Financieros sin Fronteras

KRABAN SUPPORT FOUNDATION

Microfinance Consulting

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EXECUTIVE SUMMARY

Ghana is one of the most democratic countries of Africa and its political stability has been one of the key factors for its economic growth.

It is the third largest economy in West Africa after Nigeria and Ivory Coast, and has very favorable growth prospects. However, hyperinflation is an endemic problem. Government efforts have reduced it to rates below 10% but the country continues losing competitiveness, with an industrial price index higher than 20%.

In relation to the development of the Ghanaian microfinance sector, there are currently important needs of expanding these activities: around 30% of the population lives below the poverty line; from about 3 million potential customers only 10% is covered; 80% of the population works in the informal private sector; 80% of the population lives in rural areas, and there is a 30% illiteracy.

Its level of microfinance development now occupies fourth place worldwide behind Peru, the Philippines and Bolivia, and, like these countries, microfinance in Ghana have evolved as a result of problems experienced in development: financing originally came from the poorest informal channels (loans borrowed from neighbors or other individuals) whose social costs could be very high. Organizations like Credit Unions and ROSCAS (Rotating Savings and Credit Associations) arose to avoid such potential social costs. These organizations involve lending to groups of people rather than individuals (although these activities sometimes remain informal).

In this context, KSF is a self-regulated financial NGO (not supervised by the Central Bank) that carries out a strategy for the poor, defining specific products tailored to their characteristics, from which it is worth mentioning: loans to groups of entrepreneur women, loans for displaced persons abroad, microcredit programs, loans for agricultural development and loans for the installation of energy systems in rural areas.

Due to the specificities of microfinance institutions, KSF should be analyzed with a methodology that takes into account the following considerations on these institutions:

- They operate under unstable macroeconomic scenarios, characterized mainly by high inflation impacting the real value of equity that results in unrealized losses not always reflected in their accounts. This phenomenon is a consequence of the monetary nature of the main assets of the institutions.

- Due to its social function, these institutions receive subsidies that must be distinguished from the income arising from their activity, providing a true reflection of its performance as well as the credit quality of their assets. This also facilitates a comparison with other institutions from the sector.

- There is limited information, absence of third party reports (audits, external rating agencies, regulators, supervisors, etc.) and lack of technical and human resources, especially on accounting and financial reporting.

CAMEL methodology (Capital, Asset, Management, Earnings, and Liquidity) adapts the analysis and valuation models of conventional financial institutions to the specifications of microfinance institutions[1].

In this regard, each block of analysis contained in this system assigns a score based on the value of each of the indicators calculated. By its nature, there is a distinction between quantitative and qualitative indicators.

The aggregation of the quantitative and qualitative scores determines the final grade reflecting the level of sustainability of the institution under review.

The result of applying this methodology to KSF is summarized in following chart:

CAMEL SUMMARY

QUANTITATIVE INDICATORS			QUALITATIVE INDICATORS		
INDICATORS	SCORE KSF	MAX. SCORE	INDICATORS	SCORE KSF	MAX. SCORE
CAPITAL ADEQUACY (15% max.)	8	10		2	5
1. Leverage	5	5	9. Ability to Raise Equity	2	5
2. Adequacy of Reserves	3	5			
ASSET QUALITY (21% max.)	7	15		3,3	6
3. Portfolio at risk	0	8	10. Portfolio Classification System	1,2	3
4. Write-offs	7	7	11. Productivity of Long-term Assets	1,2	1,5
			12. Infrastructure	0,9	1,5
MANAGEMENT (23% max.)				8,2	23
			13. Governance	2,4	6
			14. Human Resources	1,6	4
			15. Processes, Control and Audit	1,6	4
			16. IT Systems	1	5
			17. Strategic Planning and Budgeting	1,6	4
EARNINGS (24% max.)	8	20		2,4	4
5. ROE	0	5	18. Interest Rate Policy	2,4	4
6. Operational Efficiency	8	8			
7. ROA	0	7			
LIQUIDITY MANAGEMENT (17% max.)	0	2		11,6	15
8. Productivity of Other Current Assets	0	2	19. Liability Structure	6,4	8
			20. Availability of Funds to Meet Credit Demand	4	4
			21. Cash Flow Projections	1,2	3
TOTAL QUANTITATIVE INDICATORS	23,0	47	**TOTAL QUALITATIVE INDICATORS**	27,5	53

TOTAL KSF	**50,5**
TOTAL QUANTITATIVE + QUALITATIVE INDICATORS	**100,0**

[1] Among the additional methodologies for analyzing MFIs it deserves mentioning WOCCU, PEARL and CGAP.

The scale provided for the CAMEL methodology is expressed in base 20. Turning to the scale for evaluative purposes, the obtained result for KSF is 2.5 points, equivalent to a C grade.

Final Score	Min. Score	Rating
0.00 - 1.99	0.00	D
2.00 - 2.99	2.00	C
3.00 - 3.32	3.00	B
3.33 - 3.66	3.33	BB
3.67 - 3.99	3.67	BBB
4.00 - 4.29	4.00	A
4.30 - 4.59	4.30	AA
4.60 - 5.00	4.60	AAA

The resulting score indicates KSF difficulties in managing its loan portfolio, with basic weaknesses in several key indicators. It requires technical assistance to solve immediate problems and to "survive" without financial assistance.

However, KSF presents a high probability of success with focused support in those areas for which weaknesses have been identified, since they do not promote losses that threaten the viability of the institution as long as it receives external subsidies.

GHANA´S OVERVIEW

- **Macroeconomic and Political Environment**
- **Ghanaian Financial System**
- **Microfinance in Ghana**

1.1. MACROECONOMIC AND POLITICAL ENVIRONMENT[1]

1.1.1. SUMMARY[1]

Population	23.837.261 (1)
Official language	English
Life expectancy	57 years (1)
Religion	63% Christians, 16% Muslims, 21% other
Currency	Cedi (GHC)[2]
Per capita income	1.100 USD
GDP	26.169 MM USD (1)
Inflation	9,5% annual average(2)
Transparency index	4,1 (62nd position worldwide)
Risk rating	B (S&P)

1.1.2. POLITICAL ENVIRONMENT

Ghana's political system stands out as one of the most democratic in Africa. In general it governs the rule of law, human rights are respected and there is a separation of powers (de jure and de facto).

Since independence, in 1957, until 1992, Ghana had been overwhelmed by coups and political instability. Since the re-formation of political parties in 1992, with support from the International Monetary Fund's re-structuring plan, Ghana has experienced political stability as the country has been able to transfer power between parties without serious social conflicts. The smooth transition in the close presidential election, in 2008, showed that Ghana is fully capable of functioning as a democracy. In 2010 it ranked 122 out of 177 in the Index of Failed States Index.

Political stability has been one of the key factors for economic growth in the country in the last years. The ruling party is now the "National Democratic Congress' (NDC) with social democratic orientation and belongs to the International Socialists. The Ministry of Finance and Economic Planning (MOFEP) is responsible for economic policy and relations with international financial organizations and donor funds.

1.1.3. ECONOMIC ENVIRONMENT

1.1. 3.1. GENERAL DESCRIPTION

Ghana is the third largest economy in West Africa, after Nigeria and Ivory Coast. However, it remains a poor country that is growing rapidly but unevenly, with typical characteristics of underdeveloped countries:

- The agricultural sector represents about 30% of GDP and 50% of employment.

[2] At December 31st, 2010, the exchange rate to USD was 1.48.

- Low and middle income
- Population increases rapidly, which softens economic growth data in terms of income per capita.
- More than 30% of the population live below the poverty line and are illiterate.
- Strong dependence on traditional exports (cocoa, gold and other natural resources) which represents between 85% and 90% of total exports.

Government intends to apply traditional economic policies to reduce the public deficit and inflation, and future progress will depend on macroeconomic domestic politics (in particular

the maintenance of that attitude by the Government, taking into account the country's needs and expectations generated by future oil exports) and external factors (changes in the price of gold and cocoa).

1.1.3.2. GROWTH FORECASTS

Ghanaian economy has grown at a steady rate of between 4% and 6% between 2000 and 2007, mainly due to factors whose permanent sustainability is difficult:

- Great performance of cocoa and gold exports at historic highs.
- Increased activity in the mining sector (oil discovery).
- High volume of expenditure and public investment. Fiscal stimulus is being reduced due to large public deficit.

However, GDP growth forecasts in Ghana are very good: the IMF forecasts an average real GDP growth of 7% between 2011 and 2015. If those forecasts are achieved in the medium term, Ghana will be among the ten fastest growing countries of the decade. However, it should be noted that population is also growing very fast and for the sustainability of growth, strong structural reforms are necessary in order to avoid growth rates to mean reversion (about 5%) in the following years.

The discovery of Jubileo´s well on the west coast was the largest oil discovery in West Africa during the last decade, and the exploitation of oil and gas began in December 2010. This discovery could add up to 7% annual to the Ghanaian´s GDP. Therefore, the current optimism in the country generates positive expectations boosting consumption and investment. Attention must be focus on fiscal or inflationary tensions that could have a negative impact on this positive momentum. That is, although growth is fast, it may not be sustainable or balanced.

