty and in some sense Serbia had a functioning "middle class". For that reason, in addition to adhering to the "old poor", the objective is also to tailor the project for the "new poor" in the attempt to recapture or reclaim the development which has already existed.

On the basis of a conducted research, this paper shall propose solutions for microfinance regulation and supervision in Serbia. The recommendations shall include both scaling up of microcredit organizations and downscaling of economically viable commercial banks. The goal is to explore the scaling up of microfinance while still adhering to the social purposes of reaching the working poor which have little or no other access to financial services in Serbia. In exploring the issue of downsizing economically viable commercial banks, the goal shall be twofold: strengthening the existing banking sector and complying to EU standards on banking, primarily the Basel I and II Capital Accords and EU Banking Directives.

[1] The CGAP "Guiding Principles on Regulation and Supervision of Microfinance" (www.cgap.org) define microfinance as the provision of banking services to lower-income people, especially the poor and the very poor.
[2] The Microfinance Gateway (www.microfinancegateway.org) defines MFIs as organizations that offer financial services to the very poor. Gradually the term MFI has come to refer to a wide range of organizations dedicated to providing these services: NGOs, credit unions, cooperatives, private commercial banks and non-bank financial institutions and parts of state-owned banks.
[3] Information from the Serbian Ministry of Labor and Employment as of May 2004.

II. Existing Microfinance Scene in Serbia

In the beginning of the findings, it is necessary to mention that Serbia does not have laws governing specifically microfinance. The issuing of micro loans is governed by existing banking regulations. Similarly, Serbia does not have a law on NGOs, and thus the existing Serbian MFIs have been registered as "Associations of Citizens" under the valid legislation. On the other side Montenegro, the second constitutive unit in the State Union of Serbia and Montenegro, does have microfinance legislation, that is, the: "Decree on Micro Finance Institutions"[4], issued by the Montenegrin Central Bank, as well as the "Law on NGOs". In Serbia, there is however a draft "Law on Microcredit Organizations" created with the Serbian Microfinance Policy Working Group with the support of experts from the Microfinance Center.

When mentioning that there is no specific microfinance legislation, one may ask how are the existing MFIs in Serbia operating? Micro Development Fund and MikroFins (two of the tree Serbian MFIs) have constructed a scheme of their own. Namely, they commission their funds to commercial banks which issue the micro loans. The MFIs asses the potential clients and bear the risk of loan loss. The commercial banks are only paid a fee for the service and legally act as a Commissioner for the MFIs. In addition, MDF has also devised a guarantee deposit scheme but is in the process of abandoning due to an unfavorable arrangement with the respective commercial bank. Supervision in these case is satisfied since the commercial banks are supervised by the Serbian National Bank. These schemes are acknowledged by the governmental authorities more as an alternative solution for providing microfinance, than some new legal framework for microcredit operations.

On the other side, World Vision (the third of the three Serbian MFIs) applies the Guarantee-Deposit model. Technically WV deposits its funds into a Guarantee Fund operated by the bank. In this model the Bank is the lender and WV is the Guarantor for the credits, along with keeping its role of technical advisor. This scheme is legal according to the valid Serbian regulations, but is a little more expensive for the MFI. In all these cases we see a strategic partnership between MFIs and FFIs, which enables the provision of microcredit in Serbia.

When making a proposal for scaling-up microfinance in Serbia, the main question is do we need to introduce new microcredit organizations or can we satisfy the need with the existing institutions, such as the Savings Credit Cooperatives, Savings Credit Organizations, Savings Banks and the Commercial banks?

A) Should NGOs become more involved in microfinance?

Opponents argue that banks should be the ones disbursing the loans, rather than NGOs. NGOs with their inability to take commercial equity and deposits and thus operate as banks are largely dependant on donors, and once the donor input dries out, NGOs have no more sources of financing. Furthermore, through NGO microfinance, the beneficiaries are not supported to act in an entrepreneurial-like behavior and are not trained to develop their business. Finally, the non-commercial behavior of NGOs can on the long run, negatively impact the banking

[4] The "Decree on Micro Finance Institutions", (Official Gazette of RM no 1/2003)

sector. On the other side, proponents argue that the banking sector will not suffer since most of the MFI clients anyway cannot meet the banking requirements.

An important policy issue is the duration of NGOs which provide micro credits. The idea is that their mission would be completed once they have facilitated growth and replaced by other commercial institutions. To that purpose, one can argue that the NGO lending should only be permitted for some "limited time" to make certain that a faux market is not created and sustained for the country's poor with the result that the poor are ghettoized and de facto denied any hope of entering the power structures within a country.

Another role of NGOs in increasing the access to financial services is creating databases and track records of clients. Through client's databases, NGOs providing microcredit can assist that previously un-bankable clients to come into the formal financial sector.

As we’ve seen, there is a big and urgent need for introducing microcredits in Serbia. Having in mind that the Serbian Parliament is very slow in promulgating laws (for instance, the new Bankruptcy or VAT laws are waiting two years for their enforcement), it is questionable whether introducing a new NGO law and a Micro Credit Organizations law will meet the time requirements. On the other side, it is questionable whether the traditional microfinance schemes as developed in Bangladesh and India, or the neighboring Bosnia are the best solution for Serbia? Perhaps the traditional models could be merged with formal banking and the development of the microfinance sector be combined with the restructuring of the banking sector in Serbia?

B) Scaling-up

An issue linked with NGOs issuing Microcredits is their process of scaling up. Basically, scaling-up means MFIs that NGOs are transformed into formal financial institutions (FFI), and besides offering loans expand to a number of other services such as micro-leasing, micro-insurance, savings, housing loans etc. This presumes a number of years of NGO operations in issuing loans, available resources and market demand. So far, MDF sees a number of obstacles for becoming formal. MikroFins also sees a number of problems for scaling-up but sees Savings Credit Cooperatives as the closest form for providing microfinance services. World Vision is considering the option of becoming a Savings Bank which would best suit their microfinance programs. So far, out of the international NGOs present in the field of microfinance, only the Opportunity Bank in Montenegro has scaled up to a full fledged commercial bank in 2002. OI in Serbia has registered itself as a Savings Bank according to the valid banking regulations.

There are a number of advantages and impediments when considering scaling up and they shall be discussed in chapter V of this paper.

