NGO-LED MICROENTERPRISE FINANCE ACTIVITY DESIGN

Submitted to:

USAID/Kiev

on

September 15, 1998

by

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and
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Under the Weidemann MicroServe IQC
Dr. Roberto Castro, COTR, USAID/G/EG/MD
Contract # PCE-0406-I-00-6012-00
Delivery Order: Ukraine

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ACRONYMS

CGAP	Consultative Group to Assist the Poorest
CIDA	Canadian International Development Agency
DAI	Development Alternatives, Inc.
DFID	British Department for International Development
DM	deutsche marks
EBRD	European Bank for Reconstruction and Development
ENI	Eastern Europe and New Independent States
EU TACIS	European Union
FFH	Freedom from Hunger
GDP	Gross Domestic Product
GOU	Government of Ukraine
IFC	International Finance Corporation
IPC	Internationale Projekt Consult GmBH
KfW	Kreditanstalt fuer Wiederaufbau
LGP	Loan guarantee programs
MFA	Microfinance activity
MFI	Microfinance institution
MIS	Management information systems
NBU	National Bank of Ukraine
NGO	Non-governmental organization
NIS	New Independent States
PAEF	Polish American Enterprise Fund
PVO	Private voluntary organization
RFP	Request for proposal
SEA	Subjects of Economic Activities
SME	Small and micro enterprise
TA	Technical assistance
USAID	United States Agency for International Development
WOCCU	World Council of Credit Unions

1. Executive Summary

1.1. Background

The purpose of this assignment was to propose a design for a nontraditional microenterprise finance activity to be led by a non-governmental organization (NGO), for USAID/Ukraine and alternative institutional and funding options, while analyzing lessons learned from similar programs in other transition economies. Also included is a scope of work for the implementing organization that will provide the technical assistance. This is to be used in preparing a request for proposal (RFP). Global and regional best practices were considered in this design, with specific attention to the Eastern Europe and New Independent States (ENI) region.

Privatization and restructuring in the Ukraine has forced its citizens to quickly adjust to a free-market economy, with many former state-controlled enterprises now dealing with market forces by laying off employees. This has forced several million individuals into new activities to provide them with survival income. Even those in the professional ranks have found difficulties in this new market system, and they have added to their income by starting small businesses. This sector of the economy has serious credit needs in the context of "growing" their (small\micro) businesses.

Ukraine's neighboring countries have had similar credit problems, but a number of NGO microfinance activities have proven very successful in such financially-challenged environments. The design team used some of these and other similar models within the transitional economy context, to bring a microfinance design that would be feasible while dealing with a banking system that is experiencing significant capital and structural strains.

Women are a large factor in the microenterprise community; their concern for the family is evidenced by their part-time small business efforts. They should prove to be a reliable source of demand when microcredit funds are made available. In addition, in reviewing some small attempts at women's microfinance in Ukraine, the team found that the women had an excellent repayment record.

1.2. Financial Climate

At present, the Ukrainian banking sector is not addressing the credit needs of small borrowers, and small borrowers simply ignore banks by keeping their money "under the pillow." Banks are not trusted, are very thinly capitalized, and their constituents are large companies, the government, and international organizations. This is not a supportive commercial banking climate for the growth of small and micro enterprises (SMEs); there is a need for a sound microenterprise finance program on a large scale.

Interest rates on commercial loans are from 18 percent to 100 percent in Ukraine, depending on the customer's credit worthiness and type of financial institution (bank, credit union, etc.). These high rates are needed for several reasons including the need to cover substantial risk within a transition economy and the low risk/high return investments in government securities. This is a very sensitive issue with government officials and private sector and the design team discussed it in detail with many groups and individuals.

This paper suggests the formation of a new indigenous NGO to handle microcredit needs on a large scale in Ukraine. This has been done very successfully in similar environments and eliminates the difficulties found in an existing program, however, after visiting and analyzing many programs, the team could not find an NGO that would readily fit the proposed design.

1.3. Lending Parameters

The team visited eight lending programs (excluding the banks interviewed) in Ukraine that help small and medium-sized businesses (generally, these programs provide loans ranging from $7,000 to $1 million). Foreign governments and the international NGO community sponsor these programs. In light of these limitations and the enormous demand for micro loans, it is clear that there is a real need for micro loans in the $1,000 to $2,000 range. An indigenous NGO should either be enabled or established to fill this gap, with the program implementor having flexibility up to $10,000 (USAID's definition of microfinance in the ENI region).

The team recommends the following lending parameters:

- Base the loans on a borrower's character, through references, rather than collateral, since collateral is generally not available and difficult to foreclose on. Personal guarantees from family and friends are often used in Russia and increasingly used in Ukraine.

- Interest rates charged should be high enough to sustain the NGO program, but commercially viable to the borrower so that they can afford to repay the loan. If the interest is to cover administrative costs, inflation, and portfolio losses, it will need to be in the range of 20 percent to 24 percent above the cost of funds.

- Loan terms should not exceed one year and should average in the six-month range.

- A grace period is not recommended. In most SME programs, especially in microcredit, repayment discipline has not been fully developed at this economic level.

- Carefully review larger businesses (i.e., above $15,000 net worth), since they may already qualify for loans greater than $2,000 and can be referred to other SME programs. It was found through interviews that other programs may accept this level of net worth for collateral.

- Borrowers should be registered as legal entities or private entrepreneurs. Loans can be given to individuals or to businesses.

1.4. Pilot Programs

The team proposes establishing a microcredit pilot program at two or three sites, depending on available resources. This approach will allow for the program methodology to be tested on the ground, with systems developed, staff trained, and changes incorporated before rolling out a larger program.

The team recommends using the following criteria to select sites for a microcredit office:

- Strong small business or SME loan programs in the community and a pro-business environment, (e.g. New Biz Net, a business incubator program);

- Existing SME loan programs in the area to serve the NGOs "graduating"(to larger loans) clients, or provide loans to clients that qualify for larger loans; and,

- A well-developed business infrastructure, (e.g. good utilities, adequate roads, effective police, postal systems, etc.).

After visiting more than a dozen *oblasts* in Ukraine and discussing options with Government of Ukraine (GOU) officials, the team suggests Kharkiv in the east, Ivano-Frankivsk in the west, and possibly Sevastopol in the South. In each case, the above criteria would be met, however, there are additional circumstances surrounding these selections. These are as follows:

- The Ivano-Frankivsk *oblast* is a fast-growing tourist area with many microenterprise possibilities. The existing Canadian SME support program in this *oblast* should complement the microcredit NGO with training and consulting services, and possibly help with loans at the next level.

- In the Crimea, Sevastopol is a GOU priority area.

Based primarily on community size and the economic activity level, the team recommends the following loan upper limits:

- $1 million for Kharkiv,
- $600,000 for Ivano-Frankivsk, and
- possibly $ 600,000 for Sevastopol.

In addition, the loan repayment terms on investments of this size should cover operational costs in two to three years, including sufficient loan loss reserves.

It is anticipated that the program would roll out to at least 12 other oblasts over the next four years, with total capital funding required of at least $10 million.

1.5. Structures

The team looked at a number of possibilities for structuring a microenterprise loan program in light of Ukraine's strict laws concerning the type of institution that can give loans to individuals and companies. Only banks, credit unions, or an institution with a presidential decree can legally charge interest on loans. After examining banking laws and other SME loan programs, and discussing options with the legal community, NGOs, and GOU authorities, the team identified the following possibilities for the structure of the loan program:

- Establish an NGO that issues non-interest bearing loans and recapture costs by charging fees for services and training. This program would be possible under the law, but presents many difficulties in administration and would be contrary to policy reform activities encouraging market interest-based lending.

- Use a commercial bank as a lending conduit and become the microenterprise "branch" of another NGO that is already using this method successfully for larger loans. This would be both an expensive way of doing a microcredit program and might not attract a large borrower base since many potential borrowers do not trust banks, (due to a number of well-publicized bank failures), and prefer doing business with cash.

- Credit unions are another possibility since they are experienced in microlending and have established lending regulations, however, they can only lend to their members. This would significantly reduce the size of the proposed borrower base.

- Use a consumer loan law to provide equipment financing

- Employ a governmental Enterpreneurship Support Fund to act as a conduit for microenterprise financing,

- Push for several proposed changes in current banking laws, which would open the door for non-deposit lending institutions to provide loans (see section 5.8).

- Request a Presidential Decree through the proper channels that would allow for the formation of an NGO to provide microenterprise loans but without being able to accept deposits.

At present, the most viable option is latter one, a Presidential Decree. To expedite a significant microlending program and satisfy the growing demand for this type of program on the part of both the GOU and thousands of potential loan recipients, this is the best option. The Western NIS Enterprise Fund has set a precedent for this type of program.

1.6. Loan Capital Sources

The loan capital for revolving funds could come from many sources, once the program is "mature" or has demonstrated a good track record. However, to find the start-up capital for a program of this size there are only a few possibilities. Generally, a US NGO contractor that is familiar with capital formation or a private voluntary organization (PVO) with a large constituency base that can generate substantial funds could be sought to develop lending capital sources. But this program may initially stretch an implementing contractor's capital-raising abilities. It seems more likely that the program could raise additional capital as it matures. In light of these issues and a desire to implement the program in a rapid time frame, the team suggests that the initial loan capital of $2 million should come from USAID, assuming that no other viable source is found.

There are many possibilities for capital funding after the pilot phase has demonstrated the microcredit programs viability. These include:

- Western NIS Enterprise Fund indicated an interest in contributing funds at commercial rates;

- The State Committee of Ukraine for Entrepreneurship Development indicated a willingness to work with a microenterprise program, possibly using some of their funding;

- International organizations, such as PVOs, have become part of such micro programs;

- Other governments have provided funds to successful indigenous micro programs;

- Loans can develop from Ukrainian financial institutions whereby the NGO can work on the interest spread;

- Capital can be generated internally through retained earnings.

The above loan capital sources should allow for the program's roll-out after the pilot phase has demonstrated its success.

In terms of operating costs, USAID has agreed to provide the start-up technical assistance required for the four-year microcredit program. This includes funding for both a U.S. implementing contractor's consulting services and the office costs for program administration in Ukraine, until the program becomes self sufficient.

2. **Background**: **SMEs in Ukraine, 1991 to the present**

The development of the small enterprises in the SME sector in Ukraine accelerated in the early 1990s, when the number of small businesses,[1] which does not including cooperatives, increased by 250 percent, from 19,598 in 1991 to 50,496 in 1992.[2] Since 1992, growth has been more modest. By the end of 1996, there were 93,061 small businesses operating. The 1997 data has combined cooperatives and small businesses; according to this data, there were 135,676 cooperatives and small businesses, which indicates a 140.9 percent increase from 1996.

The geographical composition of small businesses is quite uneven. The highest number of small businesses is in Kiev City, with 8 businesses per each 1,000 in population. Kiev is also first in absolute terms: 21,124 businesses. The next *oblasts* are tied: Lviv and Sevastopol City both have small businesses at a 3.9/1,000 people rate; Kharkiv is in last place with a 3.7/1,000 rate.

These data on small businesses include only legal entities; self-employed and sole proprietors are not included while they account for quite a substantial amount of employment in the widely-defined small business sector: as for the end of 1997, there were 2,346,142 people employed in the small business sector in Ukraine, of which 1,373,250 were employed in legal entities, 89,460 worked on farms, and 883,432 were self-employed or sole proprietors.

Given the current data available, it is difficult to estimate the sector's precise size and employment. On one hand, many registered businesses are not operational for various reasons, (i.e., lack of working capital, etc.), while on the other hand, there are many small and micro businesses operating in the shadow economy. To collect more reliable data on this sector, USAID is commissioning a baseline study of the SME sector in the fall 1998.

Several donors have undertaken efforts to develop the small business sector. These efforts concentrated on:

- Developing business support infrastructure, mainly business support centers, which were established and funded by donors such as USAID, EU TACIS, and the British Know-How Fund;
- Providing financial assistance to the small business sector, usually through different credit lines of which the most important are described below; and,
- Improving the regulatory framework, mainly by providing technical assistance to institutions such as the National Bank of Ukraine or State Committee on Entrepreneurship.

[1] The official definition of small business in Ukraine is somewhat complex. The main criterion is the number of employees according to the type of industry: up to 15 employees in trade, 25 in services, 100 in science, and 200 in construction and industry.

[2] Data are from the Statistics Committee of Ukraine and were provided by the International Finance Corporation.

Several studies on microenterprises in Ukraine have also been conducted. A key reason for these studies is that this sector has possibly the highest share of enterprises that operate in the shadow economy.