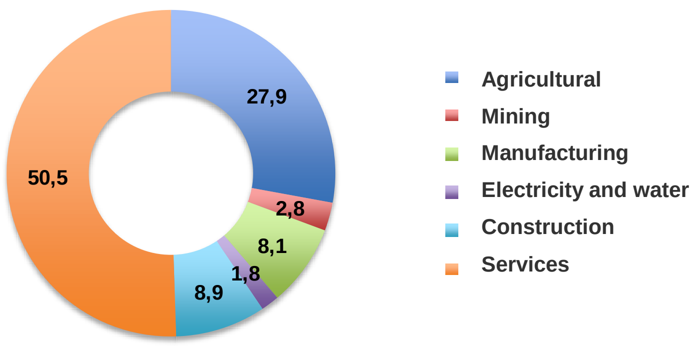
1.1.3.3. EVOLUTION OF THE MAIN MACROECONOMIC INDICATORS

1.1.3.3.1. GDP:

The structure of Ghana's GDP by sector in 2010 is described in the following page[3]:

[3] Note that the agricultural sector represents almost 30% of GDP (which in turn represents 50% of employment).

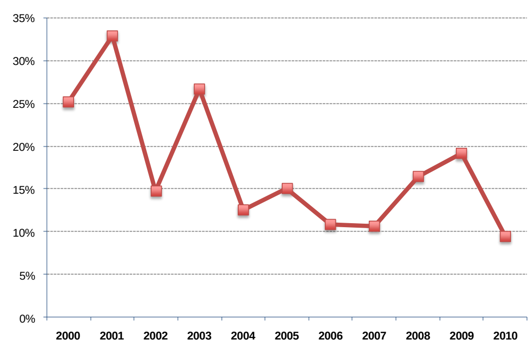
Figure 1. Ghanaian GDP´s Structure 2010



1.1.3.3.2. Prices:

Goods and services prices are generally low, while those of limited supply may be very expensive in nominal terms and purchasing power. The rigidity of supply together with increasing demand arising from growth and public incentives generate high inflation. At present, external factors such as the rising price of oil and food must be taken into account. Hyperinflation is endemic in Ghana, surpassing other African countries.

Graph 1. Inflation



Fight against inflation tries to avoid the collapse of the cedi. Efforts made, together with the actual global environment, have reduced annual rates above 20% in 2009 [4] to rates below 10% recorded from May 2010. With inflation, the Bank of Ghana reduced interest rates from rates above 20% at the beginning of the decade (year 2000) to the current rate of 13%[5].

The analysis of the CPI does not reveal the full extent of the inflation problem. The country is losing price competitiveness very fast. The PPI (Producer Price Index) is growing at alarming rates and the appreciation of the cedi would only worsen the deteriorating price competitiveness.

[4] Led to the growth experienced in 2009 caused by the presidential elections.
[5] To encourage investments.

1.1.3.3.3. Unemployment:

Due to the size of the informal economy, existing statistics are not very representative. In any case, data available shows that unemployment in Ghana remains, as in most of West Africa, a pressing problem.

It remained around 8% from 2000 until 2008, but saw an increase up to 10% and 11% for 2009 and 2010 respectively. The largest numbers of unemployed come from the youth, which poses a threat to economic stability in the long run and has a negative effect on productivity. It remains to be seen whether the oil related industry would be able to employ more Ghanaians in the near future. Even with high unemployment levels, Ghana is still the country in Western Africa with the lowest percentage of population below the poverty line, at 28.5% estimated in 2007.

1.1.3.3.4. Income Distribution:

The latest data published by the World Bank corresponds to the year 2006. In that year, 30% of the population was living on less than $ 1.25 a day, and 56% below $ 2 a day. There are regional differences, and poverty is highlighted in the three regions further north. The fact that economic growth is not being equal but mainly concentrated in cities, creates rural migration.

1.1.3.3.5. Public Accounts:

They include the following:

A. **Income:** Ghana sought help from the IMF between 2008 and 2009 to counteract balance of payments deficit due to loss of fiscal control generated by the elections of that year and the international crisis which prevented the funding of the country. IMF financing granted USD 600 MM. Currently, public revenues represent approximately 20% of GDP. An important part of these revenues comes from contributions from donors, especially of direct budget support (which is the form of cooperation commonly used by the Ghanaian government).

B. **Expenses:** Government's ability to maneuver is limited because wages and debt interests (external and internal) account for 85% of the budget, so, in order to undertake projects, they systematically need to ask for foreign aid, which creates a vicious circle of disability and indebtedness. Delays in payments in 2010 amounted to 1.6% of GDP. This is a key problem in a country where the nominal interest rate of loans is about 25%. Government has devoted revenues from bonds to eliminate this problem.

C. **Budget Balance:** Due to the facts above mentioned, the country is heading toward an unavoidable structural deficit. Moreover, in Ghana, government deficit contributes to increase the current deficit and drives out private spending, since a significant portion of their funding is done through local banks. Efforts to control the deficit helped to slow cedi´s depreciation, which in turn slowed down inflation. Inflation containment has positive effects on deficit control:

   - When setting inflationary expectations in lower levels, the cedi collapse stops and foreign investors find Ghanaian emissions more attractive, demanding a lower spread.
   - As a result of the mentioned above, nominal interest rates fall and debt interests are reduced.

- By the anti-inflationary strategy, investors accept medium-term emissions so that the State is not in the position of being continually refinancing and banks have more funds to lend to the private sector.

1.1.3.4. EXTERNAL TRADE IN GOODS AND SERVICES

Ghana suffers a trade and services chronic deficit. Its exports are dependent on few products (gold, cocoa and wood), and it imports oil and goods. While food imports are not important quantitatively, they are important qualitatively. Oil export can be used to significantly reduce trade deficit. A high oil price may not be positive as it spends more importing refined products than what they obtain from oil exports.

1.1.3.4.1. Main Trading Partners

CLIENT COUNTRIES		SUPPLIER COUNTRIES	
NETHERLANDS	335	CHINA	1100
UNITED KINGDOM	208	US	455
FRANCE	182	IVORY COAST	404
GERMANY	108	FRANCE	350
US	104	UNITED KINGDOM	290

1.1.3.4.2. Foreign investment

Besides political stability, Ghana enjoys a reasonable legal framework for the protection and promotion of investments. The Constitution and the investment laws provide guarantees against expropriation and nationalization. According to the "Doing Business" ranking, Ghana is the West African country where “doing business” is easier (rank 67 worldwide).

1.1.3.5. RISK RATING

Regarding operations coverage, Ghana is in Group 6 following OECD´s country risk classification (0-7). Regarding issuance of bonds (non-investment grade), the ratings of the most relevant rating agencies are the following:

- **Standard and Poor´s: B**. The 2010 drop in ratings was due to doubts about oil´s management and the relevant fiscal deficit. It was widely criticized.
- **Moody´s: BB-**
- **Fitch: B+**

1.1.4. OVERALL ASSESSMENT AND CONCLUSIONS

Ghana has a population of over 24 million, of which 28.5 % are living below the poverty line, thus providing a huge market for microfinance. According to a recent population and housing consensus, approximately 80% of the working population belongs to the private informal sector, which lacks access to credit facilities. Also, about 80% of the Ghanaian population live in rural areas of the country, which often lack basic infrastructure needs.

As observed in our on-field research, this segment of society´s needs is highly neglected by most financial institutions, as servicing them can be expensive. Hence, there is an urgent need to address this situation in order to eliminate the growing poverty and widespread inequality amongst the productive poor, thus boosting the economic growth of the country.

Furthermore, those who are neglected are often in the farming industry, which constitutes almost 40% of Ghana's GDP. The country has more than three million potential microfinance clients and only a very small part of the estimated number of microfinance potential clients have been served by the microfinance industry.

Ghanaian macroeconomic and political environment influences on microfinance in the following way:

- ✓ **Political stability** has led the growth of the Ghanaian economy buy not without a high level of inflation and deficits. Since the clients reached by MFI's are at the bottom of the pyramid, any type of social unrest is most likely to affect them. Due to this reason, a high risk of political instability can translate into increasing delinquencies. MFI's and foreign investors welcome Ghana's political situation as it provides them with confidence of peace and the ability of them being a going concern. An example of the importance of stability in a country is the recent visit of President Obama to Ghana (the first American President to visit Africa). With his visit, he signaled that thanks to the stability of the country more investment, and aid, would be received (e.g. the MiDA program).

- ✓ **GDP growth** is a sign of general economic growth and hence has a direct impact on the funding available to MFI's. Economic growth is linked to stability and development in a country, and in the presence of growth, investors are more likely to approach MFI's in these countries. Microfinance investors and donors will gain more confidence in the outlook for micro-entrepreneurs and thus be willing to lend to them through MFI's. The characteristics of the Ghanaian economy, coupled with current GDP growth rates, provide an attractive situation for foreign lenders to enter the Ghanaian microfinance market.

- ✓ **Inflation and interest rates** have direct and substantial effects on microfinance institutions. An increase in either will increase the cost of funding for MFI's. Since commercial borrowing rates in Ghana are already high, further increases in them will make it impossible for MFI's to borrow commercially and still lend at reasonable interest rates. An increase in the cost of funding for small MFI's (the majority in Ghana) can severely affect their ability to be sustainable, as already tight margins will be further reduced. Inflation also has a negative effect on the value of the equity of MFI's and a high inflation rate, ceteris paribus, will reduce the net value of the equity available for the institutions.

- ✓ **Unemployment** is a two-sided coin for the microfinance industry. On one hand, higher unemployment could lead to a larger private informal sector (e.g. people without jobs may turn to other forms of business such as hawking). In this sense, unemployment increases the potential market for MFI's as people would turn to microfinance institutions to start-up their businesses and shops. On the other hand, unemployment would hamper growth and productivity, which could lead investors out of the country. As foreign investors bail, so would the funding for some microfinance institutions. The start of the oil industry, MFIs in Ghana may see potential clients decrease if unskilled labor moves from the farming industry to the oil industry.