C Savings Banks

As mentioned above, so far Opportunity International has registered itself in Vojvodina. It is registered as a Savings Bank and as such operates under the Serbian banking regulations. This form of FFI foresees three major restrictions. First, OI can be involved in monetary transfers in the Serbian monetary market only in dinars and not in foreign currency. Second, OI can not take deposits in foreign currency, but only in dinars. This goes for credit lines from abroad as well. Finally, OI can on-lend only to private persons and not to enterprises, and as such, OI micro loans are treated as consumer loans from the point of view of the Serbian legislator. In this sense, OI has a limited scope of work in Serbia and on the long run is looking to register as a full fledged commercial bank.

D) Greenfield banking

In Montenegro, Opportunity International is registered as a full fledged bank under the name Opportunity Bank in 2002 and is successfully providing microcredits. OB started as an NGO in 1999 and so far is the only example of a scaled up microfinance bank.

The only Greenfield bank registered in Serbia is the ProCredit Bank. It started under the name of Micro Finance Bank as an IMI initiative for SEE and CIS countries. Now ProCredit Bank is operating in a number of neighboring countries and is expanding its activities. After three years from the initial investment, ProCredit Bank has already become profitable. This bank is specialized in microcredits and its disbursements are highly overcoming the disbursements of the existing Serbian MCOs. For instance, only in April 2004, ProCredit bank has disbursed 2.000 loans. From the beginning of its operations, until now, PCB has disbursed a total of 14.000 loans. All of these loans are below 10.000 Euros and thus fit into the microcredit criteria. Of course, all consumer loans are excluded from this statistics.

The performance of Greenfield microfinance banks so far show their capacity to grow in a short period and cover bigger portions of the client market then do the traditional MCOs. Therefore, they should be taken into account as an important and expanding actor in the field of microfinance.

Opening Greenfield banks specializing in microfinance and downscaling the existing and economically viable banks are two parallel processes currently ongoing in Serbia. LFS Financial Systems is performing the task of downscaling in Serbia together with KfW. According to their findings, from some aspects it is easier to start a Greenfield bank then to downscale the existing commercial banks. On the other side, downscaling has its advantages towards Greenfield banking. However, both downscaled banks and Greenfield banks are subject to the same restrictive banking regulations in Serbia. This brings us to the discussion of opting either for downscaled banks or Greenfield microfinance banking in Serbia.

E) Why downscale?

Downscaling is the process of training economically viable commercial banks to specialize for micro loans. In this process, the banks retain their other functions such as deposit taking and commercial transactions. Also other bank departments continue with issuing loans exceeding micro loans which is especially useful when clients overcome the micro loan demand and migrate to small or medium loans. Bottom line, one department of the bank is trained and specialized for this purpose. This process has been done by EBRD in the CIS countries and is now being implemented in Serbia through KfW programs and LFS Financial Systems. The targeted banks are Eksim, Kulska and Komercijalna bank. The case of the Komercijalna bank is especially interesting since this is one of the rare big state owned banks which has remained in operation after the bank restructuring process has been implemented from 2001 to 2003.

The question in downscaling is why would a bank in Serbia restructure itself to have a lower profit with a larger risk and less security? There are two main answers:

First of all risk diversification. The existing banks like to finance large clients since it brings high returns with a good security. However, if one large client becomes insolvent, perhaps 5%, 10% or even 15% of the banks portfolio may be jeopardized. On the other side, if one micro client goes bust, only 0,000015 of the bank's portfolio is at risk.

Second, downscaling opens new markets, since it attracts clients that otherwise would not come to the bank.

F) Non-financial services in downscaled banks

Depending on the bank's program and its implementation, some downscaled banks provide a non-financial portion of services to their clients.

1. Business plan. Banks are used to receiving the business plan. Downscaled banks are trained to formulate the business plan together with the clients. Usually they formulate a questionnaire for this purpose. It mainly serves as the credit analysis of the client.

Serbian banks which are downscaled in LFS’s program have all agreed to fulfill this non-financial service and in this way it has been attempted to prevent the drifting of the social mission of downscaled banks. It is needless to say that other commercial banks do not provide for this service and this is one more advantage of downscaled commercial banks for microfinancing programs.

Nevertheless, on the other side, ProCredit Bank as the only representative so far of Greenfield microfinance banking in Serbia is also active in creating the business plan and credit analysis, even more than some of the downscaled banks in Serbia.

2. Information on new legislation. In some countries downscaled banks inform their clients about the new legislation in order to maintain the portfolio quality. This is a favor for the clients, but also for the banks because in this way they attempt to minimize their risk of credit default, since clients are trained how to act. In Serbia, clients have come to the Kulska bank to obtain information on the newly requested register cash boxes for whose acquisition this bank was issuing micro loans.

G) Importance and advantages of downscaling

The importance of downscaling is reflected in the fact that practically downscaling in Serbia seems like the only plausible solution for microfinance banking in the current situation. Namely, the NBS has restricted the establishment of Greenfield banks. The NBS says that if you wish to go into banking in Serbia, then you should buy one of the existing banks. The reason for such a position is that the State is the majority stakeholder in most of the Serbian banks, which has happened in 2002 after the "Decree on Debt to Equity Swap". In this process, as all the Serbian banks were largely indebted to the State and insolvent, that is unable to service their debt, the State converted its debt into equity and thus has become the majority stakeholder in most the Serbian banks. Now the State has a clear interest to sell its property as opposed to allowing the establishment of new Greenfield banks.

Serbia has too much banks compared to its population, 46 banks on the population of 8 million, so the general trend now is the consolidation and not expansion of the banking sector. Besides the above mentioned obvious pragmatic reason, there are several advantages for downscaling in Serbia:

1 It is very important that the general public has trust in the Serbian banking system, therefore it is important to work with the existing banks, since this will lead to increased trust towards the banks, increase the stability of the banking system and also the image of banks becomes better in the eyes of clients. Of course, it is always good to foreign banks since they also give stability to the banking scene and create a healthy competition.

2. In addition, downscaling of commercial banks brings a new added value to the bank, since it attracts new, marginally bankable clients which otherwise would not have come to the bank.

3. The fact that downscaled banks provide more non-financial services then Greenfield banks, also favors them with regard to the social mission of microfinance.