According to the "Microcrediting Opportunities in Ukraine,"[3] a study commissioned by the Eurasia Foundation, the aggregate demand for microcredit in Ukraine is estimated to be from $ 50 million to $ 140 million.

The report, "Microenterprise Finance Design for Ukraine: An Option Paper on Various Delivery Mechanisms and Scenarios for a New USAID Microenterprise Finance Program,"[4] which preceded this assignment, describes existing programs that support micro- and small enterprises in Ukraine and reviews different options of launching a USAID-funded Microenterprise Finance Program. The report suggested four options as the most viable in Ukraine. These were to:

- Support the new European Bank of Reconstruction and Development (EBRD) microcredit program;
- Support the existing German-Ukrainian Fund program;
- Support the credit union program;
- Start a new NGO-led microfinance activity.

3. Current Micro-loan Climate in Ukraine: Assessment Findings[5]

The team visited several key institutions in Kiev, Western Ukraine, (Lviv and Ivano Frankivsk), Eastern Ukraine (Kharkiv, Dnepropetrovsk and Zaporizje), and Southern Ukraine (Simferopol, Sevastopol, and Odessa). The team met with representatives of local and regional agencies, business support centers, loan funds, banks, credit unions, business associations, and NGOs. A list of all organizations and persons contacted is included in Annex III.

Research and public opinion polls show that the development climate for micro businesses is still far from favorable. Most businesses complained about excessive taxation and very frequent changes in tax regulation, the number of inspections controlling each business many times a year, and corrupt public officials.

Excessive government control is strictly related to the size of the growing shadow economy. According to a June interview conducted with the Chief of Ukrainian Tax Service, Mr. Mykola Azarov, in terms of total GDP, the shadow economy's share has reached 60 percent.[6]

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[3] Project Consulting Group, "Microcrediting Opportunities in Ukraine: A Research Report," commissioned by the Eurasia Foundation from the, December 1996.

[4] Novick, Paul, Barry Lennon, and Colleen Green, "Microenterprise Finance Design for Ukraine. Option Paper on Various Delivery Mechanisms and Scenarios for a New USAID Microenterprise Finance Program," November 1997.

[5] All the data contained in this section are for the period before the mid-August 1998 Russian crisis; the crisis and its influence on the Ukrainian economy can strongly influence the relevant numbers.

Within the shadow economy, there is frequent use of "double books" in accounting, so that the company's "official" books kept for tax purposes downplay any profits earned, while the "grey" or hidden books show a more accurate picture of the business. According to most people interviewed in the course of this assignment, this was seen as a very common practice for most small businesses in Ukraine. A study conducted by the International Finance Corporation[7] (IFC) confirmed this finding; 70 percent of the SMEs that participated in the IFC study do not report at least 30 percent of their profits; 25 percent do not report more than 50 percent of the profits.

3.1. Current Programs

Many donor-funded funds are supporting SMEs, although their activity differs in different regions of Ukraine, they usually have high collateral requirements and, in some cases, there is a long and complex process of reviewing and approving loan applications. The funds also concentrate on loans in amounts greater than $ 10,000 and, in many cases, much greater than this amount.

The following section describes the most important projects in terms of possible cooperation with a future USAID-funded project.

3.1.1. German-Ukrainian Fund: *Kreditanstalt fuer Wiederaufbau*

The German-Ukrainian Fund (*Kreditanstalt fuer Wiederaufbau (KfW)*) started activities in March 1997. The German government provided 10 million deutsche marks (DM) in capital. *Internationale Projekt Consult GmBH* (IPC), a German consulting firm, manages the Fund. The Fund is working through selected Ukrainian banks. IPC hires young people, trains them, and then posts them in the cooperating banks.

The Fund's activity is very highly regarded because of its efficiency and very flexible approach. The loan officers assess a client's ability to repay not only on the basis of official books, but also on the basis of unofficial ones and, in the case of micro loans, the potential borrower's character.

The Fund offers three types of loans:

- For microenterprises, defined as a company with up to 20 employees, loans are up to 15,000 DM, and the annual interest rate is 23 percent (in DM).[8] The average loan in this category is 8,410 DM.

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[6] "Can Ukraine Avert a Financial Meltdown," *Transition*, World Bank, Washington, DC, June 1998.

[7] "Obstacles to Small Business Lending in Ukraine," IFC, Kiev, 1998.

[8] In this case, as in many credit programs in Ukraine, loan repayments are based on the DM's value. Loans are repaid in either DMs or in hrywna, but always on the basis of the current DM exchange rate.

- For small enterprises (a company with 21 to 250 employees), loans are up to 50,000 DM, and the annual interest rate is 18 percent (in DM). The average loan in this category is 22,972 DM.

- For medium-sized Ukrainian-German joint ventures, loans are given in amounts up to 500,000 DM. The annual interest rate is 13 percent. The average loan in this category is 71,833 DM,

Most loans that the Fund issues are working capital loans. Up to now, the Fund has issued 455 loans for a total value of 11.375 million DM. The Fund has used up most of its capital, so at present, it can disburse only what borrowers repay.

The Fund expects to receive 20 million DM from the National Bank of Ukraine and the Ukrainian Ministry of Finance. The Fund has hired, trained, and placed almost 40 loan officers in Ukrainian banks. The Fund originally started in Kiev, then opened representative offices in Lviv, Dnepropetrovsk, and Zaporyzhye. Its experience in different regions was that, the smaller the city, the smaller the average loan size.

3.1.2. The Western NIS Small Business Fund

The Western NIS Small Business Fund is a part of the Western NIS Enterprise Fund. The Fund has at its disposal $ 5 million for small business loans. The loans are issued in amounts between $ 10,000 and $100,000. The Fund has issued 70 loans totaling $ 3.5 million. The interest rate (in US$) is 25 percent. The Fund is able to lend directly on the basis of a Presidential decree. It has offices in Kiev, Lviv, and Kharkiv. Borrowers must reside in the range of 200 km. from these three cities. It is probable that the Fund has quite a high loss rate and is estimated that about 25 percent to 30 percent of its portfolio is in some state of distress.[9] The Fund plans to cooperate with the new EBRD credit line and with KfW/IPC program.

The Fund is widely perceived as having a conservative lending approach; it reviews only official books and has not been very aggressive in marketing its product.

3.1.3. Local Projects

Many interesting projects are being implemented locally, although their size is usually quite limited. One example is the Ukrainian-Canadian Business Center in Ivano Frankivsk. The Center is funded by Canadian International Development Agency (CIDA) and has a $ 5.5 million budget. Its funds are going to be available until March 2001. The Center provides a broad range of services including business consulting, small business loans, and computer, English and entrepreneurship training. In the future, the Center plans to establish a business incubator.

[9] More accurate data are still not available since the Fund is trying to assess its present portfolio after the Russian crisis.

The loan fund has $ 300,000 in capital and, to date, has issued 40 loans. The average loan size is $ 6,500. Since the Center is not able to lend money directly in a legal way, it has looked for alternative solutions, which sometimes have been temporary because of frequent legislative changes. First, the Center used leasing legislation, (which was only applicable to investment loans); then, because of legal changes, the Center decided to use the consumer credit law. In some cases, the Center uses the more common approach of using collateral on deposit at the local credit union as the basis for issuing a loan. This approach has been adopted when issuing a non-collateralized loan for a group of five people.

3.1.4. Conclusions

Based on the team's research, our conclusion are as follows:

- Most of the funds are targeted to not small but rather medium-sized businesses;

- The ability to approach micro businesses is highly connected to the level of operations, i.e., the closer the fund is to the client and the better rooted it is in the local community, the higher the possibility of reaching small borrowers for loans;

- In terms of numbers and amounts of disbursed loans, the funds that are more successful have a more flexible approach to the client. An interesting part of this approach is looking at the client's "unofficial" as well "official" books. It is possible that most businesses that might be regarded as unprofitable on the basis of official books could prove to be highly profitable when looking at the unofficial books.

- There are also some projects, usually local schemes, which, given the inability to direct lend because of legal restrictions, work in a similar way to the loan guarantee schemes. Examples include some loans issued by the Ivano Frankivsk Business Center. Moreover, two organizations in Lviv, i.e., the Counterpart Meta Incubator and Association "*Soyuz Ukrainok,*" use similar arrangements. These two organizations deposit an amount equal to the amount of a loan into a participating bank, then the bank issues a loan, collateralized by the deposit. The client provides the collateral to the loan fund. The interest on the deposit goes to the fund, while the interest on the loan goes to the bank. Such schemes do not seem to be particularly efficient as the bank takes no risk in issuing a fully-guaranteed loan, while it receives the spread between the loan and deposit interest rate, which normally would go to the fund.

3.2. Proposed Programs

The most interesting proposed program is the new EBRD-funded microcredit line that will be implemented by jointly by Development Alternatives, Inc. (DAI) and IPC. USAID provided $2 million for the technical assistance (TA); EU TACIS will also provide TA funds. The program is scheduled to start in late 1998.

The program budget of 20 million ECUs will be carved out of the SME I facility that EBRD currently has in place. On the basis of the program's performance, the EBRD will allocate more money to it. Funds will be provided to banks on the loan basis of a LIBOR plus 3 percent plus 0.5 percent (an up-front commission cost). Banks can borrow in tranches from $250,000 to $1.5 million. The program's three components are small loans, micro loans, and basic micro loans:

- **Small loans** are from $20,000 to $75,000, with certain loans of up to $125,000. Loans will be disbursed in dollars or *hrywnas*, and can be issued for companies operating in manufacturing, services, and trade. Trading companies can obtain loans for only fixed assets.

- **Micro loans** are up to $20,000, with exceptions up to $30,000.

- **Basic micro loans** are up to $10,000. It will also be possible to lend in cash, in local currency. The loans may be issued on a lump-sum basis, rather than being disbursed against invoices, as is traditional in Ukrainian banks.

All loans will be collateralized; for basic micro loans, personal goods, (such as furniture, audio and video equipment, and clothing), can be taken as a pledge and will be stored in a warehouse. The margin interest rate for micro and small micro loans cannot be over 15 percent.

The EBRD program will initially open offices in Dnepropetrovsk, Lviv, Zaporozhye, Kiev, Donets, and Kharkiv. From these centers, loans can be disbursed both locally and to neighboring regions. With time, more and more centers will be installed in additional regions. Banks already participating in the German-Ukrainian Fund will be the first lenders; in the future, new banks will be invited to cooperate.

3.3. Status of Financial Institutions

The Ukrainian banking sector is still far from being healthy. Capitalization of the banking system is very small; at the end of 1996, the entire banking system's total assets were only $7 billion, (in comparison, this is only half of the size of the assets of Komercni Banka, the biggest Czech bank, in a country with a population five times smaller than Ukraine[10]). The government's financial needs also play a very important role in making banks more interested in buying highly- profitable Treasury bills than in issuing loans. In 1997, commercial banks provided fewer long-term loans to enterprises than in 1994, when inflation was still rampant.[11] The whole sector still suffers from a substantial bad loans portfolio which, at end of 1997, was estimated to account for 21 percent of the total assets of Ukraine's 30 largest banks.[12]

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[10] Landy, Laurie, "Developing Sound Banks in Transitional Economies. Structural Reforms in Ukraine," CASE, Warsaw, Poland, 1997.

[11] "Can Ukraine...," op. cit.

[12] "Can Ukraine...," op. cit.

Another factor (connected with lack of money in the sector and competition for T-bills) is the very high real interest rates. While inflation in 1998 is expected to be equal to 11 to 12 percent, the interest rate of loans in banks (in UAH) is usually between 40 and 60 percent.

Given these conditions, it is not surprising that lending to SMEs, which is typically not very interesting for the banks, remains of low importance to Ukrainian banks. In reality, the approaches of the different banks are quite diverse. Most banks regard lending to this sector as very risky and hardly cost efficient. There are, however, some banks that see the SME sector as their market niche.

Banks, if they are willing to issue a loan to a microenterprise, usually issue only short-term loans. Interestingly, the concept of working capital loans almost does not exist in Ukraine since, according to our information, all loans must be made only on the basis of submitted invoices.[13]

The credit unions are another interesting financial market player. They are quickly developing elements of the Ukrainian financial market. While credit unions can issue loans only to physical persons, many borrowers use these loans to develop their businesses. The interest rate on credit union issued loans is usually similar, although sometimes slightly higher, than that of commercial banks; it is usually between 50 and 84 percent

3.4. Government Policy

Ukrainian government policy toward SMEs remains quite ambiguous. On one hand, government agencies, such as the Committee for Entrepreneurship Development headed by Ms. Alexandra Kuzhel, are trying to lobby for more favorable SME development. On the other hand, on the operational level, other governmental agencies are trying to oppress the small entrepreneurs by controlling them and issuing penalties.