1.2. GHANAIAN FINANCIAL SYSTEM

1.2.1. INTRODUCTION

Ghana's Central Bank regulates the banking and non-banking financial activities. Its legal framework is expressed in a 2002 law that gives the Ghanaian Central bank jurisdiction over monetary policy, regulation and supervision of banking and nonbanking institutions. The Law regulates the activity of banks is the Banking Act of 2004. It regulates non-banking financial institutions with the Law No. 774 from 2008 which regulates the activities of more formal microfinance institutions. However, under Article 1, this Act does not apply to those microfinance services operators *"with risk assets which are not more than the amounts prescribed by the Bank of Ghana and whose sources of funds do not include deposit from the public ".*

The financial system is dominated by foreign-owned banks, the British Bank and the Region Banking. Moreover, state involvement in the banking system is one of the highest in Sub-Saharan Africa. Annex 1, contains a chart with the structure of the country's banking system:

Ghana's financial sector has experienced a tremendous growth in recent years due to:

- Capital injection to meet minimum regulatory capital requirements.
- Participation of additional banks in the Ghanaian financial system.
- Expansion of branch network.

According to latest IMF's review of Ghana's financial system[6], this growth has provided new opportunities and risks:

1. Authorities have introduced reforms to strengthen the regulatory and supervisory framework in banking, insurance, pensions and policies to prevent money laundering. However, there are still significant risks to financial stability. Non-performing loans rates are high and it is likely to suffer provisions shortages that would lead to the need to capitalize on some of the small and medium-sized entities. There are also risks of concentration in credit portfolios.

2. Banks in Ghana have a rigid cost structure with high operating costs (particularly personnel and administrative costs).

3. State´s involvement through the Central Bank in the capital of 5 banks is perceived negatively. The performance of these banks has been poor because their lending criteria had focused on the development of business and not on principles of prudence.

4. Internal control and risk management should be improved with the growth of the industry.

5. The non-banking sector has limitations to its effective functioning and contribution to economic development. It is worth mentioning the shortage of long-term funding, limited access to financial services and high intermediation costs.

[6] Ghana: Financial System Stability Assessment Update (IMF – June 2011).

The implementation of Basel II in Ghana begun in 2011 and its final implementation is expected by June 2012. It will represent the most significant change to supervision of banks. However, the level of compliance with Basel core principles is low and there is a need of making a substantial effort on the adequacy of regulatory and supervisory framework.

Traditional commercial banking services in Ghana give real services to less than 20% of families. 80% of the population is in what is known as the informal economy. In general, most traditional banks have not paid attention to micro and small enterprises, mainly because they use a methodology for measuring credit risk which requires significant documentation and knowledge on the client side, including social aspects which are very difficult to find or even unavailable in the case of small businesses.

1.3. MICROFINANCE IN GHANA

1.3.1. INTRODUCTION

The concept of Microfinance is not new to Ghana. Traditionally, it has been a custom for people to save and/or take small loans from individuals and groups so as to help them establish small businesses or agriculture based activities. Available evidence suggests that the first Credit Union in Africa was established in Northern Ghana in 1955 by Canadian Catholic Missionaries.

The implementation process of this industry usually goes through 4 stages and Ghana has not been an exception:[7]

- **Phase 1:** The granting of subsidized loans from the Government began in the mid 50's.
- **Phase 2:** During the 60´s and 70´s NGOs started providing microcredits to the poorest. At that time financial sustainability was not important. In 1965, the Agricultural Development Bank was specifically created to meet the needs of the agricultural sector.
- **Phase 3:** In the 90's, MFIs started to be more formal.
- **Phase 4:** MFIs´ role in the financial sector starts to grow.

From the beginning, the microfinance industry operated in Ghana without specific policies or coordinated objectives. Over the years, governments have implemented various financial sector policies and programs that have helped shape the microfinance sector in Ghana.

According to the Central Bank of Ghana, some of the key policies are:

- Provision of subsidized credits in the 1950's
- Establishment of the Agricultural Development Bank in 1965, to cater to the financial needs of the fisheries and the agricultural sector
- Establishment of Rural Community Banks (RCBs), the formation of regulation such as commercial banks being required to set aside 20% of the total portfolio, to promote lending to the agricultural sector and small scale industries in the late 70's and early 80's.
- Liberalization of the financial sector in 1986.
- Declaration of the PNDC Law 328 in 1991 that permitted the setting up of different categories of non-bank financial institutions, such as savings &loans companies, and credit unions.

In the last decade, the Government of Ghana included microfinance in its strategy for growth and poverty reduction. The result was that, in 2006, government issued a microfinance policy, whose main objectives were:

- To create the necessary environment to support the development of operations in the sector.
- To create a sustainable and integrated financial system to help the poor and protect its customers.

[7] See document "General Background on Global Microfinance Trends".

It was agreed that this policy should be implemented within a maximum period of 6 years.

One of the main aspects in which the sector is currently working on, is consumer protection. They do this through training programs organized by SPEED and GHAMFIN. These programs try to inform customers about their rights and obligations as users of financial services. However, in Ghana there is still no law to protect the consumer, and this is a very important aspect that needs to be developed. Within the Bank of Ghana, ICRO ("The Investigation and Consumer Reporting Office") is established with the responsibility to protect and educate consumers on their rights and responsibilities (see Annex 3 for details).

We must also emphasize that the Bank of Ghana established in 2008 the regulatory framework for the provision of "branchless banking" and mobile phones usage as means of increasing financial inclusion. For now, this activity is only allowed for those entities authorized to receive deposits.

1.3.2. TYPES OF INSTITUTIONS AND STAKEHOLDERS

Entities providing microfinance services can be grouped into three sectors:

- **Formal Sector:** includes traditional commercial banks, the "Rural and Community Banks" and others as the "Savings and Loans Companies" whose operations are registered, licensed and regulated by the Bank of Ghana. The Banking Act regulates the activities of commercial banks and rural banks, while the "Saving and Loans Companies" are regulated by the Law of non-banking financial institutions.

- **Semi-formal Sector:** they are registered informal institutions not regulated by the Bank of Ghana (Credit Unions and financial NGOs).

- **Informal Sector:** Service providers not regulated by the Bank of Ghana or any other regulation, and without any legal documentation. This segment includes the "money lenders", "Susu collectors" and "Rotation Savings and Credit Associations" (ROSCAS).

While Ghana has developed a regulatory and supervisory framework for formal institutions incorporated under license from the Bank of Ghana, that same framework should be extended to other institutions operating in the country. A draft of the regulation is being discussed among the members of the sector. Annex 4 describes its main aspects.

From stakeholders´ point of view, the Ghanaian microfinance industry´s breakdown is the following: (Stakeholders´ description is given in Annex 5).

- **Microfinance Institutions**
  - Rural and Community Banks
  - Savings and Loans Companies
  - Financial NGOs
  - Primary Societies of CUA
  - Susu Collectors Association of GCSCA
  - Commercial Banks with microfinance programs

- **Microfinance Associations**
  - Association of Rural Banks (ARB)
  - ARB Apex Bank
  - Association of Financial NGOs (ASSFIN)
  - Ghanaian Association of Credit Unions (CUA)
  - Ghanaian Association of Susu Collectors (GCSCA)

- **Clients**
  - Economically active poor requesting microfinance products and services.

- **Support Institutions**
  - Microfinance and Small Loans Center (MASLOC)
  - Ghanaian Microfinance Institutions Network (GHAMFIN)
  - International NGOs
  - Universities and Research institutions

- **Government Institutions**
  - Ministry of Economy and Public Planning

1.3.3. PORTER´S 5 FORCES ANALYSIS

A Porter's 5 forces analysis will provide us with greater insight into the strategic positioning of the microfinance sector in Ghana.

Competition: High. The number of firms providing microfinance services in the region is high and the diversity of this competition provides for more aggressive strategies. As the rest of the forces will let us see, competition in the microfinance market in Ghana is currently high for KSF.

Barriers to Entry: Medium. The costs of setting up a microfinance provider in Ghana are not high. However, because of the upcoming regulation and of the economies of scale that an institution needs to attain sustainability are high, we assess that barriers to entry into the market has a medium level.

Substitutes: High. In the current environment that KSF operates, the number of substitutes is high. Management has emphasized on this several occasions. They remarked how costumers change from one institution to another since they regard the products and services from MFI's as similar.

Supplier Power: High. The bargaining power of commercial borrowers is extremely high as they require elevated interest rates from the institution or no lending will take place. As for the subsidized loans, there is a large amount of institutions that look for this funding, so this loan providers have great power in deciding who should access them or not.

Costumers Power: Medium. Microfinance clients have a strong need for the loans that KSF provides, this reduces the bargaining power of the costumers. However, the existence of a high number of MFI's (and other microfinance providers) provides the costumers with the ability to change creditors.

1.3.4. ACHIEVEMENTS AND SPECIFIC CHALLENGES

According to the “Global Microscope on the Microfinance Business Environment 2010” from "The Economist Unit", Ghana now occupies fourth place worldwide, behind Peru, the Philippines and Bolivia, being the leader in Africa.