4. In cases when the client overgrows the micro loan category, he/she can migrate to another department, still remaining within the same bank.

Although it has its advantages, downscaling can be a difficult job, due to the banks unwillingness to downscale, unreadiness of the staff to be trained etc. However, it largely depends on the bank which is chosen.

H) Comparison of the microfinance players

Applying either one of the above mentioned vehicles for providing microcredit has its advantages and of course shortcomings. Below is a short recapitulation of advantages and shortcomings of each model.

NGO MFIs. Traditional MFIs operating as NGOs can not be registered in Serbia, as there is no supporting legislative framework. Therefore, by supporting the NGO MFIs in the existing framework in Serbia, we do not support the formal financial sector and open the doors to creating a faux credit market.
However, the existing MFIs in Serbia do manage to reach to the poorest segments of population. In this way, they contribute to their social mission of poverty alleviation and increasing access to financial services of the poorest population.

Downscaled Commercial Banks. It is clear that the banks are not in the business of development but in the business of profit-making. Therefore, it is possible to expect a mission drift from poverty alleviation. Although one may argue that the downscaled banks in Serbia

offer non-financial services, the traditional microcredit clients are marginally bankable and perhaps they will not be covered by banks.
On the other side, the process of bank downscaling in Serbia is already ongoing. KfW is involved, together with LFS in the program of downscaling the Kulska, Eksim, Komercijalna Bank. Furthermore, the downscaling of banks has advantages as it will consolidate the banking sector in Serbia, since Serbia has 46 banks on the population of 8 million. Finally, downscaling will support to the domestic banking sector.

Greenfield Microfinance Banks. Again, the banks are not in the business of development but in the business of profit-making, and therefore, it is possible to expect a mission drift as the banks overall goal is not development. Also, it is arguable to which extent the banks will reach the marginally bankable clients, i.e. the unemployed, with no collateral etc. Finally, Greenfield banks will support the bank expansion, as opposed to bank consolidation, which in the concrete economic and banking reality in Serbia is not a desired goal.
On the other side, foreign banks (which will be the case of Greenfield banks) in general contribute to the overall stability of the domestic banking sector. Furthermore, Greenfield banks operating in Serbia, such as the ProCredit Bank or Opportunity Bank are profitable. Finally, the existing Greenfield banks have a regional approach for SEE, which is good since a combined strategy for the region can be devised.

I. Conclusion

The overall conclusion is that although each of these models have their advantages and shortcomings, neither one of them, nor the combination of them all together have managed to satisfy the great demand for microcredits which is in Serbia estimated to 2.5 Mio potential clients. The fact that approximately only 25 thousand clients have been served, leaves space for further involvement into the field of microfinance in Serbia.

III. Legislative Framework: Existing and Sought

As explained above, Serbia does not have regulations specifically targeting NGO MFIs. The operations of the MFIs are performed under the existing banking regulations. In order to develop Microfinancing in Serbia through NGO MCOs and MFIs, it would be necessary to promote alternative institutional types that would allow for sound financial NGOs to obtain a license to on-lend to the general public and obtain funds. In a few countries, this may be an appropriate strategy. However, in most countries, budgetary restrictions faced by bank regulators make it very unlikely that they would be able to supervise a number of small institutions offering financial services.

Serbian microcredit providers who operate in the formal financial sector disagree that a specific law on microcredit organizations is a prerequisite for developing microfinance in Serbia. They argue that Serbia is really not the easiest environment to work, but the NBS reporting is not totally over-barring especially if the FFI does not take deposits.

CGAP's "Guiding Principles on Regulation and Supervision of Microfinance"[5] differentiate in detail between prudential and non-prudential regulation of microfinance. Here, the non-prudential regulatory issues are the: permission to lend, consumer protection, fraud and financial crime prevention, credit reference services, secured transactions, interest rate limits, limitation of ownership, management, and capital structure, tax and accounting and feasible mechanisms of legal transformation which in effect is scaling-up. Prudential regulation issues are the: minimum capital, capital adequacy, unsecured lending limits and loan loss provisions, loan documentation etc.

Below is a discussion on issues of MFI on-lending, supervision, minimum capital requirements, minimum capital adequacy requirements, maximum loan size and maturity, taxation and interest rate ceiling. *Prima facie*, it may seem that the issue of taxation is the dominant issue for NGOs considering working in the formal financial sector. However, MFIs in Serbia already pay the majority of taxes so although it is a major issue, taxation itself is not the sole impediment for scaling-up. Chapter V will discuss advantages and constraints of various forms of FFIs providing microcredit.

A) MFI on-lending

The *conditio sine qua non* of microfinance is whether MFIs are allowed to on-lend to their clients. In the current Serbian regulatory setup on-lending is permitted only to banks and other financial institutions[6], whereas MFIs operations are done through a strategic partnership between MFIs and FFIs as explained in the previous chapter of this paper.

However, this partnership could be expanded in order to increase access to financial services. For instance, in one of the EU countries - France, the banking law was amended so that Associations (MFIs) can on-lend to clients, but only from their own funds. Namely, the French Law on New Economic Regulations, which modifies articles of the Monetary and Financial Code, now allows "non-profit associations delivering loans for the creation of the development of enterprises by unemployed people, on their own funds an on loans borrowed

[5] CGAP, March 2002, "Guiding Principles on Regulation and Supervision of Microfinance"
[6] Republic of Serbia, "Law on Banks and other Financial Institutions" (Official Gazette of RS no 72/2003)

from credit institutions, to deliver credits[7]. This means that, under certain conditions, a "microcredit association" will now be allowed to borrow and lend.

If such a regulatory setup was applied in Serbia, the conditions of accreditation and control for the MFIs which would like to intervene in this framework would have to be defined, by appropriate amending of the legislation.

B) Supervision

What kind of supervision to choose for MFIs?
In the Federation of B/H, where the MFI world is blossoming and that's why we take it as a comparison, there is no specific supervision of the MCOs. They have to submit their settlement of accounts half-yearly and yearly to the Tax Department of the Ministry of Finance and submit reports to their donors or commercial banks from which they have taken loans. There is no specific supervisory body for MCOs.