It seems, however, that the government can improve the SME business climate by making incremental changes towards more supportive policies. These changes include issuing a set of Presidential decrees to:

- Introduce more favorable tax regulations for small businesses. According to one potential new tax regulation, all businesses with less than 10 employees and turnover below 125,000 UAH will be taxed on a basis of a 6 percent flat rate tax.
- Reduce the number of licenses needed to conduct business in different areas to 42.
- Limit the role of inspections by establishing procedures.

[13] This is possibly the effect of the National Bank of Ukraine's policy to prevent the banks from bad loans.

3.5. Needs of the Micro Entrepreneur

According to some studies and, particularly, the experience of consultants working intensively with micro entrepreneurs, micro entrepreneurs suffer from the same problems as the rest of the Ukrainian entrepreneurs. The IFC-funded study, "Obstacles to the Small Business Development in Ukraine,"[14] conducted by the Formula Ukrainian Marketing Group in November 1997, for example, surveyed 200 small and medium-sized business owners from Dnepropetrovsk, Lviv, Kharkiv, and Vinnytsia and had the following observations:[15]

- The most important problems faced by the small businesses in day-to-day operations included: high taxes (95 percent of the surveyed business operators mentioned this problem); many different taxes (82 percent); frequently changing tax regulations (70 percent); and frequently changing legislation (60 percent).

- All the SME owners complained extensively about the lengthy, complicated, and expensive process of registering as a business and obtaining the necessary business licenses. According to the survey, to obtain a license, it took micro entrepreneurs, on average, 30 calendar days and the average cost was 277 UAH (US$ 141). While the figures for registration were 35 calendar days and 648 UAH (US$ 328), respectively

- Another, even more important problem is the very frequent inspection of businesses that are organized by different government agencies. On average, surveyed businesses experienced 78 inspections yearly and 68 inquiries that required a written response. Each manager had to spend two days per week on inspection issues; these inspections cost each business 4,200 UAH annually.

- Only 17 percent of the surveyed businessmen were willing to discuss the issue of corrupt public officials. This, in connection with the other indicators, could indicate that there is a substantial amount of corruption among public officials.

These problems highlight excessive government interventions in daily business activities. The importance of these problems was confirmed in the team's interviews in Kiev and in other regions visited.

Another interesting issue for the microentrepreneur is access to bank financing. According to the above-mentioned IFC study, only 17 percent of SME owners surveyed complained about a lack of access to credit. This small percentage seems interesting and quite out of place given the need for credit in most businesses. With the Ukrainian banking sector undeveloped and undercapitalized, and real interest rates[16] extremely high, one would expect that difficult access to credit would be an important barrier to microenterprise development.

[14] "Obstacles to Small Business," op. cit.

[15] This survey was conducted almost one year ago. Since then, licensing procedures, in particular, have been simplified and in the team's field visits, we did not hear any complaints about them.

[16] While inflation in 1998 is expected to be equal to 12 percent, the interest rate of loans in banks (in UAH) is usually between 40 and 60 percent, and in credit unions between 50 and 84 percent.

Business associations that the team met with expressed ambiguous opinions about a microfinance program. Some thought that loans of an average value of $2,000 were too low for the businesses they knew; however, this also indicated that many associations members that they knew would be interested in getting even such a small loan.

3.6. Gender Issues

Although no explicit barriers to credit exist for women under Ukrainian law, the team's discussions with local observers indicated that women can experience certain challenges with respect to obtaining business information and training, demonstrating creditworthiness to financial institutions, and providing collateral to lenders.

Ukrainian women have traditionally exercised control over family finances, while the men have operated business enterprises; this situation is similar for women and men elsewhere in the former Soviet Union. As a result, Ukrainian women are more likely to obtain financial advice and information from friends and neighbors rather than from established financial institutions, whereas men would be more likely to have existing relationships with the financial institutions. Accordingly, women are less likely to feel comfortable approaching a commercial bank for loans, and banks consider women poorer credit risks in view of their family responsibilities and limited business experience outside of the home. For example, commercial bank loan applications in Ukraine typically include inquiries regarding marital status and offspring. Banks generally consider women with children or married women without children but within childbearing years to be riskier borrowers. With respect to collateral issues, a main sources of small business loan collateral is real estate. When an apartment is privatized, the man of the household typically takes the property in his name, so that a husband would need to assign his right to the apartment to collateralize a loan for his wife. More frequent, however, is that a husband would grant a security interest in the property to secure a loan to himself, negating any opportunity for the wife to use the property as collateral for a loan. Furthermore, divorced women are more likely to have no property because apartments, upon divorce, continue to be held by the legal owner, typically the man.

Given these constraints for women, the microfinance program design should allow for collateral types that are more likely to be held by women, such as jewelry, and should work through an NGO entity that reaches women clients, rather than a lending institution. Finally, some form of training should be available to women borrowers to supplement their more traditional sources of business and legal information.

<u>Special Needs of Women Entrepreneurs</u>

According to local observers, women are not subject to explicit barriers to credit under Ukrainian law; however, women have more difficulty obtaining business and financial information, demonstrating creditworthiness to financial institutions, and providing suitable collateral to lenders (Galbraith). All three of these special issues women entrepreneurs encounter stem from women's generally limited experience and participation in Ukrainian enterprise.

Ukrainian women have, as have their counterparts elsewhere in the former Soviet Union, traditionally exercised control over family finances, while the men have typically operated business enterprises. As a result, women in Ukraine are more likely to obtain financial advice and information from friends and neighbors rather than established financial institutions with which men would traditionally have contact in their daily work. This division of labor has resulted in a strained relationship between women and traditional sources of commercial finance: (1) women are less likely to feel comfortable approaching commercial banks for loans, and (2) banks consider women poorer credit risks in view of their family responsibilities and limited business experience outside of the home. An example of the latter arises in Ukrainian commercial bank loan applications that typically include inquiries regarding marital status and offspring. Women with children, or married women without children but within childbearing years, are generally considered to be riskier borrowers by banks presumably because of the additional demands for time and conflicting priorities children and husbands can create. A microfinance program could become more accessible to women borrowers by using an NGO as the entity that works directly with the borrowers and views women's familial commitments as a source of stability and responsibility. The program could also recommend to women borrowers participation in a business training and self-esteem programs, such as the training program already provided by Winrock International.

Ukrainian women's lack of personal business acumen can also hinder their ability to provide commercial lenders with collateral to bolster their creditworthiness. One of the main sources of small business loan collateral is real estate. When an apartment is privatized, the man of the household typically registers the property in his name alone. This would require a husband to assign his right to the apartment to collateralize any loan obtained by his wife. More frequently, however, a husband would grant a security interest in the property to secure a loan for himself, negating any opportunity for his wife to use the property as collateral for her own purposes. Furthermore, divorced women are more likely to have no property because upon divorce apartments continue to be held by the legal owner, typically the man. In keeping with the above, a microfinance program could offer unsecured loans with other forms of credit enhancement, such guaranties or peer group support. If collateral were required for certain borrowers under certain conditions, a microfinance program could require collateral types more likely to be held by women, such as jewelry.

4. Useful Experiences

4.1. Loan Guarantee Schemes[17]

4.2.

As mentioned above, SMEs face a key obstacle in obtaining access to credit: The lack of adequate collateral. However, this obstacle can be overcome by using loan guarantee programs (LGPs). The team found that, except for very local and very limited initiatives, no LGPs exist in Ukraine. There is, however, a project to establish such a fund with the support of the Ukrainian Government Fund for Entrepreneurship Support and its regional branches. The Ukrainian Government will provide capital funds, with technical assistance from the Canadian

[17] A more detailed description of loan guarantee funds is provided in an annex.

Development Bank. Negotiations to establish the fund are already quite advanced, (three cooperating banks have already been chosen), but since the fund's capital is to come from the Ukrainian budget, its start date is unknown.

Demand for loan guarantees in Ukraine seems to be moderate mostly because of the poor condition of the local banking sector and very high interest rates. As lending grows to the SME sector, it is predicted that this demand would increase. Although the difficulty in accessing credit was not regarded as the most important barrier to running a business in the above-mentioned survey, this may be due to the fact that the amount of official lending, (i.e., through banks or credit unions), to SMEs and particularly microenterprises is still very small so that some entrepreneurs might not even have considered the possibility of accessing a bank loan.

The team proposes that it might be beneficial to attract another institution to guarantee micro-loans issued under the proposed program. Potential advantages are as follows:

- Providing a guarantee for the part of the loan issued will substantially decrease lending risk and may possibly decrease the interest rate charged, and

- Loans offered with a partial guarantee will be more interesting for the potential borrowers than fully collateralized loans.

If this is going to happen the loans must not be 100 percent-guaranteed; typically, in such programs worldwide, the guarantee covers between 50 and 70 percent of the loan value. The team recommends that a loan portfolio guarantee program would be more applicable that a model based on guaranteeing individual loans. By guaranteeing individual loans, each loan application is reviewed by the institution that is offering guarantees, independent from the lending institutions. The double evaluation process substantially decreases risk, but might be perceived as time consuming and even cumbersome for such small loans. In the loan portfolio guarantee program, individual loan applications are not reviewed by the guaranteeing institutions, but a guarantee is issued for the entire loan portfolio. The most known and respected LGP of this type is the USAID Loan Portfolio Guarantee Program. Such programs work quite well if two conditions are met:

- The lending institution is subject to a very thorough audit, ordered by the USAID, and,

- If the audit result is satisfactory, then the portfolio guarantee agreement is signed. If any loan from the portfolio defaults, USAID carefully checks to see if the internal banking rules and agreement provisions have been respected when the loan was issued. If any rules were broken or procedures not followed, the guarantee is not paid.

The LGP's very nature, with very strict and formal procedures, implies that it is usually, or almost entirely, applicable to banking institutions. It is difficult to say if it can be applied to an NGO microfinance program in Ukraine.

4.2. Solidarity Groups

In microfinance programs, loans are often issued to so-called solidarity groups. Such an approach is also used by two programs described in more detail in section 4.4, below, the Opportunity International Program in Russia and Fundusz Mikro in Poland. In such cases, loans are issued to group members and guaranteed by all the members.

There are several advantages of such approach:

- Decreased loan risk - group members usually know each other quite well and can apply pressure for timely loan repayment;
- Smaller number of borrowers/guarantors to assess;
- Easier project monitoring as group members usually live close to each other; and,
- Reduced amount of paperwork - i.e., signing loan agreements, and guarantee agreements.

Concurrently, however, implementing the solidarity groups concept requires certain conditions to be fulfilled. These include.:

- An adequate legal framework in place to allow group lending;
- Certain procedures in place to assess common risk for the group members, e.g., if all the group members run the same type of business then they take the same type of risk;

4.3. Regional Approaches

In many countries, efforts to develop small businesses are undertaken on the local or regional level. In many situations, it is the local government that either initiates or supports this type of development. In Ukraine, the team found that both regional authorities (*oblast*) and town municipalities in most of the places visited expressed an interest in supporting this sector of the economy.

Because of the difficult situation of Ukrainian government institutions, there are not very many examples of regional attempts to improve financial situation of the small enterprises. One positive example is the Lviv Business Support Fund that was established by the Lviv Oblast Administration. The Fund aims to support SMEs in the Lviv Oblast. The Fund's 1998 budget was 200,000 UAH (approximately US$ 95,000); the 1999 budget should be about the same size. The Fund provides interest-free loans and grants, since, according to the existing legal regulations, it cannot charge any interest on loans. This year, the Fund issued two loans with a total value of 140,000 UAH and one grant for 10,000 UAH. Information about the fund has been distributed through the local administration (*rayon*) and 620 projects have been discussed. The loan committee makes the final decision as to which projects receive loans. The committee includes consultants, and representatives of the *oblast* and city administration, business community, and business support organizations.

Given this situation, the team made the following observations:

- Issuing interest-free loans and grants when bank loans are hardly accessible and bank loan interest rates are extremely high must be creating a huge loan demand in the face of very limited loan funds.

- Having public officials administer the Fund creates a situation that is ripe for corruption.[18] We recommend that public administrators supervise this type of project rather than directly manage it.[19]

- It is very difficult to make a sensible decision about the most-deserving loan applications when there are 200 loan applications for each loan. To remedy this situation, application criteria should be more precisely designed, e.g., support should be available for a very specific group of enterprises. Consideration should also be made to using the limited funds available to develop business support infrastructure rather than for specific projects and/or businesses.