Among the achievements of the sector, it deserves mentioning:

a) **Provision of working capital funds** for many small entrepreneurs and small businesses´ owners to access to credit that was denied by traditional banking institutions.

b) **Job creation:** helping entrepreneurs allows creating job for others.

c) **Training and capacity building** for customers to learn how to handle credits, savings, etc.

d) **Supporting the communities´ development** which have allowed them to be able to improved socially with, for example the arrival of water to them.

e) **Some approaches between formal and informal sectors:** the agreement between Barclays Bank and the Susu Collectors has increased confidence in the Susu system and has enabled the leveraging of informal sector funds into a traditional bank.

Among the main challenges is the sector it deserves mentioning:

a) **Institutional Framework:** Relations between stakeholders are not well defined. It is necessary to clearly define them and their different roles.

b) **Capacity building:** stakeholders often organize training programs for employees in the industry, but basic skills are still below the desirable level.

c) **Financing needs:** new ways of "funding" must be found for the sector in order to allow them meet all their development needs.

d) **Credit Management:** credit strategies are not sufficiently diversified and are not completely efficient nowadays, therefore MFIs do not meet all the demands of their customers.

e) **Quality of information**: there is no clearinghouse in the country to collect data on microfinance institutions, its operations and its customers. Likewise, no common benchmarks have been defined in order to make comparable the institutions currently operating. Having a common database would facilitate the planning and decision making by the Government, institutions, investors, etc., as well as an assessment of its current performance.

f) **Regulation and Supervision:** a regulatory balance must be obtained in order to facilitate the incorporation of new products and services to the sector and protecting the interests of customers and their deposits, but is should not be too rigid. The supervisory role of the Bank of Ghana should be especially checked because it recognizes its lack of necessary resources for supervision of the entire sector.

g) **Coordination:** At present, it does not exists any formal institution responsible for coordinating all activities associated with microfinance, nor a formally established forum for dialogue. This leads to duplication of efforts and lack of cooperation. In this sense, the role of GHAMFIN as an "umbrella" for various industry associations should be strengthened in order to ensure the transfer of best practices within the industry.

Guidelines for action to coordinate the various associations (CUA, GCSCA, ASSFIN, etc.) should also be established. This specific weakness is also included in the Global Microscope on the Business Environment for Microfinance 2010.

1.3.5. NEED FOR MICROFINANCE IN GHANA

Ghana has a population of over 24 million, of which 28.5 % are living below the poverty line, thus providing a huge market for microfinance. According to a recent population and housing consensus, approximately 80% of the working population belongs to the private informal sector, which lacks access to credit facilities.

Also, about 80% of the Ghanaian population lives in rural areas of the country, which often lack basic infrastructure needs. As observed in our on-field research, this segment of society´s needs is highly neglected by most financial institutions, as servicing them can be expensive. Furthermore, those who are neglected are often in the farming industry, which constitutes almost 40% of Ghana's GDP.

Hence, there is an urgent need to address this situation in order to eliminate the growing poverty and widespread inequality amongst the productive poor, thus boosting the economic growth of the country.

KRABAN SUPPORT FOUNDATION (KSF)

- Introduction and Overview
- Products Portfolio and Social Impact
- CAMEL Methodology

2.1. INTRODUCTION AND OVERVIEW

KSF is a self-regulated financial NGO and is not under the supervision of the Central Bank, at least until the approval of the regulatory framework for semi-informal and informal microfinance institutions. KSF was established on January 21st, 1997 as a private voluntary organization under the law Nº 179 that regulates Companies Code of 1963, to promote micro-credit as an element of human development.

The company headquarters is in Accra and has two branches, one in Takoradi and another in Somanya. According to the information in MIX Market, it has 43 other service points where they can provide their services without having a physical infrastructure.

The number of clients of the institution at December 31, 2010 amounted to 8,017.

KSF's vision is to develop a strategy for the poor in response to social and market demands focusing on gender equality. They expect to be the leading financial NGOs in Ghana in 2025.

Its mission is defined through the development of innovative strategies to strengthen the capacity of the groups at risk of social exclusion to operate independently and effectively in the informal sectors of the Ghanaian economy.

The medium and long objectives of the institution according to the latest definition of its Strategic Plan 2008 are:

- Collaborate with other institutions to plan, develop, implement and manage microcredit and educational programs related to subjects such as rural health, health improvement, water management, AIDS, etc..
- Direct financial resources to organized groups that generally have not had access to traditional banking.
- Helping to improve their clients´ qualities and skills used in their business.
- Increase customers' financial education.

The institution's methodology is based on group lending (which is called TEACH strategy). It is developed through educators or "community animators" to help members of rural communities to carry on their business while making good use of KSF funds. That makes a basic aspect for informal economy sector which is the Institution’s main target.

The institution´s organization chart is pending formalization. There is a draft of it that in Annex 6.

If we make a qualitative SWOT analysis of KSF, our conclusions are:

Strengths

- CEO´s good academic skills and wide professional experience in the microfinance sector (14 years)
- CEO´s active collaboration with most important sectorial institutions.
- Strong social orientation, the institutions is reaching the poorest segments of the Ghanaian society.

Weaknesses:

- Rudimentary management information and financial systems.
- Absence of formalized procedures.
- Weak Board Performance.
- Lack of monitor compliance with Strategic Plans.
- Unclear definition of the institution´s key financial and social indicators.
- Need of improving transparency with different stakeholders.

Opportunities

- Stable macroeconomic environment in Africa.
- Worldwide recognition of microfinance as an element for poverty reduction.
- Absence of competitors in the districts where it operates.
- Existence of other regions / populations with financing needs, not being covered yet.
- Alignment of KSF´s mission with the interests of the target communities.
- Ability to develop innovative new products, leveraging new technologies.
- Favorable environment for foreign investors.

Threats:

- Difficulties in obtaining stable funding over the medium and long term.
- Burgeoning competition due to the success of microfinance in the country
- Increased regulatory and supervisory pressure and expected capital requirements for financial NGOs.

2.2. *PRODUCTS PORFOLIO AND SOCIAL IMPACT*

2.2.1. OVERVIEW

As part of its vision, KSF believes in a strategy to combat poverty through the provision of efficient and effective services that improve customers' lives in their communities. For the understanding of KSF as a financial institution, it must be clarified the concept of product, which is not linked explicitly to the typical products of savings or credit, but focuses on a social order that affects a particular group, from which use financial services as a method of association, commitment and improvement of the participants´ economic activity.

The ultimate goal of KSF is to try to gain access of small entrepreneurs to financial services. This is carried out mainly through the "Savings and Credit Cooperative Societies" (CSCS) which are groups of people in a community where members deposit their savings and subsequently lend to them. Basically, 98% of the recipients of the loans are women.

KSF aims to increase the benefit of households, economic security and employment opportunities among the members of the groups. The creation of the CSCS and the groups is as follows:

- **Group selection:** there is a prior analysis of potential communities through visits and research to identify economically viable and active communities. This analysis (individuals, entrepreneurs, existing schools and water, etc.) not only helps the formation of the group, but the detection of relevant training needs of its members.

  Members of each group are also analyzed individually to ensure that they accept the rules of the program based on the principle of solidarity lending. Similarly, group members are educated on the characteristics of loan fees and interest charged and the manner of repayment. [8]

- **Loan Amount:** The first time, loans are set at 100 cedi regardless of the scale and the capacity of the company. The following loans are determined by the regularity of the customer's savings and loan payments, the amount of previous loans and assistance to group meetings.

- **Follow up:** After the loans disbursement, loan officers summon the group to KSF weekly meetings. During those meetings, loan officers collect the loan principal and interest agreed per week. Each group member has a passbook, where savings, amortization and other expenses are registered. This ensures that loan officers are able to track the loans. Clients in arrears are tracked to their businesses or homes if they do not attend meetings.

This methodology is called TEACH (Training, Education and Credit for Health) by KSF and this is carried out through the "community animators", KSF employees committed to working in these rural areas. The "community animators" perform training activities on health related issues and give the clients the skills needed to improve the members of the group´s entrepreneurial performance. With the TEACH methodology, KSF adapts the characteristics of products and services offered to the needs of its customers.

[8] Each client´s passbook contains, on its first page, the 12 rules that govern the operation of the CSCS.

According to comments from the CEO of KSF, this group methodology is based in the model of the famous Grameen Bank of Bangladesh [9], which was headed by Nobel laureate Muhammad Yunus until recently. Annex 7 describes the Grameen model.

KSF currently has two products following group methodology, which are the following:

- **SIKA ROSE**: This microfinance program started in November 2004 primarily to reach groups of women entrepreneurs. It is financed by a fund to be renewed annually by the Social Investment Fund (SIF) and is managed through the association of rural banks. Customers from this program are located in 10 communities. According to data from KSF´s CEO, the interest rate on these loans in 2010 was 40%.

- **AGAPE**: These loans have a humanitarian character and are granted to displaced persons that generate income to support their families within the informal economy in Ghana. The program began in May 2005 and it is supported by the International Alliance of Women (TIAW) - a micro-enterprise development organization based in Ontario, Canada. The interest rate charged is 20%.