What should be the case for Serbia?
Initially there was an idea of creating the Serbian Financial Service Authority, following the U.K. example, which could serve this purpose. The justification for this model was that as the supervision process would start with the registration process, only MFIs which have the goal of supporting the economy and reducing poverty could be registered. In this case as micro financing would be done in parallel to the banking institutions, the responsible governmental body would be the Serbian Ministry of Finance.

It is interesting to mention here the that recommendation from the Grameen Foundation in creating a pro-microcredit regulatory framework was to create an Independent Microfinance Commission, comprising of representatives of the government, donors, NGOs, academia and the private sector[8]. This Commission would make the initial recommendations and either become a regulatory body itself that would implement its recommendations, or give authority to another appropriate institution, such as a microcredit wholesale fund. The role of this Commission would not be supervision *per se*, but recommendations for interest rates, savings mobilization, capital requirements, standardization, transparency, microfinance specific legislation, etc.

Having in mind the experience so far in Serbia to introduce microfinance through non-banking institutions, it is rather unlikely that any of these solutions may be accomplished. After all, it would be unimaginable to have a deposit taking MFI which would not be supervised by a governmental body. Therefore, it is most likely that microfinance in Serbia shall be regulated through FFIs and thus supervised by the National Bank of Serbia.

C) Maximum loan size and maturity

Should MFI lending be limited with regard loan size and maturity? Through not exceeding the loan size and maturity, MFIs will be prevented in slipping to a mission drift. They will be directed in a way to stay focused on their primary goal and target the working poor.

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[7] For more details check www.european-microfinance.org The European Microfinance Network
[8] Counts Alex and Sobhan Sharmi, Grameen Foundation USA, 2002, "Recommendations for the Creation of a Pro-Microcredit Regulatory Framework"

Limitation of maximum loan size is an important policy issue. Proponents argue that offering higher loans leads to a mission drift and targets the better off segments of population. Is this always the case? For instance, some of the micro enterprises may grow quickly. Starting from the first loan of 2.000 Euros, to the second in a year of 4.000 Euros, in another year or two, if they develop their business well, they may ask for 20.000 thousand. However, the Serbian Draft Law on MCOs foresees the maximum limit of 10.000 Euros[9] (as a reminder, the average micro loan in Serbia is from 1.000 to 1.500 Euros).

Consequently, in case the maximum loan size is limited, these clients, often called “golden clients” can not be followed anymore by the MFI. And in this case, the best clients will leave their MFI after several years of successful financing and migrate to the formal banking sector, since the have overgrown the MFI, and it can no longer cover its needs.

Here we see another advantage of downscaling, since in case this client overgrows the micro loan category, he/she will migrate only from one department to another one, still within the same bank. Therefore in scaling-up, we should seek for an FFI which would allow for “golden clients” to stay within the same financial institution once they become successful as well.

D). Minimum Capital Requirements

In order to prevent the mission drift, it is necessary that minimum capital requirements for MFI establishment are imposed. Such a requirement is necessary in order to prevent the misuse of MFI establishment for purposes other than aiding the working poor and general socio-economic development. The amount of this pre-condition which would satisfy the development goal of MFIs should be discussed. For instance, the Grameen Foundation recommends a rather flexible proposal: “that the minimum capital requirements for MFIs should be realistic”[10].

So far the Serbian "Law on Banks and other Financial Institutions" (Official Gazette of RS no 72/2003) foresees the following capital requirements: for Savings-Credit Cooperatives – 200.000 Euros, Savings-Credit Organizations 1.2 Mio Euros, for Savings Banks 2 Mio Euros and for full-fledged Banks – 10 Mio Euros. However all these relate to FFIs and one of the proposals from the Serbian Draft Law on MCOs is that the capital requirements for MCOs be capped at 100.000 Euros[11].

E) Minimum Capital Adequacy Requirements

It is necessary to differentiate between minimum capital requirements and minimum capital adequacy requirements. This is important for microfinance provision through FFIs. Namely, the minimum capital adequacy requirement defines the amount of capital in relation to the active at risk. Both Basel 1 and 2 Capital Accords foresee the amount of 8%. In determining

[9] The Serbian Draft “Law on Micro Credit Organizations” was made in February 2003 by the Serbian Microfinance Policy Working Group
[10] Counts Alex and Sobhan Sharmi, Grameen Foundation USA, 2002, “Recommendations for the Creation of a Pro-Microcredit Regulatory Framework”
[11] The Serbian Draft “Law on Micro Credit Organizations” was made in February 2003 by the Serbian Microfinance Policy Working Group

the capital requirement basis, as defined, the NBS should follow, in general, the concepts of risk weighting for assets and off-balance sheet items as given in the 1988 International Capital Convergence Agreement made by bank supervisors (Basel 1 Capital Accord) but shall simplify or modify as it deems necessary for Serbia and may from time to time adjust such risk weightings as circumstances call for.

As the supervisory authority, it is the responsibility of the National Bank of Serbia, to ensure minimum capital requirements for financial institutions and the on-going capital adequacy requirements for financial institutions.

F) Taxation

The issue of taxation should be carefully approached. NGOs are non-profit organizations and as they have no profit, they can not be taxed. The existing Serbian MFIs issue loans through commercial banks as their agents and the banks are only entitled to a commission fee for handling the credit, which is taxed in accordance to commission deals regulations.

In effect, depending on the concrete arrangement with the commercial bank, Serbian MFIs pay most of the taxes:

1. Profit tax at the end of the month
2. Profit tax at the end of the year,
3. Tax on employees salaries (medical, pension, disability and unemployment insurance along with the tax on the employee's monthly income),
4. Tax on financial services, which is of temporary character as it will be abolished at the end of 2004.

Comparing these tax expenditures, Serbian MFIs pay more tax than MFIs in Montenegro which operate on basis the Decree issued by the Montenegrin Central Bank.

In Bosnia, the MFIs are exempt from profit tax obligations on grounds of reinvesting their profit. Namely, the: "Law on Profit Tax", stipulates that organizations which reinvest their profit are liberation from paying the profit tax. The Serbian "Law on Profit Tax"[12] provides a number of tax incentives. Unfortunately, they can not adequately be applied for increasing access to microcredit in Serbia. However, the pending VAT law may bring some alleviations for MFIs, and especially for FFIs in Serbia.