The team found that the regional approach for providing loans to SMEs can be very useful and helpful. A good example is the cooperation between the Ukrainian-Canadian Business Service Center and both local and regional governments. Both the Ivano-Frankivsk *oblast* and city administration are shareholders in the business center, their representatives are loan committee members, the city has provided free office space for the Center while *the oblast* administration provides free transportation in the *oblast* are for Center employees.

4.4. Success Stories from Poland and Russia

4.4.1. Poland: Fundusz Mikro

[18] The team did not observe any corruption taking place, but the situation appears to be one that could give rise to corruption.

[19] For example, the team found that Fund's management was not well-informed about similar SME loan activities and did not know about institutions such as the regional branches of KfW and Western NIS funds.

The Fundusz Mikro[20] in Poland is an interesting example of very successful microcredit scheme. Fundusz Mikro started its operation in 1994 and disbursed its first loan in February 1995. It was founded by the Polish American Enterprise Fund (PAEF). The PAEF received a USAID grant of $ 4 million for operating expenses of the micro loan fund. The PAEF has founded an American not-for-profit company, Microfund Inc., and provided the company with a loan of $ 20 million. Microfund, in turn, founded Fundusz Mikro, a Polish limited liability company.

At present, Fundusz Mikro is operating through 29 local branches throughout Poland. Through the end of May 1998, it has issued 14,777 loans with a total value of $ 24.6 million; the average loan size was $ 1,665. The outstanding balance is $ 9.7 million. The default rate is 1.35 percent, while the delinquency rate is 2.55 percent. Working capital loans account for 45 percent of the portfolio and investment loans account for 55 percent. Of all loans issued, 54 percent are for businesses operating in trade, 35 percent in services, and 11 percent in production.

About 80 percent of the Fundusz Mikro loans are group loans to four to seven microenterprises, each of which agrees to guarantee each others' obligations. The enterprises that apply for loan do not provide collateral; they must provide at least three personal guarantors. The interest rates charged by Fundusz Mikro are slightly higher than those charged in Polish commercial banks and, depending on the number of borrowers, vary between from 29 percent, (for group of four to seven borrowers), to 37 percent, (for a single borrower). For comparison purposes, rates in commercial banks are usually between 24 percent and 30 percent.

The enterprise/person applying for loan should:

- Be registered for at least three months previously,
- Be profitable and should demonstrate positive cash flow for at least the last three months,
- Employ not more than 10 people, and,
- Be unable to access appropriate bank credit and should not be indebted.

The success of Fundusz Mikro was due to the following factors:

- Charismatic leadership in addition to the committed staff,
- Detailed credit analysis and administrative procedures,
- Very good marketing and public relations activity,[21] and,
- The organization's ambitious and challenging mission.[22]

[20] This information on the Fundusz Mikro is based on the following documents: "Fundusz Mikro Annual Report for the Year 1997," "Fundusz Mikro," a presentation by Rosalind Copisarow on The Third National Small and Medium Enterprise Conference in Warsaw, Poland, on June 16-17, 1998, and internal documents kindly provided by Fundusz Mikro.

[21] Thanks to this, Fundusz Mikro has managed to benefit from a Ministry of Finance exemption from paying stamp duty and VAT on loans issued.

[22] The mission is to be the premier microlending institution in Poland, one of the leading microlending institutions in the world, and contribute to the advancement of the global microlending industry.

4.4.2.1.1. Russia: Opportunities International

The Opportunity International program in Russia began in 1994, and operates in five cities: Nizhny Novgorod, Novgorod, Rostov-on-Don, Saratov, and Voronegh. The partner NGOs in these cities provide local small businesses with training on business issues, consulting services, and micro loans. The average loan size is about $ 1,600. Approximately 3,500 loans, with a total value of $ 5.5 million have been loaned to date. The program's default rate is about 5 percent.

The program has three different components: group loans with an average value of between $300 and $700, individual loans with an average value of $6,000, and a leasing program. The average value of leased equipment is $20,000.

The majority of the loans are the group loans. The interest rate for both individual and group loans is 5 percent monthly (in rubles) and for the leasing program 18 percent annually (in US$). For both group and individual loans, personal guarantors are used; for the leasing program, leased equipment serves as collateral.[23]

All registered economical entities can benefit from the program, including both legal entities and single traders.

From the legal point of view in Russia, it is absolute legal to issue loans on the basis of owned resources as opposed to credits issued from savings: the latter activity is licensed.

4.5. Possible cooperation with existing USAID programs

To provide maximum synergetic effect, the team recommends that the future microfinance program closely cooperate with existing USAID-funded programs. Such cooperation could occur in the following areas:

- Changing the legal environment to make it possible to issue loans by a non-banking institutions, through close cooperation with the regulatory reform program. In particular, it would be extremely helpful to have legislation that enables the creation of many microfinance institutions (MFIs) that fulfill certain criteria,
- The local SME-supported USAID-funded projects could provide advice to the startup NGO MFI concerning possible locations based on the most supportive environment and interest in micro-loans, and
- When the project is operational, neighboring USAID-funded local projects (particularly business centers) could promote the existence of microloan schemes and business centers could also assess credibility of future clients.

[23] These data apply to the situation before the Russian crisis in August 1998.

5. Analysis of Structuring Options

5.1 Introduction

The Ukrainian legal system is in the midst of continual change as the country moves to a democracy with a functioning market economy. Among observers of Eastern European legal systems, Ukraine is widely regarded as one of the least-developed and most tightly regulated. The old Soviet law still governs certain important commercial relationships to some degree, such as certain lending transactions, which necessitates structuring around often paternalistic legal and regulatory controls.

In the most basic terms, Ukrainian law stems from three sources:

1. The Ukrainian legislature, or *Verkhovna Rada*, passes codes or statutory law.

2. The President can issue decrees regarding areas not governed by existing law while submitting at the same time draft legislation with respect thereto. (See "Ukraine Law Digest" contained in <u>Martindale-Hubbell Law Digest</u>, 1998 edition, p.1 ("Digest") Such a decree will take effect within 30 days of issuance unless action with respect to the draft law is taken by the Rada prior to such time. ("Digest," p.1) Legislative statutes take precedent over presidential decrees.

3. Arms of the government, such as the National Bank of Ukraine (NBU), Ukraine's central bank, can issue orders or regulations in keeping with their delegated power.

This section of the report addresses legal issues and was prepared based on interviews and meetings conducted, and materials obtained during the assessment. The author of this section (Jan Siok) is not licensed to practice law in Ukraine and has relied on the accuracy, authenticity and completeness of the materials and information, both in oral and written forms, supplied to her, including information and materials supplied in translation. The report is therefore not a legal opinion with respect to questions of Ukrainian law. The report is intended to present an analysis of the issues set forth in the scope of work for the above-described mission and is not intended to present an exhaustive discussion of all possibly relevant legal issues with respect to structuring a microfinance program in Ukraine. Advice of qualified local counsel is recommended with respect to the implementation of this report's recommendations.

<u>Non-Interest Loans pursuant to Civil Code</u>

Legal Framework

I. Governing Law

Pursuant to Part 32, Article 374 of the Civil Code, legal and physical entities can lend as a "loan," as opposed to a "credit" provided by a registered commercial bank, local currency on a non-interest basis to other legal and physical entities. (See IFC Memo, "Non-Interest Loans

Under the Civil Code.") A physical or legal entity cannot on-lend funds borrowed from bank, (Burhan).

II. Structure

Under this provision, an NGO could provide loans on a no-interest basis and obtain income from mandatory consulting services, marked up to include an imputed interest rate of the loan, provided under a separate agreement. A security agreement could create a security interest in collateral to secure payment of both the non-interest loan and the consulting fees.

Analysis

Lending pursuant to the civil code is a structure used by microfinance programs in other parts of Eastern Europe. In Poland, the civil code allows for loans to be extended by legal entities from their own funds to other legal entities or physical persons (Jaczewski). In contrast, Polish financial institutions can lend funds obtained as deposits (Jaczewski). A discussion with Krzysztof Jaczewski at Fundusz Mikro indicates that this aspect of the Polish civil code allows the Polish microfinance program to extend loans on an interest basis without a banking license. Loan funds, however, must be in the form of a grant because the program cannot use borrowed funds to on-lend to microfinance borrowers (Jaczewski).

A Ukrainian attorney consulted indicated that the no-interest loans under the Ukrainian civil code offers the closest proxy to the Polish structure available under Ukrainian law (Burhan). This no-interest loan structure obviously presents a benefit in that the NGO can lend funds directly to the borrowers and yet avoid licensing requirements. The consulting fee scheme, however, is difficult to explain and can be offensive to borrowers who may not want consulting services. This structure is better suited to a small program with a substantial training component. In a large-scale program with a primary objective to disburse funds widely, the mechanism is complicated for borrowers to understand and potentially difficult for them to accept.

<u>Structure Based on Credit Union Law</u>

Legal Framework

I. Governing Law

No legislation currently governs the formation and operation of credit unions in Ukraine. The World Council of Credit Unions (WOCCU), with the help of the NBU and another credit union industry group, UNASCU, prepared a draft credit union statute that is, as of the date of this report, under discussion in financial institution and legal circles; however, according to financial industry observers, there is no strong support for the draft that would make its adoption likely in the foreseeable future. Until then, credit unions are formed and governed primarily under the following two governmental documents: (1) Temporary Statement on Credit Unions in Ukraine No. 377/93 dated September 20, 1993 by order of the President of Ukraine ("Statement"), and (2) NBU Order No. 41 dated March 17, 1998 ("Order"), both of which are read in conjunction with the law "On the Civic Associations" No. 2460-XII dated as of June 16, 1992 ("Civic Associations").

The lack of clear legislative directives with respect to credit unions has led to an uncertain supervisory and regulatory environment for their operations. Discussions with NBU officials and those involved in the promotion of credit unions indicated that there is no single regulatory and supervisory body for credit unions and, as such, they are subject to interference from an unlimited number of authorities, not the least of which, according to anecdotal information, has been local tax authorities. As one of the few non-bank financial institutions in Ukraine, credit unions are also subject, to some extent, to supervision by the NBU, including the NBU's initial review and approval of all new credit unions' organizational documents. A description of the credit union structure follows:

II. Formation and Membership

Credit unions are formed as non-profit legal entities and must be registered with the appropriate *oblast*, *raion*, or city authorities depending upon the membership scope of a given credit union (Gerasimenko; Civic Associations, Articles 1, 9, 14). Credit unions must have at least 50 members, each of whom must be physical persons at least 18 years old and residing in Ukraine, but they need not be legal citizens of Ukraine (Statement, paras. 4,7). Each member holds one vote despite his/her percentage share in the credit union (Statement, para. 3). Unlike other civic associations that can be formed as national or international entities, a credit union must be organized and operated on a local basis (Statement, para. 6). The members must be drawn together with a common purpose or tie, such as profession, geographical location, or religious affiliations (Statement, para. 5).

Credit unions are formed by a written agreement executed by each of the members and governed according to the credit union by-laws adopted by the members (Statement, paras. 7, 8). The NBU has promulgated a form of model by-laws for credit unions pursuant to the Order. The by-laws describe the rights and obligations of each member, entry fee and share payments, lending policy, and liquidation procedure, among other issues (Statement, para. 8). Prior to the credit union registration with the appropriate state or local authority, the regional office of the NBU must approve the credit union by-laws pursuant to the Order. The Order states that the NBU regional office will review, in particular, the number of members, identify the sources of funds for the loan fund, reserve fund and any other funds, the nature of credit operations, and the credit union governing and administrative bodies (Order, Section I).

III. Powers

Credit unions have the power to engage in, among other things, the giving of loans, including mortgage loans, to its members, the taking of "depository payments" from members, the giving of dividends on members' shares, the establishing of funds, such as the loan fund and reserve fund, the guaranteeing of member obligations to third parties, and the lending of excess "capital" to other credit unions, credit union associations (Statement, para. 11). In strict legal terms, credit unions cannot take deposits as they are defined under Ukrainian legislation

(Gerasimenko). Instead, credit unions deal in member fees designated as either of the "deposit type" or "share type," however, member fees of the deposit type are, for all intents and purposes, deposits (Gerasimenko). Credit unions are prohibited from founding commercial legal entities except those with respect to communications media, and are prohibited from business activities except for the sales of goods with the credit union logo (Statement, para. 11). Credit unions are expressly prohibited from performing activities not described in the Statement (Statement, para. 11).

IV. Governance

A credit union is governed by a general meeting of all its members with respect to changes in the credit union's organizational documents and the credit union's liquidation (Statement, para. 12). Loan and deposit policies are determined by a board of directors chosen from among the credit union members (Gerasimenko). A credit committee that determines credit decisions and a supervisory committee, which is independent from other committee, are also formed from the credit union members (Gerasimenko). Executive management is typically hired to undertake day-to-day management of the credit union (Gerasiminko).