KSF also grants loans on an individual basis:

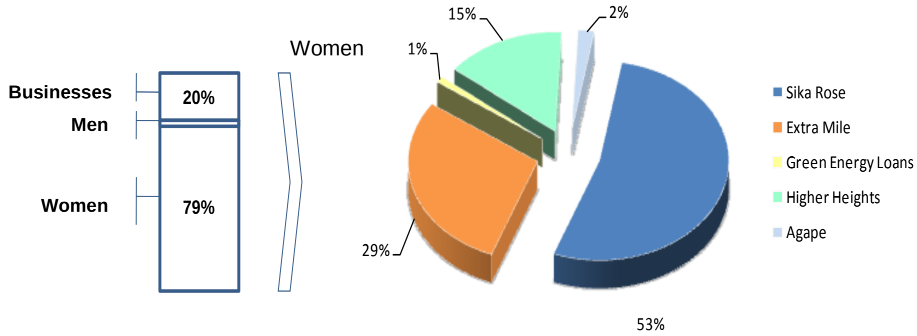
- **EXTRA MILE:** It is a microcredit program whereby people around the world make loans to KSF´s individual customers through the KIVA Microfunds website. KIVA Microfunds is based in San Francisco, California (USA). The scheme began in November 2006 and reached 600 KSF´s clients. Currently KSF is not participating in the program. The interest rate applied is 40%.

- **HIGHER HEIGHTS**: The program is funded by MiDA (Millennium Development Authority) for the development of agriculture. At the end of 2010, it had benefited a total of 188 farmers. The rate applied is 30%.

- **GREEN ENERGY LOANS:** This is a program for the installation of energy in rural areas, supported by the American association “Energy - in - Common (EIC)”[10]. They have distributed 48 solar lanterns to individual customers. The interest rate is 20%.

The figure on next page represents the composition of KSF´s portfolio:

Figure 2. KSF´s portfolio by gender and type of product



[9] See www.grameen-info.org. It deserves mentioning that KSF has not established a pattern of decisions and indicators to measure the social impact of the institution.
[10] http://www.energyincommon.org/

Since its origins, KSF has developed other programs and products in order to meet its customers´ needs. Details of some of them can be seen in Annex 8.

2.2.2. OVERALL ASSESSMENT AND RECOMMENDATIONS

KSF has a strong relationship with the groups created in the areas where they operate. When meeting with clients during our visit to the Doryumu, Kordiabe and Somanya´s districts, we were able to verify the confidence that members of different groups had in KSF.

We value positively KSF´s commitment for developing innovative credit products with a previous analysis of the community where those will be granted, in order them to meet eligibility criteria of the institutions with which KSF´s collaborates. In any case, we recommend KSF to formalize the process of analyzing and developing programs with those institutions and to start considering possibilities of creating its own pilot projects to develop new products in order to start reducing its dependence of other institutions´ programs. If by any reason KSF did not have access to those partnerships in the future, the survival of the institution would be difficult.

During our field visit we found out that some of KSF´s clients did not completely understood their credit conditions and due to the absence of a translator, we weren't able to check in depth their view on the institution. As part as KSF´s commitment to ensure transparency on operations with its clients and to demonstrate its economic, social and human engagement with them, the institution should make sure their clients know all the conditions´ details of their credits and should collect, process and investigate all complaints from those clients, trying to respond their demands quickly. In order to do so, we recommend the freely available tool "survey monkey", (http://es.surveymonkey.com/home.aspx). This step will also help the institution to improve its operations efficiency and social impact and to improve its image, increasing its clients´ loyalty.

We believe KSF should strengthen its social impact assessment to increase the attractiveness of the institution to potential investors, and thus systematize the benefits and assistance they provide to their customers. Although KSF´s CEO showed us a client´s satisfaction questionnaire, KSF have no practical indicator for measuring its social impact. It should also measure the conditions of the community before its entry into the community and after the concession of microfinance products and services.

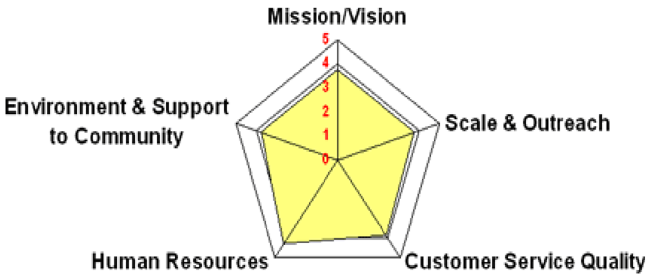
KSF could make use of the 22 indicators defined by "The Social Performance Task Force", a worldwide organization with more than 1,000 members representing. These indicators are available at http://www.sptf.info/

Other option could be to use some tools for assessing poverty, publicly available online:

- **Progress out of Poverty Index (PPI)**: it was designed by the Grameen Foundation to measure the organizations´ social impact in all countries where it operates. It measures the poverty levels of groups and individuals and monitor changes in poverty levels over time. The Ghanaian PPI is a set of 10 non-financial indicators that are easy to collect, http://progressoutofpoverty.org/new-ghana-ppi

- **Poverty Assessment Tool (PAT):** Tool developed by USAID. The latest version developed for Ghana is from 2010. As in the previous case, it collects information through the application of a questionnaire. http://www.povertytools.org/countries/Ghana/Ghana.html

- **INCOFIN ECHOS:** From the standpoint of the investor, the microfinance investment management firm INCOFIN has developed a tool to measure the social impact of the entities in which it invests through a questionnaire of 44 questions focusing on 5 dimensions:



- **Indicators developed by ACCIÓN Internacional:** This institution developed a framework for measuring social impact taking into account six factors (social mission, clients´ welfare, transparency of information, consumer protection, community partnership and work). This tool, available at http://www.accion.org/, allows the institution´s evaluation of success from the social point of view. This complements the financial assessment tool provided by ACCIÓN´s CAMEL.

It should also be noted that one of the future plans of the institution is to increase the portfolio of products offered (microinsurance, microleasing, etc.).

2.3. CAMEL METHODOLOGY

2.3.1. INTRODUCTION

The application of the conventional analysis of a financial institution does not identify the strengths and weaknesses of microfinance institutions for three reasons:

1. They develop their activity in unstable macroeconomic scenarios, with high inflation, which can significantly impact their financial statements. The main assets of MFIs are of monetary nature and the real value of equity decreases with time, representing an unrealized loss for the entity that is not always registered for accountancy purposes.

2. Due to its social character, most of them are subsidized entities, therefore, in order to determine the financial sustainability of the microfinance activity *per se*, the analysis must distinguish between the subsidized part and that which is not. Thus, we can get an idea of the institution's financial performance and the quality of its loan portfolio, and we can also compare it with other entities.

3. The poor quality of available information, both in the absence of third parties contrasting reports (audits, rating agency reports, reports from industry analysts, reports from the supervisory body, etc..), and the lack of technical and human resources regarding the accounting and financial reporting system.

These characteristics have created a need to make an accurate adaptation of the tools of conventional financial institutions´ analysis and evaluation to microfinance. One of the best known methodologies for the analysis of MFIs is the ACCIÓN International's CAMEL. The issues discussed in this methodology are described in Annex 9.

2.3.2. FINANCIAL STATEMENTS´ ADJUSTMENTS

For better analysis of the nature of an MFI, ACCION´s CAMEL proposes six previous adjustments to the financial statements. Below, we will assess their impact on KSF, based on the financial statements (USD denominated) set out in Annex 10.

2.3.2.1. ADJUSTMENT 1: FOR MICROFINANCE ACTIVITIES

This adjustment is intended to exclude from analysis any activity not related to microfinance. It does not apply in KSF because all its income is derived from such activity. KSF currently considers BDS (Business Development Services) Fees as a non-operating income. Nevertheless, as it is obtained from its own microfinance activity, it should be included into the operative results. This adjustment would suppose a 17% increase in the operative income.

Therefore, it is recommended that KSF makes the registration of the BDF fees so that they can reflect operative results. See figure on next page.

Adjusting for the Scope of Microfinance Activity (USD and %)								
	2010		2009		2008		2007	
Unadjusted Total Income	138.033	100%	98.221	100%	122.511	100%	93.877	100%
BDS Fees (Business Developement Services)	23.181	17%	31.028	32%	58.701	48%	11.774	13%
Adjusted Total Income	**161.214**	**117%**	**129.249**	**132%**	**181.212**	**148%**	**105.651**	**113%**

2.3.2.2. ADJUSTMENT 2: PORTFOLIO IMPAIRMENT

CAMEL proposes an adjustment to the loan loss provision applying predetermined percentage rates according to defaulted loans aging. The provisioning rates are based on the experience of ACCIÓN International.

According to KSF's 2010 Audit Report, the institution' annual provision varies between 3% and 5% of the current portfolio, based on its own historical experience. We believe this policy is not sufficient and does not have a correspondence with the figures reflected in the financial statements.

By applying the CAMEL's 2008-2010 accumulated loan loss provision adjustment, a 77.4 thousand USD shortage in the reserve is found. This represents 6% of the total portfolio, and would increase the provision from 85 thousand to 163 thousand USD: In terms of the total portfolio this represents an increase from 7% to 13%. The following chart shows the development and detail of the adjustment:

Portfolio aging USD (% of total portfolio, %grw)								
	2.010			2.009			2.008	
Up to 30	1.097.161	89%	23%	889.432	94%	11%	803.233	89%
31-90	115.511	9%	182%	40.968	4%	(54%)	89.193	10%
90-180	8.991	1%	5%	8.586	1%	12%	7.693	1%
>180	12.994	1%	195%	4.408	0%	66%	2.650	0%
Total loan portfolio	**1.234.656**		**31%**	**943.394**	**1**	**4%**	**902.769**	
Adj. Loan loss provision (% of total loan portfolio)								
Loan loss provision	30.841	2%		28.160	3%		12.231	1%
Adjustment	21.123	2%		(31.714)	-3%		88.065	10%
Adj. Loan loss prov.	**51.965**	**4%**		**(3.554)**	**0%**		**100.296**	**11%**
Adj. Loan loss reserve (% of total loan portfolio)								
Loan loss reserve	85.284	7%		54.442	4%		26.282	2%
Adjustment	77.474	6%		56.351	5%		88.065	7%
Adj. Loan loss reserve	**162.758**	**13%**		**110.793**	**9%**		**114.347**	**9%**

We consider that KSF result is strongly penalized by this adjustment due to the way loans are registered (it is impossible to distinguish between regular loans and up to 30 days past due, because both types are integrated in the same epigraph called Outstanding loan portfolio).