The issue of taxation should be carefully considered along the fact that an increased cost structure will impede the sustainability of non–financial services and thus impede the primary micro credit aim of social and economic development. It is necessary to propose the optimum tax requirements for MFIs and downscaled banks, having in mind the aim of increasing the access to financial services by the working poor. It is the general conclusion that it is necessary to provide a preferential tax treatment as an incentive for banks to be mobilized into the downscaling process. In this case, the micro loans issued by the bank would have a different – preferential treatment then the other loans issued by the same bank.

[12] Republic of Serbia, "Law on Profit Tax", (Official Gazette of RS, no 70/2003)

For instance, if NGO MFIs were scaled up they would be subject to an additional profit tax of 20% before expenses depending on the monthly coefficient of the cost of living, and a 14% tax on profit at the end of the month. The final profit tax is understandable, but the 20% tax varying on the monthly coefficient is a constraint for both FFIs in Serbia, the Greenfield Microfinance Bank – ProCredit Bank and the Savings Bank – Opportunity Savings Bank. Namely, this is a tax based on the monthly coefficient of the living cost published by the Serbian Ministry of Finance. If the interest rate of the FFI is higher than 0.05% of the monthly coefficient, then the FFI is charged an additional 20%. The problem is that FFIs can not plan their interest rate accordingly since this monthly coefficient relates for the previous month. Experience shows that this monthly coefficient relating to the cost of living can vary anywhere from +4.5% to -7%. It is expected that the taxation will be harmonized and this specific tax abolished after the VAT law is introduced, but for the time being, the above mentioned taxation system represents and impediment for microfinance in Serbia. In any case, the fluctuating 20% tax requirement depending on the monthly coefficient of the cost of living is built into the interest rate, which makes microloans even more expensive for the vulnerable clients that it is aimed for.

Finally, FFIs in Serbia are charged taxes for other services they provide, such as the opening of a savings account, opening checking account, administrative fees etc. However, these and other services represent only 5% of the bank's operations. 95% of the bank's income comes from the on-lending portfolio. If the income generated from the on-lending portfolio was subject to preferential tax treatment, this would represent a huge advantage for the FFIs providing microcredit, and accordingly make microcredit cheaper, that is more accessible to clients.

G) Interest Rate Ceiling

The regulatory function should not be to fix the ceilings of credit amounts of MFIs, particularly since there can be other incentives and reasons to do so. So far the Serbian regulator has not fixed the interest rate ceiling. However, the microfinance industry in developed countries, such as France cap the interest rate to 10%. This in effect results in French MFIs to become economically unsustainable and dependant on donations. Recently ADIE, one of the largest French MFIs[13] has been lobbying for the government to increase the cap on the interest rate. Bottom line, this example can serve as a good argument for not capping the interest rate. Finally, Principle 7 of CGAP's "Key Principles of Microfinance"[14] argues that interest rate ceilings can damage poor people's access to financial services.

H) Conclusion

To *conclude*, the above issues are crucial, but not exhaustive, to be considered when determining the appropriate legal framework for Serbia. The overall question whether to have or not to have a separate law on microfinance and what type of law depends on many country specific issues and the existing laws etc. In the previous years, Serbia had a bad reputation for microfinancing due to the non-existence of specific microfinance legislation. This paper confirms that the existing legislative framework along with some improvements can be used for microfinance. The experience from Bosnia shows that regulation itself can not be the

[13] www.adie.org ADIE - Association pour le Droit a l'Initiative Economique
[14] CGAP, June 2004, "Key Principles of Microfinance"

major impetus for microfinance development. In this case, as the existing microfinance law has become obsolete with regard to microfinance demand, new legislation is on its way. The main argument for the new microfinance legislation in this case is that the existing legal framework does not provide MFIs with the possibility to attract new sources of capital. Therefore, one of the conclusions would be that overregulation may hinder the industry in its growth and that is not a desired goal.

After all, some provisions such as the non-existence of a minimum capital requirement may be counter-productive, as it may lead to the registration of MFIs whose goal is not coinciding with the social mission of microfinance.

The main impediment for microfinance regulation so far was the Serbian National Bank's unwillingness to allow a financial system which would not be supervised by it[15]. This opinion has been derived from the negative experience of the destruction of the financial system in the beginning of the 90-s of the last century. By scaling-up into the existing legislative framework, along with introducing some amendments to the banking laws and introducing a preferential tax treatment for microfinance providers, the microfinance industry in Serbia can continue its development. Finally, some arguments for not having specific microfinance legislation in Serbia can be found in Chapter V of this paper.

[15] National Bank of Serbia, October 2001, "Letter of the NBS Vice Governor to the Serbian Ministry of Economy"

IV. Other Policy Issues to be Considered

Almost all of the topics discussed in the previous chapters give rise to a number of policy issues. However, the afore mentioned is not the final list of policy issues necessary to be discussed in the framework of microfinance in Serbia. Below are other topics to be considered when making a sound strategy for microfinance in Serbia.

A) Type of clients

An important policy issue arises from the question whether all the clients are covered with banks involved in micro loans? The answer is negative, since banks will not issue loans to the unemployed, without cash –flow, without security, collateral etc. For instance, in Bosnia, there is 365 Mio Euro annual turnover and 61.000 active microcredits issued by MFIs. In Serbia there was a total 20.6 Mio Euro turnover, and 16.500 clients, whereas the number of active loans is 7.400. However, there is a 33% unemployment rate, 1/3 of the population is on the verge of poverty and the estimation is that more than 2.5 Mio people would be potential clients of Microfinancing activities. This data give a clear justification for introducing microcredit issuance other then through banks, since not all of the above potential microcredit clients will be bank clients, at least not in the near future.

B) Cost structure

An overall issue in microcredit activities is preventing the cost structure to impede the sustainability of the non-financial services portion. Cost structure in general impedes the providing of non-financial services necessary for the working poor since it makes the profits non-sustainable. On the other side, in the process of scaling up, we want to make financially viable MFIs. Microfinance banks provide deposit facilities, money transfers and checking services in order to support rapid growth of the assets. Furthermore, income is taxed. In such a scheme, MFIs would have to limit their developmental activities in order to become sustainable. This again brings us to the question if this way we can create viable MFIs without a substantial mission drift?