V. Assets and Income; Loan Funds

The property of a credit union consists of the entry fees, deposits, interest income derived from lending operations, income from the sale of goods bearing the credit union logo, income earned from the arrangement of lectures and programs, and other income as allowed by law (Statement, para. 13). In addition to the loan fund lent to members, the credit union should establish a Reserve Fund (Statement, para. 15, 16). The Reserve Fund, created at the time of formation by the members, covers loan losses and must be within a range of 5 percent to 15 percent of a credit union's "capital" (Statement, para 15). The Statement does not include any restrictions on the source of the Reserve Fund. In contrast, the Loan Fund is stipulated to consist of member entry fees and member "deposits" and, less expressly, from donations from physical persons and legal entities (Statement, para. 16).

This language creates uncertainty as to whether a credit union can on-lend borrowed funds. Credit unions are expressly allowed to lend funds to other credit unions; however, there is no language allowing credit unions to take on debt from a financial institution, and powers beyond those expressed in paragraph 11 of the Statement have been expressly prohibited, as discussed above. In contrast, under paragraph 13 of the Statement, credit union property can include "incomes gained from activities allowed by Laws," which arguably may allow for funds sourced from a bank (Burhan). In any event, industry observers confirm that on-lending of borrowed funds does occur (Gerasimenko). An accepted way to effect such on-lending is for an entity to provide temporary financial assistance to the credit union in the form of loans rolling over within three years on a no interest basis to avoid a currently 30 percent tax at the credit union level (Gerasimenko). This structure does not easily accommodate working with funds from banks.

VI. Distributions and Liquidation

Profits are divided among members according to each member's share, and upon withdrawal of membership, the credit union "should pay to the member the equivalent of his share in total property" of the credit union (Statement, para. 17). The credit union members determine their rights in the event of a liquidation in as determined in the by-laws. No limitation is made regarding the manner of distribution among members in a liquidation; however, the Reserve Fund is available to members only in the case of a liquidation (Statement, para. 15).

VII. Lending Activities

Within certain limitations, lending mechanics and terms are generally more flexible for smaller borrowers in credit unions than those of commercial banks due primarily to the credit union's relatively limited "depositor" base, smaller loan size and borrower profile. Loans can be made in short and long terms in cash or through credits to a member's current account (Order, Section II). There is no general requirement to obtain collateral under existing credit union, which allows credit unions to tailor their lending policies to the needs of their borrowers. According to industry observers, credit unions may lend only in local currency, which is in keeping with credit unions particular borrower base. The NBU in its Order has stipulated four limitations of credit union lending activity: (1) new loans cannot be granted to a member with "overdue debts," (2) the total amount of loans of any given credit union cannot exceed its Loan Fund, (3) the excess of a loan exceeding the total "money contribution" of a member must be secured, and (4) no single loan can exceed 10 percent of the Loan Fund (Order, Section II).

These restrictions appear to present no issues for a microfinance program such as the one contemplated. The collateral requirement in section (3) can be met by obtaining personal guaranties from other members of credit union (Gerasimenko; G. Aksionov). In addition, no single microloan would ever exceed 10 percent of the Loan Fund at the projected funding levels, and program policy would restrict loans to those overdue on existing loans from the credit union or another debtor. However, the limitation of loans to the amount of the Loan Fund could create an additional restriction against on-lending funds if such borrowed funds could not be classified as part of the Loan Fund.

Analysis

The credit union structure offers the following benefits:

- Fewer authorizations are required: There is no requirement to obtain an NBU banking license and submit to the time-consuming bank licensing procedure. The structure already allows for cash-based lending in small loan sizes.

- Limited NBU involvement: The NBU does not have clear supervisory authority over credit unions, which allows credit unions greater freedom to establish their own supervisory process and regulatory body. This also limits credit unions' need to adhere to a complex and often internally-inconsistent body of banking law.

- Shorter lead time: The credit union structure is in place and has been embraced by some microfinance providers such as the International Renaissance Foundation. As such, the precedent exists for the structure's use as a microfinance mechanism. Numerous credit unions have been established throughout Ukraine, and their registration process is not tied to any one jurisdiction or office. A regional officer very difficult to deal with could be avoided.

- Capability to go regional: Credit unions are entities of *oblast* or city registration and a credit union can be expanded and registered in up to half the *oblasts* in Ukraine. Credit unions offer a nice balance of community lending structure with the potential to expand throughout regions. Through associations, credit unions can create inter-lending schemes to fund each other.

- Tax benefits: Credit unions are non-profit NGOs (albeit subject to profit tax in certain circumstances). that do not pay VAT tax and enjoy an exclusion of income derived from lending activity.

While significant, these benefits are outweighed by the following three primary concerns:

1. Fiduciary responsibility: The credit union has a responsibility with respect to member funds. A failure of the credit union resulting in a loss of deposits could harm Ukrainian citizens and USAID's reputation. The credit union could be structured to require minimal entry fees and no further membership funds; the credit union would be in any event dependent upon grants or temporary financial assistance, and possibly, borrowed funds for loan funds.

2. Uncertain on-lending capability: As discussed above, credit unions can on-lend funds provided to it on a non-interest basis, but less certainty in the industry exists with respect to the availability of on-lending funds obtained on an interest basis from commercial banks.

3. Lending to members: Under the terms of the Statement, credit unions can lend to members only, restricting their legal lending capacity to physical persons. In an effort to channel funds to legal entities, credit union borrowers can lend on a non-interest basis to their separately-formed businesses. This way of channeling funds to legal entities does not allow the legal entity to deduct the interest expense on the loan (Palyvoda). Despite this wrinkle, certain credit unions routinely lend to funds to its members to be used ultimately by a legal entity as a way of making the legal structure of credit union fit the microenterprise borrowing environment. In addition, credit unions require that all borrowers become members. This requires the borrower to invest time in the organization and necessitates that the borrower understand its rights and obligations with respect to the credit union. This may be unattractive to certain microenterprise owners who would have no time or interest in such involvement. The credit union structure works best as an overlay onto an existing community structure, such as a church group, which limits penetration of the program into a widespread area.

Accordingly, the credit union structure provides a strong basis for a microenterprise program to be implemented in existing community bases but is less useful for a national program aimed at developing businesses.

Banking Conduit Approach

Legal Framework

I. Governing Law

Pursuant to the primary legislation governing the commercial banking sector and the role of the NBU, "On Banks and Banking Activities," dated March 20, 1991, as amended, ("Banking Statute"), banks are the only legal entities that can engage in credit activities unless legislation provides otherwise (Banking Statute, Art. 3). Although not apparently defined in the Banking Statute itself, "credits" are commonly defined as loans provided on an interest basis by commercial banks licensed by the NBU to take deposits. (Burhan. See IFC Memo, "Non-Interest Loans Under the Civil Code" for discussion of credits and loans.) Current insurance legislation allows registered life insurance companies to extend long-term credits from funds contributed under life insurance policies to finance housing construction (IFC Memo, "Who Can Provide a Credit in Ukraine"). In addition, under a Cabinet of Ministers' Decree, all legal entities, physical persons and registered private entrepreneurs can extend credits within undefined parameters in foreign currency pursuant to a license granted by the NBU for each credit transaction on a case-by-case basis (IFC Memo). Also, credit unions and pawnshops are not licensed by the NBU but generate interest income through lending activity. Despite these exceptions, the concept of a non-bank financial institution that engages in credit activities does not exist under the Banking Statute. Discussions with the Deputy Director of the Lviv branch of the NBU indicated that a non-bank financial institution was created by means of a NBU exemption to Article 3 with power and authority to perform currency transactions and other activities outside of providing credits. Article 3 of the Banking Statute prohibits the NBU from licensing an entity other than a bank to engage in crediting activities.

As a result, the primary method of providing microenterprise finance in the current legal environment in Ukraine that avoids use of credit unions, or even pawnshops, is contracting with a local bank to act as a conduit for funds credited, or lent, to local microenterprises. These programs, by virtue of working through the banking system, are subject to the numerous banking restrictions on credit and cash activities. Pursuant to the "Policy on Procedure for Licensing Banks in Ukraine," No. 77, dated March 27, 1996 ("Licensing Policy"), banks can be licensed to handle all or a part of the activities allowed commercial banks under law. Accordingly, separate licenses are required for the following activities outlined in Section 2 of the Licensing Policy that would be applicable to a conduit program:

1. "cash servicing of customers"
2. "extending credits to legal entities"
3. "extending credits to individuals" and

4. "attracting and investing foreign exchange funds in the domestic market."

These activities are core banking activities under other banking systems; however, the NBU uses the withdrawal of licensing as its primary enforcement method (Gegenheimer). Therefore, not all banks are suitably licensed to handle a conduit program, and any bank selected as part of a conduit program would have to be convinced to obtain a new license itself if it did not already possess the required license.

II. Relationship of Bank, NGO and Borrower

What exactly defines crediting activities is unclear under current banking law. Article 3 of the Banking Statute states that a registered bank may carry out, among other powers, "the attraction and placement of money on deposit and credits." To what extent a legal entity can join forces with a bank and provide para-crediting services and at what point such para-crediting activities cross over to credit operations requiring a license is uncertain. Suffice it to say, Soyuz Ukrainok and Counterpart Meta Center are two banking conduit programs in Ukraine that have moved the majority of crediting services to an NGO. The bank retains disbursement responsibility, but holds no or limited credit risk.

The conduit structure comprises three relationships: (1) NGO and bank; (2) bank and borrower; and (3) NGO and borrower. In general, the NGO deposits funds with a bank to secure loans provided by the bank to borrowers selected by the NGO. In practice, an NGO or newly-formed NGO establishes relationships with microenterprise owners, assesses their credit worthiness through extensive due diligence of their businesses and determines whether and under what terms to lend to the business owner. The bank can either not be involved in the credit selection and structuring process, or the program can be given veto rights with respect to any credit decisions of the bank. The bank then disburses funds to the borrower with either a staff member accompanying the borrower to the bank to reduce the bank's role in the credit process or the borrower is left to negotiate directly with the bank. The borrower typically makes payments directly to the bank. The bank is then responsible for reporting on loan repayment in specified intervals to the NGO. In the event of a default, the bank draws down on the deposit account and the NGO enforces the loan and any collateral rights.

Discussions with staff and legal counsel for Counterpart Meta Center indicate that the following three types of agreements are drafted to govern the three relationships described above:

- First, the bank and NGO relationship is governed by some form of umbrella agreement setting forth, among other things: the bank's agreement to lend to borrowers selected by the NGO; the NGO's agreement to enter into a separate cash collateral agreement for each loan; general procedures, notices and timing for drawdown of the cash collateral account; and bank compensation for services and its reporting requirements.

- Second, a cash collateral or guaranty agreement describes the amount and term of the NGO's cash collateral deposit with respect to a given loan and requires the bank to assign its rights to the NGO under the loan agreement with the borrower in the event of a drawdown under the cash collateral account.

- Third, the borrower and bank enter into a loan agreement and a security agreement, or some combination of the two, setting forth the borrower's obligation to repay the loan and the borrower's grant of a security interest in the collateral in the favor of the bank. The mechanics of reporting and calculating interest accrued on the deposit account is under a separate umbrella agreement between the NGO and bank.

Analysis

The conduit structure presents the following benefits:

- Proven structure: This is a popular scheme for avoiding bank licensure requirements and several programs in Ukraine operate under this structure. Although loan amounts are generally higher under other programs than the proposed microlending program, Soyuz Ukrainok in Lviv lends from USD 500 and USD 2000 in local currency through two progressive local banks. These existing programs have contracted the bulk of the credit activity to the NGOs themselves, leaving the banks to act as cash funnels, and have not run afoul of the NBU.

- Potential for banking changes: Working even in such a restricted nature with the local banks can lead to increasing bank interest in the microfinance market. Successful arrangements such as these can create long-term change in the banking industry.

These benefits are outweighed by the following issues:

- **Banking sector attitude and condition**: With some exceptions, primarily Electron Bank, whose president says she sees microfinance as a source of future larger corporate business, Ukrainian banks are not interested in the microfinance sector due to the high administrative cost of servicing such loans and the low prestige of the sector. Commercial banks in Ukraine have made a living primarily by purchasing governmental debt obligations: few Ukrainian banks actually lend money to enterprises and individuals. Furthermore, the banking industry in Ukraine is severely undercapitalized. Accordingly, finding a national bank or series of local banks interested in such a national program in good financial condition at affordable rates presents a real challenge. The microfinance conduit programs in place are locally-based and set up with one or maybe two banks local to the area. To date, no precedent exists for a large-scale national program.