Since Camel suggests to set aside 10% of the up to 30 days past due loans, we have assumed to apply the provision to all outstanding loan portfolio epigraph, which implies a risk overestimation of the portfolio.

Being aware of the technical and human resources limitations related to the portfolio management (high rotation and payment frequency standards, communication procedures between branches, etc.), we highly recommend to implement an information system allowing distinction between current loans and loans past due up to 30 days.

Given the importance of portfolio risk in the decision making of potential investors, we also recommend KSF to adopt a more consistent and clear policy for the calculation of the reserve portfolio impairment (such as the system proposed by the CAMEL method).

2.3.2.3. ADJUSTMENT 3: NON-PERFORMING LOANS

Unregulated microfinance institutions do not cancel their bad loans on their balance sheets, since they are not legally compelled to do so. Consequently, their assets get increased artificially. The adjustment proposed by CAMEL considers any 180+ non-performance credit as bad loans or litigious. At December 31st, 2010, KSF must canceled 12.9 thousand USD from its balance sheet with the following details:

Write-off Adjustment (% over portfolio, %grw)

	2.010			2.009			2.008	
Adjustment	**8.586**	**1%**	**388%**	**1.758**	**0%**	**-34%**	**2.650**	**0%**
>180	12.994	1%	195%	4.408	0%	66%	2.650	0%

KSF have to cancel from the total loan portfolio all the Non-performing loans and charged it to reserves, so that portfolio accurately reflects the total amount of recoverable credits.

Given that the loan loss reserve has been previously adjusted to absorb the write off, there is no net effect neither on the balance sheet nor the income statement. Although there is no impact on the financial statements, this adjustment provides more reliability and credibility to the management or financial reporting and accounting that KSF develops.

2.3.2.4. ADJUSTMENT 4: EXPLICIT AND IMPLICIT SUBSIDIES

To determine the viability of an MFI and to determine the entity's ability to cover the cost of financing at commercial rates, the financial statements must be adjusted for subsidies.

In this sense, we distinguish between the effect of donations (which are generally accounted as current income) and debt at below-market rates. The adjustment considers the former as equity investments, while for the later, the difference between the subsidized price [11]and the commercial rate is considered a higher financial expense.

When applying this adjustment in KSF, although grants and donations are clearly identified in the financial statements, it has not been possible for us to determine the cost of debt of KSF, since we did not have access to precise information on the maturity structure of liabilities.

We've been forced to approximate using the weighted average cost of debt at the end of the period. As shown in the chart below, the cumulative adjustment to December 31, 2010, is 80.6 thousand USD.

[11]CAMEL regards subsidized debt to all those liabilities at a cost of less than 75% of the market price which the entity has normally access to.

End of period Debt USD (% and weighted average rate)									
	2.010			2.009			2.008		
	Amount	%	Int.rate	Amount	%	Int. rate	Amount	%	Int.rate
Subsidized Debt	324.313	87%	12,36%	164.721	67%	12,03%	263.899	90%	8,14%
Commercial Debt	48.480	13%	30,90%	81.836	33%	36,14%	27.824	10%	30,00%
	372.793		14,77%	**246.556**		20,03%	**291.723**		10,22%
Adjustment for Subsidized Debt USD (% of increase over original financial expenses)									
Financial Expenses	24.038			14.741			12.321		
Adjustment	51.506			15.026			14.069		
Adjusted Financial Expenses	**75.544**	**214%**		**29.767**	**102%**		**26.390**	**114%**	
Accumulated Adjustment	80.601			29.095			14.069		

We estimate that KSF would have to support financial expenses of 214% higher if it had no access to subsidized debt. Given the limited room for maneuver on the rest of their operating costs, we believe that the only way to bear this financial burden would be to apply its clients an average rate of interest as close as possible to the APR (Annual Percentage Rate) set by the CAMEL Method for sustainability: 39.5% (currently, we estimate that 32.7% applies).

Within this section it would also be necessary to adjust the services provided at below-market price and other gratuities. Even if according to the information provided by KSF there are no items of this nature, We recommend KSF to adopt measures in order to clearly identify in its accounting records, all the services (personnel cost, supplies, outsourcing etc.) provided at a price below market, indicating the amount subsidized in each one (obtained by the difference between actual price and market price), in order to better monitor the sustainability of the activity.

2.3.2.5. ADJUSTMENT 5: INFLATION

This specific adjustment devalues equity and revalues fixed assets by inflation data (year to year, end of period) and compares it to the provision recorded to the effect, if it exists. KSF does not make any adjustment in accounting, showing an undervaluation in real terms of equity, since they are funding primary monetary assets (loan portfolio represented 95% of assets in 2010). In this case, KSF has to take into account the effect of inflation because their own funds have suffered a loss of value of 22% using as starting in 2008.

As shown in the chart below, the loss is barely compensated for the revaluation of fixed assets, and is a cumulative 22% of the total equity in 2010. This would be the percentage in which KSF should increase its capital in nominal terms in its aim to maintain the value of the portfolio in real terms and thus to ensure sustainability and solvency (ratio: active on equity). In this sense, the entity should affect inflation to their customers as an additional financing cost.

Inflation Adjustment (USD, % of Equity)				
	2.010		2.009	
Inflation	9%		16%	
Equity	812.374		697.499	
Fixed Assets Revaluation	593	0%	1.688	0%
Equity Devaluation	(69.690)		(111.415)	
Annual Adjustment	(69.098)		(109.727)	
Accumulated Adjustment	(178.825)	22%	(109.727)	16%

By the effect of inflation, KSF should increase the average size of its portfolio: first, to remain being competitive against their clients, who will require higher amounts in nominal terms, and second, to be efficient from an operational standpoint, offsetting the effect of inflation on operating costs (assuming it does not affect the gross margin). If KSF does not take account of this fact, its operational efficiency and competitive market advantage would be greatly reduced.

Average Portfolio Size (USD) and Inflation (base 2000)

	ACC.	2.010		2.009		2.008		2.007
Average portfolio size	43%	154	20%	128	16%	110	2%	107
Inflation	49%	478	9%	440	16%	379	18%	321

The improvement in inflationary expectations in Ghana for the next few years allows estimating a lower impact in this respect in the coming years.

2.3.2.6. ADJUSTMENT 6: ACCRUED INTEREST

This adjustment reduces revenues in the amount of accrued interest on nonperforming loans (over 30 days). Given the high portfolio turnover and frequency of payment typical of the microfinance industry, is rare the recording of accrued interest, and if applicable, its amount would not be significant.

Although KSF does not record such accrual, we considered to make the adjustment because of KSF´s portfolio management that considers as current receivables those that are outstanding for 30 days. The amount of the resulting adjustment is immaterial (USD 741 income reduction).

Annex 11 contains KSF´s financial statements after making the adjustments discussed in this section.

2.3.3. CAMEL INDICATORS

CAMEL methodology analyzes 21 indicators. Eight of them have a quantitative approach and weight 47% of the qualification and the remaining thirteen are qualitative and weight 53%. The score at the end is a number on a scale of zero to five, being five the measure of excellence. Like rating agencies, this numerical score, in turn, corresponds to an alphabetic rating (AAA, AA, A, BBB, BB, B, C, D, and unclassified).

The result of our analysis for KSF is a C rating.

The distribution of the score allocated in each of the quantitative and qualitative indicators are shown in the chart on next page:

CAMEL INDICATORS

QUANTITATIVE INDICATORS			QUALITATIVE INDICATORS		
INDICATORS	SCORE KSF	MAX. SCORE	INDICATORS	SCORE KSF	MAX. SCORE
CAPITAL ADEQUACY (15% max.)	8	10		2	5
1. Leverage	5	5	9. Ability to Raise Equity	2	5
2. Adequacy of Reserves	3	5			
ASSET QUALITY (21% max.)	7	15		3,3	6
3. Portfolio at risk	0	8	10. Portfolio Classification System	1,2	3
4. Write-offs	7	7	11. Productivity of Long-term Assets	1,2	1,5
			12. Infrastructure	0,9	1,5
MANAGEMENT (23% max.)				8,2	23
			13. Governance	2,4	6
			14. Human Resources	1,6	4
			15. Processes, Control and Audit	1,6	4
			16. IT Systems	1	5
			17. Strategic Planning and Budgeting	1,6	4
EARNINGS (24% max.)	8	20		2,4	4
5. ROE	0	5	18. Interest Rate Policy	2,4	4
6. Operational Efficiency	8	8			
7. ROA	0	7			
LIQUIDITY MANAGEMENT (17% max.)	0	2		11,6	15
8. Productivity of Other Current Assets	0	2	19. Liability Structure	6,4	8
			20. Availability of Funds to Meet Credit Demand	4	4
			21. Cash Flow Projections	1,2	3
TOTAL QUANTITATIVE INDICATORS	**23,0**	**47**	**TOTAL QUALITATIVE INDICATORS**	**27,5**	**53**

CAMEL sections are the following:

2.3.3.1. CAPITAL ADEQUACY

The objective is to measure KSF´s financial solvency in order to determine whether the risks are adequately compensated with capital and reserves, so that they can absorb losses.