C) Consumer loans

Microcredits are a development tool for the transition and developing countries. In this form it is not established in the developed countries, since the administration costs are too high. However, in these countries, commercial loans issued by commercial banks have replaced the category of microcrediting. Recently, as the banking sector in Serbia is stabilizing, many commercial banks have started issuing consumer loans to their clients. Currently, Serbian banks are very happy to issue consumer loans since they have a number of advantages compared to micro loans:

- First of all, the required documentation for issuing a consumer loan is minimal.

- Second, there are no balances, statutes, registrations of companies, etc., to be checked prior to issuing the consumer loan.
- Finally, there is no checking whether the loan has been used for a specific purpose.

Having in mind the above advantages, this has the effect that many consumer loans issued by banks are replacing micro loans and entrepreneurs use them for their business. This is an important indicator to have in mind in order to anticipate the future development in the field, and the possibility that consumer loans take over the traditional microfinance clientele.

D) Credit Cards

To some extent, credit cards can serve as a microcrediting tool. So far in Serbia credit cards are mostly used for short-term consumer loans and not as a tool for microcredit. Credit cards as a microcredit tool are another issue for consideration in the overall scope of introducing microfinance in Serbia.

E) Microleasing, microinsurance, housing loans

The Serbian MCOs are interested to enter fields of microfinance, other than just providing credits for business purposes. These would include microleasing, microinsurance, housing loans etc. However, it is premature to speak about this issue having in mind that not even the issuing of credits is currently regulated. However, the above can constitute core activities of developed MFIs and their consideration should take place in parallel with discussion microcredits.

In Serbia, microleasing is an interesting option for the local MFIs. The advantage is that the registration requirements are 100.000 Euros. The disadvantage is that according to the current legislative setup only fixed assets can be leased, whereas leasing working capital is not allowed[16]. This way a large number of potential beneficiaries of MFIs would be excluded from this service.

F) Conclusion

To *conclude*, to satisfy the plurality of needs of microfinance clients, a pluralism of institutions and tools for their achievement should be considered. Consumer loans and credit cards can to a certain extent replace microloans. Microleasing, microinsurance and housing loans come as a product of an advanced microfinance market and are not expected in the near future in Serbia.

[16] Serbia, “Law on Financial Leasing”, (Official Gazette of RS, no 55/2003)

V. Existing FFIs that can be used for Scaling-up

The overall question is whether the existing types of FFIs could be used as vehicles for providing microcredits in Serbia? So far there are three MCOs (Micro Development Fund, MicroFins, World Vision), one Greenfield bank (ProCredit Bank) and one Savings Bank (Opportunity Savings Bank). What about other forms of institutions which are regulated in the Serbian law, such as the Savings Credit Cooperatives and Savings Credit Organizations?

A) Savings Credit Cooperatives

So far Savings Credit Cooperatives[17] (SCC) are the closest system for issuing microcredits which has a legal basis. There are approximately 10 SCC registered in Belgrade. The Serbian MCOs have considered this form but have found the following obstacles:

1. Very restrictive conditions for registration which include a big portion of conditions requested for banks,
2. Shareholders organization of SCC which the complicates ownership,
3. No tax reductions and other alleviations,
4. As SCC are profit oriented, the question is in which scale would the donors contribute with their resources,
5. Registration requirement of 200.000 Euros,

The issue in this case is whether the state can provide alleviations for SCC which plan to go into microfinance activities. The issue for potential investors in the field is whether they can adjust to the above requirements and consider this form for their microfinance programs? So far, due to the above obstacles Micro Development Fund is not considering going into this direction. MicroFins is considering going formal in the future, depending on a number of issues and in that case, the SCC would be the preferred form of FFI they would chose.

B) Savings Credit Organizations

A similar form to the SCC are the Savings Credit Organizations[18] (SCO). Originally, SCOs were conceived as organizations of large state corporate systems and used for financing the employees of such systems. In addition, the MFIs have not considered them as an option for their scaling up due to similar restrictions as foreseen for the SCC's and also the registration requirement of 1.2 Mio Euros. In case of depositing such a significant amount, a Savings Bank would be a better solution which would in addition provide a larger scope of microfinance activities.

[17] Articles 72 to 75 of the Serbian "Law on Banks and other Financial Institutions" (Official Gazette of RS no 72/2003)
[18] Articles 68 to 71 of the Serbian "Law on Banks and other Financial Institutions" (Official Gazette of RS no 72/2003)

C) Savings banks

So far only OI has registered itself as one of the FFIs and chose the form of a Savings Bank[19]. Following this example, World Vision is considering scaling-up to Savings Bank. As mentioned before, this form has its obstacles, three of them being the main ones hindering access to financial services:

1. Inability to work with enterprises, but only with private persons,
2. Inability to take credit lines in hard currency for on-lending
3. Inability to take savings in hard currency, but only in dinars

Furthermore, there is a regulatory restriction that Savings Banks in Serbia should be owned by a local company, but in effect this does not represent a problem for registering. Namely, shareholders can purchase a local company which can serve as an investment tool.

However, in the work of Savings banks, there is one specificity. As Savings Banks can not issue loans to enterprises, but only to individuals, all loans issued by Savings Banks are considered as consumer loans. Nevertheless, this does not represent an obstacle for increasing access to financial services, since from the aspect of NBS, issuing consumer loans requires less paperwork as explained in the chapter before.

Finally, the Savings banks, as well as full fledged commercial banks are obliged to keep a 47% of their deposits with the NBS as security for the depositors. Banks object that as a result of this requirement, their on-lending portfolio is decreased for exactly 47%. They argue that by waiving this legislative requirement, their on-lending portfolio would be increased thus providing increased access to financial services. The NBS on the other side argues that microcredit is risky and therefore such a large deposit on savings is very much justified in order to protect the depositors. Hence, it is unlikely that the NBS will waive the 47% deposit requirement in the near future.

D) Downscaling or Greenfield banking?

As discussed previously, the other options for microfinancing in Serbia are downscaled and Greenfield banking. In considering whether to downscale an economically viable commercial banks into microcredit programs or to start new, with Greenfield bank, there are eight parameters[20] to consider. Basically, either option has its strengths and shortcomings.