- **Licensing**: As described above, each bank involved would need to obtain, if it were not already suitably licensed, appropriate licensing to administer a microfinance conduit program. Obtaining such licenses would be a time-consuming and administratively-burdensome task.

As a result of the above, the bank conduit structure does not offer an appropriate option for creating a large-scale, national microfinance program.

Retail Sales Consumer Loan Law

Legal Framework

Under the decree of the Cabinet of Ministers No. 997 dated as of July 1, 1998 ("Consumer Decree"), physical persons can obtain financing for purchases of household items and motor vehicles for terms of up to two years at market interest rates. This law could possibly be used as the basis for a microloan program to offer equipment financing by purchasing goods from local suppliers and selling them on an installment basis to microenterprise borrowers as part of other financing options offered by the microloan program, as done in the Ukrainian-Canadian Business Center in Ivano-Frankivsk.

The Consumer Decree states that consumer loan financing can be provided by "trading operations held by residents and non-residents" (referred to in the Consumer Decree as "Subjects of Economic Activities" ("SEA")) that are (1) "based on state property or property of appropriate territorial community," (2) "of the system of consumer cooperation" approved by the boards of *raion* consumer associations and raion consumer fellowships or are "part of the administrative side of the Ukrainian Cooperative Association," or (3) of "other forms of ownership in accordance with their founding documents" (Consumer Decree, Section 2). Physical persons "including citizens-subjects of entrepreneurial activities which do not acquire a legal entity status" can obtain consumer loan financing from such SEA (Consumer Decree, Section 1). In addition to household goods and supplies, financiable consumer items include "non-food products" such as sewing machines, construction materials, plumbing supplies, personal computers, and "means of transportation" (Consumer Decree, Section 4). To obtain a loan, borrowers must present to the lender certification from employers or, in the case of students, educational institutions, of employment or studies, as applicable (Consumer Decree, Section 6). Upon repayment of the consumer loan, a person can obtain additional certificates for further loans (Consumer Decree, Section 7). The total amount financed should not exceed three months' salary where amortization extends to six months, six months' salary for loans shorter than one year, and an annual salary for loan terms under 24 months (Consumer Decree, Section 11). Interest rates allowable under the law are limited to the rates for financial credits from a bank lending to the SEA (Consumer Decree, Section 9).

Analysis

Although we understand that the Ukrainian-Canadian Business Center provides equipment financing pursuant to the Consumer Decree, the structure is costly and labor-intensive. The program would obtain the equipment or goods and provide financing as an intermediary; however, some borrowers would have limited incentive to finance its purchases through the microfinance program rather than borrow directly from the goods supplier. As with the Ukrainian-Canadian Business Center, this form of financing is best as a supplement to a working capital loan program due to the generally greater success of working capital loan programs.

Lombards or Pawn Shops

Legal Framework

Pawnshops in Ukraine are either state- or privately-owned and operated. Pursuant to Article 378 of the Civil Code, pawnshops issue loans to physical persons only secured by household goods and personal belongings. Terms of lending activities are not clearly defined under the Civil Code; instead reference is made to the Pawnshop Standard Statute passed under the old Soviet regime, a copy of which was unavailable at the time of writing this report. Lombard rates are set by the NBU pursuant to the Banking Statute. Discussions with local attorneys and the NBU indicate that pawnshops are not largely regulated by the NBU.

Analysis

In addition to credit unions and special non-bank financial institutions formed under a presidential decree, pawnshops provide one of the primary means of lending on an interest basis outside of the commercial banking system. The pawnshop structure offers the same benefits of a credit union in offering the ability to lend to physical persons on an interest basis without a lending license, and Lombards specialize in taking security interests in non-traditional collateral such as jewelry and certain precious metals, which is a restricted activity for commercial banks (Burhan). Furthermore, the pawnshop mechanism can be easily replicated nationally. However, pawnshops are formed on a for-profit basis as limited liability companies, and as such would be subject to full taxation (Burhan). As with any trading operation in Ukraine, the pawnshop must clearly state its Lombard status in a sign on the operation's buildings (Burhan). Accordingly, the pawnshop presents potential issues with respect to financial sustainability due to high taxes and image due to signage required.

Ukrainian Foundation for Entrepreneurship Support

Legal Framework

The Ukrainian Foundation for Entrepreneurship Support ("Fund"). operates pursuant to a Presidential Decree that allows it to lend funds on the basis of interest. The Fund is slated to receive government funding equal in amount to 5 percent of the income derived from the privatization of state-run enterprises. In addition, 0.5 percent of the *oblast* budgets are to be dedicated to support entrepreneurs, which may add further funding. To date, no such funding from either source is known to be given and no known loans have been granted.

Analysis

Although eager to collaborate with USAID in a business development program, Fund management has no experience in, or background suitable to, microenterprise. In an upcoming election year, even using the Fund as a funding conduit opens the program to political objectives of the Ukrainian government. This makes the fund an unsuitable funding source or lending mechanism.

Conclusions

1. Push through new lending legislation: As conditionalities to its further advance of funds to Ukraine, the World Bank requires the adoption of new legislation to govern banking activity and the operations of the NBU. Under the existing draft law with respect to banking activity that is currently in the commenting phase, entities that provide credits are subject to NBU licensure either as a commercial bank or a non-bank "credit institution," both of which are envisioned to take deposits and extend credits. Discussions with Gary Gegenheimer, Senior Legal Adviser at the National Bank of Ukraine, indicate that there is some movement toward changing the draft law to delete the repetitious non-bank credit institution concept and to define banks strictly as those entities that both take deposits and lend money. Lenders that would not take deposits would not be considered a bank and would not be subject to banking laws and licensure. According to Gegenheimer, the likelihood of having such a change implemented in the draft banking law is at this point unclear. Assuming the draft law were adopted as such, some form of additional legislation describing the non-depositary lender, its formation, its supervision and governing law would be necessary.

Another way to reach this same point it appears is to amend the Civil Code to allow for loans to be provided by a non-depositary lender with interest, as in Poland. This route could be less preferable because a new law with respect to non-depository lenders could be tailored to fit the needs of USAID's microfinance program. Simplified registration, minimal supervision, and other benefits could be included in the new non-depositary lender law.

In light of the importance of World Bank funding to Ukraine, significant attention will be placed on the draft laws in upcoming months. For example, the World Bank will hold seminars throughout the fall to focus on the proposed legislation and to support its adoption.

2. Seek a Presidential Decree: If the above fails, or proves too time-consuming, USAID should obtain a Presidential Decree to clear the way for an NGO-led microfinance program. Although not providing lasting changes to banking law, the Presidential Decree may provide a solution under a shorter timeframe.

6. Recommendations For Design/Implementation

The following proposed microenterprise finance design assumes that a new NGO can be formed as the result of a Presidential Decree or a change in banking law, as described above under institutional options.

6.1. Start-up (12-18 months)

6.1.1. Other Successful Programs

Microenterprise programs have shown that a learning curve should be allowed for when moving to new locations, and this is especially true when the scope of the program will ultimately be countrywide in terms of replication. The team is therefore suggesting a short term (12-18 months) pilot program, which would provide effective lessons, learned before a roll-out to new communities within Ukraine.

6.1.2. Pilot Phase

The team proposes establishing a new Ukrainian NGO, which would be registered with the GOU. The NGO would be organized to carry out a major effort of microenterprise finance based upon the design of similar programs and it would use lessons learned during its pilot phase for a significant program roll-out. During the pilot phase loans would be less than $10,000 with the programs initial target averaging in the $1,000 to $2,000 range. This NGO would be assisted in its development by a U. S. contractor (a for-profit firm or a PVO, to be determined) that has significant experience in microfinance program implementation.

6.1.3. Pilot Site Selection Criteria

It is recommended that this NGO be assisted in establishing a pilot program of microfinance in two cities, one large (Kharkiv) and one smaller (Ivano-Frankivsk), possibly in early 1999. This approach may give insight into the effect of community size on the program. Other cities can be chosen for the pilot program, but the team suggests these because of a well-developed business support infrastructure (postal service, police, adequate roads, sufficient utilities, etc.), the strong USAID SME programs in the areas, a willingness of government authorities to cooperate, and the clear need for a microenterprise loan program. Synergies from other SME programs, including the Canadian program in Ivano-Frankivsk, include training for clients, access to the next level of loans through reference and exchanging of information/ideas between programs. The contractor would be responsible for short term evaluation and monitoring of this pilot during its first 12 months of activity, after which lessons learned would be rolled out over 3 years to at least 12 more cities, strategically located.

6.1.4. Board of Directors

The team recommends that a Ukrainian board of directors for the new NGO be appointed (or selected) with assistance from the US contractor. At least five individuals would serve on the initial (national) board, with varying backgrounds including at least a successful businessperson, an attorney, an accountant, a banker, and preferably a leader from the NGO SME community. In addition, each loan office would need a local committee of at least three professionals to oversee the program. Before each loan is disbursed, it is recommended that two local committee members and the local manager/lending officer approve (sign off on) the loan. This would avoid certain loan integrity issues, which can develop, e.g. channeling loans to family and friends. At least one local committee member would serve on the national board.

6.1.5. Partner Agreement

This program would include a partner agreement between the NGO and its U.S. contractor partner. The terms of this agreement would include all actions required by both parties, e.g., technical assistance provisions, revolving fund responsibilities, operating budget requirements, personnel needs, program goals, etc. An agreement of this nature requires that as many operational issues as can be anticipated be agreed to in writing before the pilot phase begins. The contractor would have access to such agreements, since they represent experiences recorded by those in the microenterprise loan business over many years. Of course, the agreement must be adapted to issues unique to Ukraine and a local attorney would help in the final design.

6.1.6. Marketing

In terms of the NGO finding possible clients, or loan recipients, the challenge of marketing a program will be communicating its benefits to the target group, i.e., those in need of <u>business</u> loans in the $1,000 to $2,000 range. This can be accomplished with targeted advertising and effective brochures. Word of mouth would bring many possibilities to each microcredit office and once there, a well-informed/trained credit officer would provide sufficient details for loan opportunities. There are successful microenterprise loan programs that have designed targeted marketing plans, which the contractor can procure and tailor to the Ukrainian experience.

6.1.7. Local Management

It is recommended that the program manager (CEO) responsible for the NGO's success have a strong financial background, a good education, evidence of leadership traits, and able to communicate well in both English and Ukrainian. The CEO can then manage staff, liaison effectively with both USAID and the U.S. partner, prepare program analysis, participate in proposal writing and liaison well with the indigenous board of directors. This individual would ultimately be located in Kiev for the development of effective communications/relations with future program participants (loan capital sources), but during the first 18 months most time would be spent in the pilot offices.

Each office would be initially comprised of a loan officer with experience in financial management/credit analysis and a secretary/office manager with a background in a financial organization. A loan officer would ultimately be able to manage up to 100 loans, thus with the total loans outstanding an office would need 4 to 7 loan officers, depending on its loan portfolio size. The loan officer would provide limited training in the context of basic business plan suggestions and provide council when required, e.g., workout late payment problems, provide helpful brochures/reading materials, reference other funding sources when applicable, etc.

The costs for the NGO's office administration would be underwritten by USAID (see funding requirements in Annex IV) over a four-year period. As each office matures, it would become independent of USAID funding, generally two to three years after start-up. The technical assistance provided by the contractor, through USAID funding, would approximate two years for each NGO office.

6.1.8. Loan administration

Each loan recipient would be provided a simple, two-page business plan outline. The plan would include the name, address, phone, nature of current business, reasons for loan, basic cash flow, principal repayment plan, etc. This is necessary to evaluate the circumstances involving the recipient and whether there is a good reason(s) to give the loan. An experienced loan officer can collect information that would reflect the plan's integrity. These loans would not exceed one year, with their length to be determined by the loan officer's judgment related to this type of business. A loan recipient would be able to receive loans from this program in the future after they demonstrate a good credit history.

A legal loan document would be part of any loan package. This document would be drawn up by a Ukrainian attorney and used for each loan recipient, e.g. with the standard document on file in the NGO office and the loan officer simply filling in the blanks (name, address, amount, terms, signature, etc.). The document would be as simple and clear as possible, but enforceable. Country/program specifics would be allowed for when the contractor designs the loan document with the attorney. Other microcredit programs have designed similar documents to which the contractor can refer.

Since these are character-based, rather than collateral-based loans, the loan recipient would be provided with a form to complete that confirms the debtor's character, to be signed by three non-family members. Using character guarantors is consistent with similar programs, but would be flexible during the pilot phase as lessons are learned. In those cases where equipment is being purchased, the equipment could be used as collateral with a separate legal document supplied by the NGO. This document again would be simple, legal, and enforceable.