- **Leverage:** it is the relationship between weighted assets by risk level and its own equity. The observed KSF´s ratio is 1.87 times. It is positive that the leverage is low because these entities are normally more exposed to bad debt, operating expenses are higher compared to other financial institutions and finally because the possibility for NGOs to attract new funds is more limited than of a commercial bank.

- **Reserves´ Sufficiency:** Measures the extent to which the institution is able to absorb hypothetical future losses by loan portfolio impairments. The level of provisions made by KSF is 52.4% above those required by the model, taking into account the level of delinquency that KSF has for different periods. One limitation found in the study was the inability to identify outstanding loans and those past due 30 days of delinquency. Due to this we have calculated a 10% provision on this term within the portfolio.

- **Ability to obtain Capital:** assesses KSF´s ability to respond to a need to increase the equity in a given time. The institution is able to maintain its capital in real terms, but relies on donations from individuals, corporations and development institutions, which, in case of shortage, would adversely affect the entity.

<u>Aspects for improvement and recommendations:</u>

- ✓ The record of disbursement and products´ payment operations must be done in a more rigorous way, making a clear distinction of the dates on which payments are made. Provisions must be calculated for each maturity and not as a generic percentage over 100% percent of the portfolio.

- ✓ The institution must have a clear policy and effective way to mobilize a significant amount of private sector capital and obtain commitments of future capitalizations. We recommend KSF to study possibilities of creating new partnerships with private companies as part of their Corporate Social Responsibility Strategies.

2.3.3.2. ASSET QUALITY

- **Portfolio at Risk:** measures past due loans over 30 days. Typically, loan terms in microfinance institutions are between 120 to 180 days with weekly repayments, and therefore any delay in payments of more than 4 weeks is considered at risk of default.

  Since KSF makes no distinction of renegotiated loans, and due to of the difficulty of identifying between the current portfolio and delinquent one of 1 to 30 days, we have assumed that it has 100% of its portfolio at risk.

- **Non-performing Loans:** reflects the portfolio impairment according to the risk weight assigned by the model for delinquencies of more than 180 days. KSF identifies 1.1% of its portfolio as uncollectible.

- **Portfolio Classification System:** this is the qualitative review of the terms of the portfolio impairment and the assessment of the institution´s policies associated with the portfolio at risk. KSF has not got any formal portfolio´s ranking system. However, it has databases of information available to develop one.

- **Productivity and Long-Term Assets:** The institution manages its assets over time without a thorough analysis of its impact on the entity. However, at this time, this lack of analytical rigor does not represent a risk to the institution.

- **Infrastructure:** The institution has adequate basic infrastructure, but with certain deficiencies that can impede productivity.

Aspects for improvement and recommendations

- ✓ The institution must have a formal ranking system portfolio broken down by level of risk and delinquency and based on a historical analysis of the classification of its portfolio.

- ✓ Renegotiated loans must be identified and provisioned accordingly.

2.3.3.3. MANAGEMENT AND GOVERNANCE

In this section, we analyze management and corporate governance policies developed by the institution. This is one of the aspects to be evaluated in a microfinance institution in accordance with the CAMEL methodology. In the microfinance industry, it has been proven that strong governance and management are required to ensure success. This entire section is based on qualitative measures and the conclusions reached are based on our professional judgment.

2.3.3.3.1 Ownership and Governance

KSF´s shareholders are three:

- Mr. Nana Opare Djan: Director and founder of the institution with 50% of the capital. He is also the CEO of the entity.
- Mrs. Hilary Grace Wobil: Co-founder and institutional manager with 35% of the capital (Mr. Opare´s wife). She works in a textile company.
- Mr. Ricky Boakye-Yiadom: Co-founder and businessman with 15% of the total capital. He works as distributor of Guinness beer brand.

KSF´s Board has overall responsibility for coordination and supervision of all activities planned by the institution and is exercised mainly through the CEO who is also member of the Board. Topics discussed during board meetings are related to the functioning of the institution, its operations, regulatory issues and human resources. As it was expected that the maximum time spent in the Board was two consecutive periods (of 4 years each), it was resolved to enable members to continue beyond that period.

It consists of 5 persons (3 men and 2 women), 3 with experience in the financial sector. The quorum for meetings is 4, and the CEO has no right to vote.

KSF has an additional committee that is dependent of the Board, and it is called the "Committee of Trustees on Credit". It is the body responsible for approving and monitoring credit operations. According to data provided by KSF´s CEO, “The Committee meets when necessary”. They do not formalized minutes of its meetings and it has not been possible to verifiy that there is a format for submission of applications for credit approval.

Aspects for improvement and recommendations:

- Overall, our impression during the visit to KSF´s headquarters was that the corporate governance and control environment could be improved. On the one hand, they were unaware of many of the inquiries we carried out despite having been anticipated by email with a comprehensive list and specific questions. On the other, when we asked for basic information such as books of Acts of Board Minutes of the Credit Committee, procedure manuals, etc, we found out that relevant information about the institution is kept in a disorganized way.

- ✓ It is necessary to establish a policy that reinforces the proper functioning, monitoring and allocation of responsibilities of the institution since currently there is no clear separation between the Board and Management. There is too much concentration of functions in KSF´s CEO who is at the same time member of the Board and CEO of the institution. Apart from the risk associated with the concentration of functions in one person, this can create distrust from the perspective of different stakeholders, especially international investors. A distinction between ownership and management is useful because it allows investors and contributors to join and leave without necessarily affecting the MFI's activity

- ✓ KSF should strengthen the frequency of its meetings (we have only been able to verify the conclusion of two of them in the last year). The quality of the minutes or meeting´s records should be improved by incorporating a section in which to express the agreements reached and the review of the key financial and social indicators. Additionally, it should include a section where special mention is made of changes in laws and regulations in the sector and the institution´s efforts in finding new ways of financing. Finally, it is worth mentioning that minutes shown had not been signed by the members as agreed in KSF´s statutes.

- ✓ As a good practice, and specially in this case, KSF should formalize COTC´s functioning (Committee of Trustees on Credit): mission, regulation, members, periodicity of meetings, agreements to be taken, performing acts, and so on.

- ✓ Taking into account KSF´s current organization, and the board´s willingness to include new members, it is recommended to further develop the formalization of procedures, the definition of mechanisms for the selection of new members, description of roles and responsibilities and dismissal´s procedures and establish 1) a Code of Conduct adopted by the Board to set policies to prevent conflicts of interest 2) Ethical principles to guide the organization 3) General set of standards and policies for a financial institution, 4) CEO and Board member´s accountability mechanisms

2.3.3.3.2 Management

KSF´s CEO was interviewed during our visit in Accra. He has adequate studies and nearly 15 years of experience in the banking and microfinance sectors. He is also ASSFIN´s General Secretary and one of its most active members. He has participated in various regional forums representing the association.

Moreover, the administrative and financial department of KSF is managed by a 35 years employee, who has spent more than three years working in the institution. The average staff´s age is 35 years and they have worked an average of 6 years in the institution.

Regarding the information provided by the institution, the staff was reduced from 16 to 10 people in 2008-2009. According to the CEO, this was due to some dropouts based on studying or human capital flight. They did not hire more staff to reduce costs and improve operational efficiency ratios, these people were replaced by volunteers. This decline has been able to be verified by the information in MIX Market website and the field visit.

As described in the following section, we received drafts of the institution´s procedures documentation very late, and we weren´t able to verify its content during our field visit. Annex 12 contains a dratt of KSF´s future Human Resources policy.

Aspects for improvement and recommendations

As mentioned earlier, due to the concentration of tasks and decision making on the CEO, for the good functioning and sustainability of the institution there are two issues that must be urgently addressed 1) the formalization of processes in order not to jeopardize the management of the organization in case of the CEO´s absence and 2) the monitoring and evaluation of the CEO´s accountability in order to increase potential investors confidence on the institution.

KSF has a draft of is new HHRR Policy, which, although we believe it should be developed further in the future, it is for now a good starting point. We believe there is one topic that should be included for now, which is the definition of the indicators to assess staff´s performance.

Since the true competitive advantage of any institution lies in its employees, we recommend KSF to invest time and efforts in:

1) Promoting and increasing the integration and participation of employees in the institution by organizing biweekly meetings in which they are listened, can share ideas, show complaints, expose their challenges and their plans to overcome them, etc These meetings should become a tool to improve the work environment, to increase the staff spirit and commitment to the organization.

2) Training its own staff, especially in the following areas: Office, Accounting, credit risk management, receipts and payments control and administration. CGAP and

   ACCIÓN Internacional are relevant sources of information in issues related to these topics, containing freely available workguides in their websites, that can supply momentarily the staff attendance to more specific courses.

Because of the already gained experience of the institution working with volunteers, we recommended KSF give a boost to this idea. The same way KSF has volunteer community animators, it could consider the possibility of designing a strategy to expand this activities, (perhaps with students) who can assist the staff in urgently needed administrative and organizational tasks. (like organizing and making soft copies of all KSF´s documents)

2.3.3.3.3 Internal Control and Audit

After our request, the CEO sent us KSF´s manuals of procedures 15 days after our visit to Accra, so many of the issues addressed on them could not be verified. The explanation for this delay was that the document was not duly formalized and was expected to be approved at the next Board meeting. The draft of these policies is contained in Annex 12.