1. Initial Investment/Setup: When considering the costs of the initial setup, the advantage is on the side of downscaling the existing banks. This is self-explanatory since the investor can use the existing structures: human resources, computers, premises etc.
   The cost of initial investment in setting up Greenfield banks is high since the investor starts from the beginning. Thus, the advantage on this parameter is with downscaling.

[19] Articles 64 to 67 of the Serbian "Law on Banks and other Financial Institutions" (Official Gazette of RS no 72/2003)
[20] Information on downscaling in Serbia was acquired with the assistance of LFS Financial Systems

2. <u>Training/Education Effects:</u> The effects of personnel training are high with downsized commercial banks. However, the effects are partial, since in downscaled banks, only the credit officers are trained. However, this is less costly then the Greenfield investment.

   In Greenfield banks, all the staff needs to be trained. Here the effects are also high but the whole institution is trained. It is needless to say that this approach is more costly then partial training of downscaled banks staff.

3. <u>Access for Particular Target Groups:</u> Downscaling may have a restrictive client approach, depending on the bank's policy. In practice, this means that the bank will not give a loan to certain categories of clients which it deems inappropriate for its bank.

   On the other side, a Greenfield bank can focus on all target groups and even take over the ones that the downscaled banks have omitted. This particularly relates to clients working partly or mostly in the grey economy sector. Thus, the access for particular target groups is high with Greenfield banking.

4. <u>Efficiency:</u> With already existing and now downscaled banks, the efficiency of the bank depends on the bank itself. It is mostly depending from the possibility of the bank to decentralize, that is, delegate loan decision making to the branches.

   With Greenfield banking, the efficiency is usually very high since the structure of the bank is with the exact intent and it is tailored for SME and microfinancing.

   The efficiency of the bank is reflected in its Credit Boards. In Greenfield banks, decisions are reached quicker then in downscaled banks. Usually in Greenfield banks, the loan decision making should be reached within 3 working days, whereas in downscaled banks, this process lasts longer.

   Finally, downscaling can be strenuous and long-lasting and at the end not to achieve the expected results. In this case, we see a clear advantage of Greenfield banking.

6. <u>Profitability:</u> The profitability in downscaled banks is higher since the there is an existing and established structure. Therefore, the break-even can be reached quickly.

   On the other side, the break-even in case of Greenfield banking can last longer.

   However, this parameter is closely linked to the initial investment and set-up costs.

7. <u>Implementation of principles:</u> In downscaled banks, the implementation of principles depends on the existing staff. Sometimes it can work out fine, but usually it is not so easy since it is hard to persuade the staff for a change they are not in for. This is especially the case when the bank director or SME department manager are replaced, the whole downscaling program may be cancelled. Therefore, this approach involves an amount of risk.

   The implementation of principles is easier with Greenfield banking since the investor will choose the whole bank staff depending on which target group you wish to credit. In practice, when you have your institution, you can have the influence, appoint your director and not replace him as long as he does his job as planned.

8. <u>Internal control:</u> Issuing loans is risky business. Control is always difficult, since you can face scams, fraud, forged documents etc.

   Practice shows that control is more difficult with downscaled banks. One can never exempt risk 100%. This goes well with the fact that banks in general are not fans of external control.

With Greenfield banking, control is easier since the investor has made his own structures. The investor is even more familiar with the procedures than the bank officers and can predict what can happen.
To conclude, internal control is especially important in the phase out when the consultants are leaving the bank. The most important is the fact that the fact has a sound audit control. However, in LFS's experience in Serbia, the banks have proven to be very professional since they have realized that internal control is their interest as well.

E) Advantages of FFIs

The Mix Market Micro Banking Bulletin[21] compared FFIs to NGOs. Its findings are that FFIs are much more sustainable then NGOs, since they work in a regulated environment where FFIs are responsible to their shareholders, which bottom line makes FFIs become most productive using the limited resources they have.

Some other advantages of becoming formal in Serbia are that:

1. With FFIs, the registration requirement is actually not an impediment. Namely, the capital deposited for registration can be used as the on-lending portfolio in all mentioned cases of FFIs.

2. Supporting the exit of Serbia from the grey market is another advantage of scaling-up into FFIs.

F) Impediments for scaling up into FFIs

In transforming NGOs there are many obstacles. Campion and White[22] define four main disadvantages of NGO transformation:
On the short run these are:
- High costs, especially for the first transformation in the country.

On the long run, these are:
- Higher tax costs,
- Burden of reporting requirements.
- No turning back – permanently linked to the formal financial system.

In Serbia, the following concrete impediments exist for MFIs to become FFIs:

1. Scaling up to an FFI includes new investment, primarily in the field of the Management and Information System (MIS). The MIS is an issue and it is necessary to have a strong MIS to work as a bank. Also, when installing the new MIS, the conversion of data from the old system to the new one is quite risky since some data may be lost. Additionally, it is necessary to develop the policies and procedures to safely offer the product to clients. Bottom line, the MIS includes a huge amount of

[21] The Mix Market Micro Banking Bulletin no. _________________
[22] Campion Anita and White Victoria, 1999, "Institutional Metamorphosis: Transformation of Microfinance NGOs into Regulated Financial Institutions" Occasional Paper No. 4, Microfinance Network

work to protect yourself and clients as well, and also to work according to Regulations.

2. The tax requirement. The NGOs are not motivated to scale up into an FFI since this would require them to pay additional tax. In general, it is questionable how many NGO MFIs could survive this requirement, since throughout the Region, many NGO MFIs are not fully operational and sustainable. This brings us to a *circulus vitiosus* that NGO MFIs agreeing to the requirement of the regulatory body to pay tax, would not be profitable. However, on the other side, if NGOs are not operationally sustainable, they will not pay profit tax.

3. Finally, there are registration requirements established by the Serbian banking regulations. However, this seems like the least problem since the deposits required as the registration requirement may be used by the FFIs as their on-lending portfolio, i.e., 200.000 Euros for Savings Credit Cooperatives or 2 Mio Euros for a Savings Bank etc.

G) Strategic Partnership between MFIs and FFIs

In choosing a partnership with a bank, MFIs are encouraged to find a bank which is not too large and will thus have enough time for the MFIs operations. Also, the goal would be that the MFI one day merges with this bank which has stimulated and supported its growth. However, in reality, smaller banks often do not have the capacity for this task. Sometimes their Management Information System is not of the best quality. Also, smaller banks have a smaller portfolio, they wish to accrue a larger benefit from the MFIs portfolio.