Basically, loans would be provided to those already in the business for which they are applying. It is important that the debtor have demonstrated sound experience with the skills required as outlined in their plan. New businesses/ideas are generally not incubated through micro loan programs since the risks are much greater.

Women need to participate much more in the Ukrainian financial system and the NGO can be a significant help by providing loans and suggesting/encouraging participation in good training programs. They are a significant and growing part of the micro business community and would be encouraged to apply to the program. The repayment experience of Ukrainian businesswomen has been excellent. When a loan officer feels that collateral is necessary from a client (this needs to be an exception), a woman would be able to use personal effects such as jewelry, since generally she would not have sufficient assets for collateral as explained above (see section 3.6).

The size of a firm requesting a loan up to $2,000 would be considered in making disbursement decisions. Generally, a business with a net worth valued at greater than $15,000 would be reviewed carefully, since there may be other SME programs available to help and also provide them with larger loans because more collateral is available. Below this amount would include the vast majority of microenterprises.

The contractor would prepare an operating manual to be used by the offices selected for the pilot phase. This manual would include loan procedures, personnel policies, examples of forms to be used, reporting requirements, etc. Again, such manuals have been developed by others in the business of microenterprise lending and could be adapted to Ukraine.

6.1.9. Internal Controls/Reporting

In general, loans would be disbursed in cash since many Ukrainians neither trust nor use the banks. There are a number of reasons for this attitude including: well-publicized bank failures, personal tax issues, size of the client's enterprise, etc. This cash disbursement system requires especially strong internal controls for the NGO at each location, and would be developed by the contractor with help from an accounting firm. Solid internal controls can help prevent fraud and maintain financial integrity for the NGO. Also, monthly project reports would be designed (and submitted to the board) that describe on-going project activities that are then correlated with the monthly disbursement of funds for internal control purposes.

Financial statements would be prepared monthly by an outside accounting firm and include both loan activity and operational costs. An annual audit by a reputable accounting firm would be a part of the NGO's operating costs. Fortunately, most contractors involved in microenterprise activities already have the systems and forms designed for the above requirements, although the contractor may need to make them country specific.

A central office in Kiev would be established in the latter part of the first year. This would be a small office with an administrator (not the level of a program manager), who can serve as liaison/communicator for program related issues during the second year. During the latter stages of the pilot phase, the program manager would work out of this office developing proposals, building bridges to funding group, continuing to guide the pilot program and developing, encouraging, and managing field offices.

6.2. Roll-out (12 to 48 months)

Based on the success of the pilot program, the team proposes a staged roll-out of the microfinance loan program to other Ukrainian communities. The selection of these new locations would be determined through discussions between the contractor, USAID, and the NGO. After the first year (thirteenth month), the contractor would provide for an independent evaluation of the pilot program to disclose lessons learned and provide information that is consistent with appraisals of similar microcredit programs (e.g., payback results, average loan size, types of businesses, costs per loan, delinquencies, etc.). After these operational issues are resolved and standards finalized, the operations manual would be edited by the contractor for use by each new loan office. A more comprehensive picture of operational guidelines and program roll-out may be found in the annexes.

6.2.1. Loan Capital

It is assumed that an initial $2 million of loan capital would be committed to and in place before the pilot phase begins. These funds would most likely come from USAID and the majority would be disbursed through the pilot offices over the first two program years (see Financial Projections in Annex II). Financial controls for loan fund disbursements would be consistent with cash flow projections and budgets agreed to by USAID and overseen by the contractor.

The team is proposing establishing four new microcredit offices each year, after the pilot phase, for a total of 14 microcredit offices after four years. Additional contractor personnel (at least two would be required in the pilot phase and an additional two in the second year) would be required after the pilot phase. This roll-out needs loan capital of approximately $8 million in addition to the pilot phase, but the financial projections show that capital funds beyond the initial $2 million would not be needed until year three, due to start-up issues for each new office. Generally, it would take the average office approximately two years to loan their entire allocation of capital funds, recognizing that funds would also be revolving back during this time. Realistically, raising capital of an additional $8 million over four years would be a stretch for any contractor and the NGO. However, history has shown that donor groups and others would come on board once a program is successful, e.g. other international government programs, major church groups, foundations (Lilly, Ford, Soros, etc.), corporations with a vested interests, Ukrainian NGOs, State Committee of Ukraine on Entrepreneurship Development, the Western NIS Enterprise Fund, and other creative financing methods need to be developed. This process has occurred successfully in other countries, but not without significant effort in proposal writing and networking to all potentially interested parties. In addition, creative financing methods need to be considered as the Ukrainian financial system matures.

With an average loan portfolio of $750,000 per office, and the program being spread over four years, a contractor and the NGO have time to raise a significant amount of capital for this program. The US contractor would have to use their technical skills in developing major donors for this program, e.g. tap major international funding agencies using their proposal writing skills to encourage the World Bank, UNDP, USAID, and others to make funds available for the program outlined above.

Overall, there are a number of possible contractors (for profit and PVOs) in the U.S. with microfinance experience and the ability to develop revolving funds. They have established effective procedures and strong operating manuals, which would fit the requirements of a new microenterprise lending program in Ukraine. The size and nature of the above program is not out of reach for those contractors interested in expanding to the Ukraine, but significant financial help would be required from USAID, especially in the early stages. As a result of the revolving nature of this program and its graduation to self sufficiency, it would continue to provide valuable microloan services long after the contractor and USAID have departed, and many thousands of additional Ukrainians would participate in the long term.

6.2.2. Operational Strategies

The contractor would assign one full-time staff member to each office for the first six months, with weekly visits over the next six months, and monthly visits during the second year, spending several days at their former office each month. A new office can be opened by one contractor staff member, with the help of a local manager, every six months. This translates into at least two new offices being developed toward the latter part of the pilot phase. It is suggested that the program continue this pattern of expansion, with two new offices being opened every six months, for a total of 14 offices after 42 months. Of course, if the lessons learned prove effective faster than expected, and the offices are successful more quickly than expected, additional contractor staff can be assigned to accelerate the program, with USAID approval.

6.2.3. Developing New Locations

The criteria suggested above for identifying a good location for a microcredit office would hold true for the longer term, recognizing that lessons may be learned during the pilot phase in this area as well. However, it is very important that significant training be undertaken before opening any new office, taking advantage of program evaluations, and lessons learned. The training would be for contractor personnel and NGO office staff, both new hires and those in offices, which are operating. Discussions concerning new location(s) between the contractor, USAID, and the NGO would get underway at least six months before opening any new office.

Program logistics and coordination, over time, are very important for the contractor and NGO to consider while in the pilot phase. It would be essential to develop effective reporting systems to provide the necessary management tools to monitor and improve the overall program. There have been many such systems developed by microcredit programs, which could be used by the contractor. It would be important that each microcredit office has their reporting computerized and where possible, e-mail can be used to quickly consolidate operational reporting.

Annexes

I:	Scope of Work for NGO-Led MicroEnterprise Finance Activity Design for USAID
II:	Financial Projections
III:	Short Description of the Polish Loan Guarantee Fund's Experience
IV:	Draft Scope of Work for Implementing Contractor
V:	Individuals/Organizations Met

Annex II: Financial Projections

The financial projection is based on the following assumptions:

- In Year 1, two loan funds are going to be operational, in Year 2 six funds, in Year 3 ten funds and in Year 4 fourteen funds,
- We assume finally that there will be 7 bigger funds (loan capital app. 1,000,000) and 7 smaller ones (loan capital app. 600,000),
- There are 10 loan officers + manager + secretary in the >bigger= fund and 6 in the smaller one + manager + secretary,
- The gross salary of the program manager is $ 1,200, $ 800 for the local managers $ 700 for the loan officers and $ 400 for secretary,
- The number of outstanding loans per each loan officer is around 85 when funds reach the full operation stage,
- To simplify the calculation, all the loans were assumed to be for 6 months and their average value is $ 2,000; in variant 2 of the projection, it is assumed that the average loan value will be increasing from $600 to $3,400.
- The first two funds reach sustainability after 3 years of operation, next ones reach it in 2.5 and 2 years= time. This assumes, however, extremely good management and very supportive environment; because of it this assumption should be regarded as very optimistic,
- There is one foreign long term consultant for the whole life of the project and another one for the first and second year of operation, the rest of the TA is provided by the local consultants,
- Short-term TA (both local and foreign) is budgeted for $ 20,000 for the first quarter, $ 60,000 for next two quarters each and then $ 40,000 for each quarter of operation until the end of the program,
- The monthly cost of 1 external long term TA is budgeted (including fee, allowances, accommodation, travel etc.) for $ 20,000 and for 1 local long-term TA for $ 3,000.

Annex III: Short Description of the Polish Loan Guarantee Fund's Experience[24]

Objectives of Loan Guarantee Funds

Practically in all countries the access to bank financing for small and medium enterprises is difficult. One of the examples of institutions trying to improve the situation are the loan guarantee funds. They are the institutions which are trying to remove some of the barriers, mostly lack of collateral required by the bank to extend a loan but also lack of credit records which demonstrate that an enterprise is capable of repaying a loan; and lack of skills necessary to complete a loan application on the part of small business

LGFs usually guarantee from 50 to 80 percent of the principal. The client must provide collateral for the remaining part. It seems that guaranteeing 60 to 70 percent of the principal is most advisable.

LGFs may have different target groups of enterprises to which they provide support. Most often they address their offer to SME, often with different industry preferences. Hence, there are many funds which are available only to craftsmen, farmers, trade enterprises, etc.

The cooperation with banks is very important. Usually it is recommended that the fund should cooperate with at least two banks, on the other hand, the number of such banks should not be too high. The key issue is to cooperate with such banks which extend or are willing to extend significant number of loans to SME.

The Fund=s operations involve relatively high risk. Due to their nature as such some loans guaranteed by them may be unrepaid and therefore banks will collect payment from the funds. On the other hand, this should not discourage the fund from applying (reasonably) the so-called prudent practices to minimize risks.

There are two basic models of loan guarantee funds: individual and portfolio. The first one is much more common and its idea is that every application for each loan is separately reviewed. In the latter case a LGF guarantees (in a certain part) the entire portfolio of loans extended by banks to entities fulfilling specific criteria. The fund does not get individual applications for guarantees, and its role is limited to monitoring compliance with procedures by banks. Naturally the second option requires the fund to rely on the bank to a great extent.

The evaluation of the effects of LGFs' operations varies a lot and depends on solutions adopted in each country and in particular circumstances.

[24] This annex was prepared on the basis of Jan Szczucki=s presentation at the seminar in Tomsk, Russia, in November 1997, organized by the OECD and Tomsk Oblast Administration.

The History of Loan Guarantee Funds in Poland

The emergence of funds providing loan guarantees to small and medium enterprises in Poland has been for obvious reasons related to the introduction of market economy. Until mid-1994, however, there were no SME loan guarantee funds in the classic meaning of this term. The activities consisting of providing guarantees were relatively developed, however they related to a different group of entities. Guarantees were granted by the State Treasury, mainly to large enterprises and in connection with large, often foreign, loans. Activities consisting of guarantee providing were conducted by regional development agencies. However, this was not in the form of loan guarantee funds, as there were no formalized procedures for applying for a guarantee and the purpose of guarantees was more to help a specific enterprise than support SME development in the region in general.

Starting from 1994 there has been a growing interest in loan guarantee funds. Then eight local loan guarantee funds were established under the Phare Local Initiatives Program. Most of them usually operated within an area covering one small town together with several neighboring local authorities, guarantees were offered to local small and medium enterprises operating in manufacturing or services business.

In 1995 the loan guarantee fund financed from the central budget became operational. It had a significant capital (PLN 45 mln.) and was established within the structures of Bank Gospodarstwa Krajowego. It also focused on supporting small and medium enterprises and the maximum value of a single guarantee it offered was relatively high, as it was as much as PLN 6 mln. Unfortunately, the Fund has not had a successful history, because for a long time its operational rules were highly complicated and not very attractive for potential clients (this was primarily due to the lack of understanding of the essence of operations of a loan guarantee fund). At present its rules are much more favorable, yet still the number of its clients is not particularly impressive. To a great extent, this is a consequence of a rather controversial idea of creating a loan guarantee fund on the central level, whereby the fund is far from its clients and far from banks wishing to extend loans. As a result, the promotion of the fund is very difficult and procedures must be more formalized, which hinders efficiency of operations.

The next to be launched were guarantee funds established under the Business Support Program financed by the UK Government, operating in Lublin and Bialystok voivodships.