For the above reasons, some MFIs in Serbia prefer larger banks exactly as a result of a better MIS, and better conditions of work since the relatively small portfolio of the MFI is not so important for the larger bank's benefit. Finally, experience shows that larger banks have proportionally smaller expenses.

Below is a synthesis of the major advantages and shortcomings occurring in the strategic partnership between MFIs and FFIs in Serbia.

The problems in the MFI - FFI partnership are the following:

1. Bank's policy, which creates a dependency on the bank. Namely, depending on the bank's policy, the bank may unilaterally increase the interest rate,
2. Bank's conditions. Namely, depending on the banks conditions, it may not be possible to disburse all the funds. For instance, in the arrangement of the Micro Development Fund with one of the local banks, the bank required a 18% compulsory reserves of the portfolio, which therefore, MDF could not distribute to beneficiaries.
3. Increased expenses, which influence the MFIs sustainability.
4. Duplication of administration. Namely, both the MFI and the bank create a database of clients containing the same information.
5. Time consumption occurs when the a) administration is duplicated, b) client's are informed about the reimbursements, and in the c) actual travel to the bank.

The major advantages of the MFI - FFI partnership are the following:

1. Provides a legal framework for MFI operations,
2. Opens possibilities for further access to capital,
3. Easily applied, although it includes increased expenses.

Following the experience of this partnership so far, the MFIs would like to direct it in the following framework:

1. The MFI becomes one branch of the bank specialized in microcredit,
2. The loans from banks and other financial institutions are obtained under conditions more favorable than the usual commercial conditions,
3. The melting of an NGO into a bank does not result in a mission drift

If the above framework could be accomplished, scaling up of MFIs would result in the increase of access to capital for beneficiaries. Also, scaling-up would mean that MFIs themselves would have an increased access to capital. It looks that scaling-up in parallel includes both of these benefits.

G) Recommendations

Lieberman, Djankov et al.[23] propose three groups of recommendations for NGOs going formal:

1. Ease operating constraints on the existing MFIs,
2. Examine and change the existing banking regulations to encourage small firms' lending,
3. Avoid state-sponsored financial intermediation

Lyman and Lauer[24] give a coherent plan of developing an enabling legal an regulatory environment for microfinance in Serbia, divided on short-term, medium-term and long-term actions. Besides the education and policy awareness-building and the monitoring and supporting of relevant reform initiatives, as well as interim operating strategies, this study propose specific legislative changes in the fields of banking law, NGO law, tax law and the laws related to foreign currency borrowings.

Finally, Littlefield[25] predicts that commercial and state banks will become core providers in building the financial services for the poor.

The Policy Brief accompanying this paper gives recommendations of a two-fold character. One group is for the Serbian authorities and the other one is for donors, interested investing in this field.

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[23] Djankov Simeon, Lieberman Ira, Mukherjee Joyita, and Nenova Tatiana, April 2002, “Going Informal: Benefits and Costs”, World Bank

[24] Lauer Kate and Lyman Timothy, April 2002 “Survey of the Legal and Regulatory Environment for Microfinance Institutions in the Republic of Serbia”

[25] CGAP, Littlefield Elizabeth, May 2004, “Building Financial Systems for the Poor”, Presentation at the MFC Conference, Warsaw, Poland

H) Conclusion

In Serbia, it is possible to use the existing legal infrastructure for microfinance. All MFIs that meet the capital requirement can scale up and register as one of the FFIs, which would provide them a legal framework to operate. This would comply with the worldwide trend on scaling-up into FFIs. For instance, Littlefield[26] found that worldwide "microfinance is melting into the financial sector": unregulated MFIs report to national credit bureaus, MFI clients access international ATM networks, MFI banks issue credit cards, there are 62 partnerships between banks and MFIs in 36 countries, etc.

As the existing legal framework in Serbia includes a number of barriers for MFIs to scale-up, it is necessary to link it with the process of bank restructuring and downscaling, to amend the banking and tax legislation and strengthen the existing strategic partnerships between MFIs and FFIs. In this way, using the existing and new infrastructure, MFIs would increase their access to commercial funding and deposits and thus increase overall access to financial services.

[26] CGAP, Littlefield Elizabeth, May 2004, “Building Financial Systems for the Poor”, Presentation at the MFC Conference, Warsaw, Poland

VI. Resume

There is a big need for microfinancing in Serbia, as approximately one third of the population, that is, 2.5 Mio would be potential beneficiaries. This need will increase even more due to the forthcoming restructuring of the economy and the foreseen downsizing of the employed population. The Serbian government recognizes that microfinance can be a vehicle to overcome such problems and increase employment.

The overall question is would specific microfinance legislation lead to a greater provision of microfinance in Serbia? Both the policy-makers and the practitioners agree that this would be the case. However, the existing microfinance players in Serbia prove that the non-existence of the law does not mean that it is not possible to operate microfinance in Serbia, and thus lead us to conclude that the existing legislative framework can be used for that purpose. In order to improve access to financial services through microfinance, the existing legislation needs amendments, primarily in the fields of banking and tax legislation. However, it is important to carefully draft these amendments since overregulation may hinder the industry in its growth.

Scaling-up includes a number of obstacles. Besides complying with the existing legislation, MFIs need capital for the high costs of transformation. Such costs may hinder the MFIs financial sustainability on the short or medium run and thus make them hesitant to scale-up. However, on the long run scaling-up does not mean only increasing access to financial services to the clients, but also increasing the MFIs access to capital through deposits and commercial funding.

This research proposes a number of recommendations for overcoming obstacles for scaling-up microfinance in Serbia. One group are recommendations for the Serbian authorities and they include: linking of microfinance to bank restructuring, linking of microfinance with bank downscaling, involving the same players in bank restructuring and bank downscaling with scaling-up microfinance, amend the bank legislation, provide tax incentives, strengthen the existing MFI and FFI partnership, consider EU regulations and also the Basel Capital Accords. For donors interested to invest in this field in Serbia, the recommendation is to use the existing legislative framework for microfinance, not asking to create a parallel system which would be in contradiction with the requirements of the National Bank of Serbia in the fields of financial control and supervision.

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