The next significant step was the establishment of mutual loan guarantee funds. The idea behind such funds is that businessmen, members of the fund, may apply for a guarantee by making available to the fund their own small collateral increasing the guarantee capital of the fund. Such funds were established (or transformed from existing Anormal≅ funds) in three places in Poland, i.e. Bilgoraj, Dzierzgon and Ustrzyki Dolne.

At present (August 1998) in Poland there are fifteen successfully operating loan guarantee funds. The effects of their operations are presented in the table at the end of this paper.

Conclusions which may be drawn from the operations of the funds in Poland are as follows:

- There is a serious disproportion between the performance of funds operating on a local and regional scale and a fund operating nationwide (even though there is only one representative of the second category). In the author=s opinion, the difference is not a result of differences in management efficiency, but primarily of the specific characteristics of operations on the local and regional level. In the latter case it is not only easier to promote the fund=s operations, but also contacts with clients are easier, and all problems with the bank may be clarified in a simpler and faster way. This gives grounds to a conclusion that it is extremely difficult to create and manage effectively a fund on a national level or even at a regional level if the sheer size of the region hinders direct relations with the client or the lending bank. If we look at the table at the end of the paper, we can see that guarantee funds in Lublin and Bialystok are very successful and yet operate within the area of an entire voivodship. However, these are not large voivodships and most large banks have their offices in the two cities.

- The key determinant of success is the cooperation with a bank. Banks, as was already mentioned, should fulfill the following criteria: they should understand the objectives of a guarantee fund and the benefits they may derive from a fund=s operations; they should be interested in lending to SME sector. We should remember that cooperation with an efficiently operating LGF significantly reduces the bank=s loan-related risk. On the one hand, a significant part of a loan is guaranteed by the best possible collateral - cash blocked on a bank account and on the other hand, the fact that the fund=s personnel and committee who decide on granting guarantees independently review the client=s application increases both quality and reliability of the evaluation of the client.

- An important element of the fund=s operations is to involve local businessmen in its operations, preferably in the capacity of members of the committee reviewing applications for guarantees. Such solution helps to minimize the risk of taking a wrong decision on providing guarantees (as businessmen, particularly on a local level, usually know one another well and are able to assess the creditworthiness of the applicant). It also helps in promoting the fund among the most important target group.

- It is always very beneficial when local authorities support the operations of a fund, for instance by providing office premises free of charge. From a local authority=s point of view the existence of the fund is very beneficial as it promotes local economy development, also the existence of a fund is an argument in favor for a commercial bank to open a branch in a given town. Representatives of local authorities may sit on committees which decide on granting guarantees.

- The key function which is neglected by many funds are on-going promotional efforts to propagate services offered. Because funds are often situated somewhere in between the public and private sectors and because they are perceived as aid institutions, it is wrongly presumed that clients will come by themselves. Even if a fund is not profit oriented, still the product it offers should be treated as a quasi commercial product the promotion of which requires methods similar to those applied in ordinary business operations;

- The very low percentage of losses (0.55 percent of guarantees provided) by virtue of payments of guaranteed amounts to banks will most likely increase in the future (a large part of loans guaranteed by funds are in an early stage of repayment), however even today we may claim that well managed funds have a very low ratio of losses.

- In some cases the guarantee funds established very fruitful cooperation with the Labor Offices which issue loans to the unemployed starting the business. Many funds were guaranteeing such loans which, although very risky was highly regarded by the local community.

Summary

The Polish experience of the past four years proves that loan guarantee funds may have an important role to play in a post-socialist economy, by advancing SME development, and increasing the willingness on the part of banks to lend to this sector. However, when establishing and managing a loan guarantee fund, it is important to bear in mind particularly these two items:

- Funds will not operate successfully not only unless banks (or another credit institutions) are interested in lending to SME, but also if SME are not interested in borrowing from banks (e.g. because of high interest rates). Loan guarantee funds cannot function totally independently, on their own; they are always dependent on the institutions providing loans (usually banks),

- It does not seem reasonable to combine providing guarantees with other forms of operations, such as lending, leasing, etc. Such a situation may lead to accumulation of risks from different lines of business and in addition it may distort the assessment of financial efficiency of a fund.

If you remember about these principles, you may hope to be able to manage a fund effectively. However, please remember that even the best advice will not replace good management. As in other areas of business, also in loan guarantee funds, it is the key to success.

Operations of Loan Guarantee Funds in Poland - (as at the end of May 1998)

Fund	Present fund capital	Number of guarantees issued	Amount of guarantees issued	Amount of loans guaranteed	New jobs created	Number of guarantees lost	Amount of guarantees lost
Bigoraj:	1 534 000	106	1 939 600	3 550 000	280	2	29 800
Dziadowo:	1 153 847	138	2 929 717	7 560 356	349	1	6 000
Kutno	723 000	35	700 000	1 300 000	70	1	9 600
Nidzica	966 000	39	1 110 047	2 824 500	228	0	0
Nidzica II	1 049 352	46	1 838 000	4 451 080	250	1	5 000
Starachowice	1 532 371	67	1 735 000	2 858 221	270	2	16 000
Ustrzyki Dolne	643 343	23	390 943	931 100	41	0	0
Wicko*	802 707	40	1 055 950	2 163 614	120	1	1 405
Zelów	1 039 200	43	1 086 300	1 810 500	300	0	0
Biaystok:	7 000 000	105	7 324 700	15 858 400	200	0	0
Lublin	5 800 000	186	12 333 050	21 853 030	-	2	74 000
Dzierzgoñ	471 260	15	358 500	632 500	30	0	0
Konin	200 000	1	5 600	9 000	0	0	0
Biaogard:*	1 073 131	6	1 128 974	5 704 356	12	0	0
KFPK BGK	76 600 000	131	28 100 000	70 000 000	-	1	200 000
TOTAL (without	**100 488 211**	**981**	**62 036 381**	**141 506 657**	**2 150**	**11**	**341 805**
Fundusz Gwarancyjny	30 016 221	0	0	0	0	0	0
TOTAL (incl. PARR)	**130 604 432**	**982**	**62 066 381**	**141 506 657**	**2 150**	**11**	**341 805**

* data for the end of 1997

Fund	Guarantees to capital	Average guarantee amount	Guarantees issued to guarantees lost	Average length of loan	Number of cooperating banks
Bigoraj·	126.44%	18 298	1.54%	2.5	1
Dziadowo·	253.91%	21 230	0.20%	2.4	6
Kutno	96.82%	20 000	1.37%	3	5
Nidzica	114.91%	28 463	0.00%	3	1
Nidzica II	175.16%	39 957	0.27%	5	2
Starachowice	113.22%	25 896	0.92%	3	3
Ustrzyki Dolne	60.77%	16 998	0.00%	4	8
Wicko*	131.55%	26 399	0.13%	-	-
Zelów	104.53%	25 263	0.00%	2.75	5
Biaystok·	104.64%	69 759	0.00%	1.5	6
Lublin	212.64%	66 307	0.60%	1.5	11
Dzierzgoñ	76.07%	23 900	0.00%	2.5	3
Konin	2.80%	5 600	0.00%	-	1
Biaogard·*	105.20%	188 162	0.00%	-	1
KFPK BGK	36.68%	214 504	0.00%	-	39
TOTAL (without	**61.67%**	**63 238**	**0.55%**	**xx**	**xx**
Fundusz Gwarancyjny	0	0	0,00%	xx	10
TOTAL (incl. PARR)	**47.52%**	**63 204**	**0.55%**	**xx**	**xx**

* data for the end of 1997

Source: The Polish Foundation for Promotion and Development of Small and Medium Enterprises, Policy & Action Group - own research

All the data in Polish zloties: 1 USD =3.6 PLN

Annex V

Name	Organization
Gennadiy Aksionov	International Renaissance Foundation, Kiev
Ihor Aksionov	International Finance Corporation, Kiex
Galich Alexander	Sewastapol, Crimea City Government
Eileen Andersen	The Alliance
Alberta Ashbrook	ACDI/VOCA
Andrey Azarov	Credit Union AFirst Credit Association≅, Odessa
Edem Bakhshish	Crimea Integration & Development Programme
Oleksandra Baytsar	Soyuz Ukrayinok, Lviv
Evgeniy Belyaev	Marine Transport Bank, Odessa
Lentun Bezaziew	Deputy Prime Minister of the Crimea Autonomous Republic
Zoryana Bilyk	Soyuz Ukrayinok, Kiev
Natalia Bourjaily	International Center for Non-Profit Law
Taras Burhan	The Silecky Firm
Scott Carlson	Western NIS Enterprise Fund
Oleksander Cherkas	Peace Corps
Youri Dmitriev	I.P.B.-Tacis, Odessa
Alexander Dudka	New Biznet
Taras Fedak	Lviv Oblast Administration
Oksana Fedorovych	Ivano-Frankivsk Oblast State Administration
Ludmila Foresman	U.S. Agency for International Development
Marykay Fuller	European Bank for Reconstruction and Development
Cara Galbraith	Winrock International
Gary Gegenheimer	Barents Group LLC
Yevgen Gerasimenko	WOCCU
Gennadiy Gnedash	Dnipropetrovsk Regional State Administration
Colleen Green	U.S. Agency for International Development

- Justin Holl — Ukraine Enterprise Land Privatization/Sales Project
- Laura Hoover — ACDI/VOCA
- Jeff Houghton — Development Alternatives, Inc/NewBizNet
- Valerie Ibaan — Peace Corps
- Gagauz Inna — Ukraine B.I.D., Kharkiv
- Rostislav Ivanov — Marine Transport Bank, Odessa
- James A. Jaffe — Counterpart Meta Center, Lviv
- Michajlo Kaplunovskij — Association of Entrepreneurs of the Kharkiv Oblast
- Serhiy Kasyanchuk — NewBizNet, Lviv
- Lilia Kim — Kharkov Women=s Fund
- Gleb Klevenkia — U.S. Agency for International Development
- Alexander Kondrashov — National Mining Academy
- Igor Kolot — Kharkiv Oblast Administration
- Alexey Kosmin — Marine Transport Bank
- Anatolij Kovalev — Intmar NewBizNet, Odessa
- Jaroslaw Kozubal — Ukrainian-Canadian Business Centre
- Petro Kozynets — Ukrainian National Association of Savings and Credit Unions
- Boris Kucher — Sebastapol, Crimea City Government
- Olexandra V. Kuzhel — State Committee of Ukraine for Entrepeneurship Development
- Laurie Landy — U.S. Agency for International Development
- Lyubov Lubianetska — Counterpart Meta Center
- Timothy Lyman — Day, Berry & Howard LLP
- George Mackiw — Ukraine B.I.D.
- Yuriy Matiyenko — Ukrainian Foundation for Entrepeneurship Supporting
- Elena Miszina — NewBizNet, Zaporize
- Maria Mogilnitska — National Bank of Ukraine, Lviv
- Mickey J. Mullay — Winrock International

- Olga Nagornaja Carl Duisberg Gesellschaft
- James Neeley U.S. Agency for International Development
- Eleonora Nikolaichuk Delegation of the European Commission in Ukraine
- Stephen Orlesky Internationale Projekt Consult GmbH
- Lyuba Palyvoda Counterpart Creative Center
- Andrii Palianytsia International Centre for Policy Studies
- Ludmilla Panova Sewastopol, Crimea City Government
- Galina Prokopchuk Intmar Odessa
- Natalia Prokopovich State Committee of Ukraine for Entrepeneurship Development
- Volker Renner Internationale Projekt Consult GmbH
- Carole Riechert Internationale Projekt Consult GmbH
- Stella Roudenko U.S. Agency for International Development
- Oleg Savenkov Crimea Integration & Development Programme
- Ivan Schvets U.S. Agency for International Development
- Volodymyr Seniuk Canadian Embassy
- Roman Shevchyk Ukrainian-Canadian Business Center
- Zinoviy Shkutyak Ivano-Frankivsk City Council
- Steven Silcox U.S. Agency for International Development
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- Kenneth Smith ACDI/VOCA
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- Sergiy Timofeev Internationale Projekt Consult GmbH
- Yuriy Tokarev Western NIS Enterprise Fund
- Michajlo Tuz Association of Entrepreneurs of the Odessa Oblast
- Elena Voloshina International Finance Corporation
- Harold Walters U.S. Agency for International Development
- Max Yacoub International Finance Corporation

- Nikolay V. Yakimenko IESC
- Eugene Yanchenko International Renaissance Foundation
- Frank Yanicheck Peace Corps
- Konstantin Yokubenko U.S. Agency for International Development
- Larisa Zagorodnya Electron Bank
- Witalij Zamkowoj Intmar NewBizNet, Odessa