It deserve mentioning that, within the policies of transparency and consumer protection, KSF is among the entities that have reported to MFTransparency, an association recently born in the United States in order to promote transparency of prices charged in the microfinance industry.

KSF has no internal audit department given its size.

KOFI KYE & ASSOCIATES is KSF´s external audit firm, which has always performed its studies according to the information available on Mix Market and the comments of the CEO. This company has no website. The opinion issued by this company has always been normal. The external auditor's report is a mandatory requirement established by the Company's Code 1963. Internal control and audit

As expressed in the 2011 audit´s report,[12] the external audit has always been conducted according to international auditing standards. In its report, the auditor confirms that:

- All the information and explanations needed have been obtained.
- In his opinion KSF keeps adequate accounting records.
- Financial statements (balance sheet, income and cash flows statements, etc.) fit the accounting records.

We note that among the information appearing on MixMarket´s website (www.mixmarket.org) the report containing external audit for 2008, 2009 and 2010 was not published.

Aspects for improvement and recommendations:

From the External Audit point of view, KSF should send to Mix Market all the information in a timely manner. Likewise, KSF should set an auditor rotation policy to establish a change in audit firm after a specified period. Moreover, it is desirable that the external auditors issued a periodic report with recommendations to improve internal control which can be made up.

Regarding internal control, KSF should ask an external auditor to elaborate an internal audit of the institution with a memorandum of the situation and areas of improvement, every 3 years. KSF also needs to formalize its procedures manuals[13] and set the following additional policies for the proper functioning of the institution:

- Manual with all job descriptions.
- Manual on receipts and payments management
- Manual of financial planning and budgeting.
- Manual of accounting principles (credits considered failed, portfolio provision, etc.).
- Manual for the acquisition of fixed assets.

2.3.3.3.4 Rating

KSF got a 4 diamond qualification for the transparency criterion in Mix Market. This is supposed to happen when institutions provide audited financial statements, including the audit opinion and notes for at least two consecutive years, but, as mentioned before, KSF has not published its 2008,2009 and 2010 audited financial statements in Mix Market yet.

Aspects for improvement and recommendations:

- ✓ As the microfinance industry matures, microfinance rating services have gained increased attention from investors, practitioners, and donors. The growing relevance of MFIs has lead to the development of specialized microfinance rating agencies that

[12] Despite our insistence to the CEO of the Institution in the importance of having for this report the audited financial statements signed by the external auditor for 2010, it has not been possible to obtain this document.
[13] Annex 12 shows main aspects of the draft of these policies and also some recommendations to improve them.

perform global risk assessments and credit rating for MFIs. KSF must maintain complete and updated information in MIX Market and try to collaborate with other rating agencies. Since KSF currently has no website, this in the only way to make stakeholders aware about the existence of KSF and its current performance. By doing this, KSF will not only be contributing to create a discipline and control in the industry, but also will be introduced to a greater number of potential investors and other stakeholders and will improve its image by projecting a strong desire to maintain its transparency, social impact and good practices.

2.3.3.3.5 Management Information Systems

Technological infrastructure is key to the effective functioning of the institution since it reassures automatic registration of the accounting and the system for registering credits granted. It also allows the monitoring of those credits.

Existing systems are obsolete. It all works with an Office-based system, registering all accounting and recording of loans through Excel spreadsheets. It lacks a comprehensive Management Information System (MIS). Office equipment is very basic too.

They also do not have a formalized policy to back up and to assure data protection for data stored on each person´s computers. Similarly, when we visit KSF´s offices, we notice little organization on the information stored on computers, making it difficult to facilitate us our requirements on information. Additionally, we observed a lack of a complete knowledge by staff of the company regarding the use and management of microcomputer tools),

The collection and generation of basic information lists (budget monitory, projected cash flows, distribution of the loan portfolio according to different information levels, lists of collections and payments, etc.) are also subjected to operational risks

Aspects for improvement and recommendations

In the absence of a comprehensive information system (MIS), our recommendations are:

- ✓ Implement an anti-virus software on all computers. AVG is freely available at http://free.avg.com/us-en/free-antivirus-download

- ✓ Make use of free programs to store KSF´s information on the network (www.dropbox.com can be a good possibility). This also would facilitate an organized storage.

- ✓ KSF must consider de possibility of building its MIS on free operating systems such as Linux, since they are more stable and secure systems and are compatible with Windows.

- ✓ Install some sort of software to connect the accounting system with the loans granted by the company. In the meantime, KSF can develop a basic database application on MS Access to store data and produce the necessary reports. Somebody from the staff should be in charge of maintaining it updated. The needs of the organization must be identified in terms of accounting data, client data and other items such as cash flow matching (asset liability management).

    - Forms could include the follow:
        - Application form
        - Loan schedules

        - Employee information
        - Client data-entry form
        - Payment schedules for borrowings.
    - Reports could include:
        - All new requirements that will be put in place by ASSFIN
        - Loan aging schedules
        - All financial statements
        - Cash inflows and outflows

✓ As mentioned earlier, update staff knowledge on basic computer tools.

2.3.3.3.6 Business Plan

We reviewed the last two strategic plans and the CEO also showed us two Excel spreadsheets with financial projections. They did not incorporate the assumptions in which they were based, and there was no traceability as described in the strategic plan.

In our opinion, it business plan has a high formal component but it is not integrated into the current everyday management and decision making of the institution.

Aspects for improvement and recommendations

About the development and monitoring of the strategic plan, our recommendations are the following:

✓ Develop a strategic plan that is integrated into the daily management of the institution through the development of a scorecard that sets out the basic monitoring indicators (financial and social), which can be monitored on a monthly and yearly basis (in the Board meetings, in the annual report, etc.). They also need to develop a detailed action plan for achieving its goals in the medium and long term. Results should be monitored and evaluated by the board every 4 months to correct possible deviations from KSF´s objectives.

✓ Add to the Financial Plan all the assumptions on which it is based according to the strategy of the institution and provide different scenarios (optimistic and pessimistic normal) depending on several variables: changes in default rates, portfolio volume, changes in the yield curve, number of customers, etc. It should also be included a macro and micro analysis of the Ghanaian economy.

✓ Analyze the impact of the defined strategy for the estimation of resources.

✓ Use free tools available on the Internet for modeling financial projections. One of the most widely used for modeling business plan is available in www.microfin.com [14]

✓ Develop and verify annual financial projections and contrast them against reality periodically, analyzing causes of deviation.

✓ Especially in case KSF wants to establish international partnerships at different levels, it would be interesting to include a section with the current political and macroeconomic environment in Ghana, especially considering foreign investors.

[14]This is a worksheet designed to help microfinance institutions to develop detailed financial projections, including balance sheet, income statements and cash flow, after capturing a number of assumptions regarding the products and services, personnel, number of offices, funding sources, etc..

2.3.3.3.7 Partnerships

KSF is part of GHAMFIN and ASSFIN. These associations are already described in the section of the Ghanaian microfinance system.

Other affiliations held by the institution are:

- Ghanaian Private Voluntary Organizations in Development (GAPVOD)
- Ghanaian National Coalition on the rights of the child (GNCRC)

<u>Aspects for improvement and recommendations</u>

- ✓ In order to exploit the global nature of markets, KSF should develop its own strategy for establishing different types of partnerships with public and private institutions and national and international levels. By creating those partnerships, the institution will have access to exchanges of information, new technologies and technical processes to improve its global efficiency, will increase stakeholders confidence and even investors interest. It is also advisable to start exploring possibilities of establishing new partnership models that could bring together microfinancing activities with private non-financial corporations as other MFIs are doing.

2.3.3.4. EARNINGS

- **ROE**: measures the ability of the institution to maintain and increase its wealth through income from operations. Due mainly to adjustments made in CAMEL provisions of loan portfolio, the benefits are affected to the point of reporting losses. For this fact, ROE obtained for KSF has been -10.5%.

- **Operational Efficiency:** measures and monitors progress toward achieving a cost structure that is closer to the level reached by formal financial institutions. The total operating costs on the portfolio incurred by the institution are only 3.1% of the loan portfolio.

- **ROA**: ROA, measures the extent the assets of KSF are used or the institution's ability to generate revenue for a given asset base. Just as for the CAMEL ROE adjustment, ROA has affected the profits to the point of reporting losses. For this fact, ROA obtained for KSF has been -6.8%.

- **Interest Rate Policy:** measures the extent to which the entity's management analyzes and adjusts the interest rate, taking into account the institution's loan portfolio, the cost of funds, the goal of profitability, and the macroeconomic environment. A key indicator of sustainability for any MFI is the annual percentage rate (APR) which takes into account the costs incurred by the institution, its growth prospects and economic environment variables of the country where the activity occurs. The result gives a guide to the MFI about the average interest should be set to its products order to be sustainable and become less dependent on donations.

  KSF´s result is 38.2%, which compared with 30% average which is attributed to their microfinance products, reveals the strong structural dependence of its current assets to grants and subsidized credit. KSF set interest rates based solely on the market for loans charged by formal and informal lenders, and does not include a cost analysis.

Aspects for improvement and recommendations

- ✓ According to the CAMEL model, the weighting given to indicators of operational efficiency, ROA and ROE is very high and these are affected by common and observed. Proper structuring of the terms of loan portfolio, due and renegotiated are key to assign an adequate supply, assess risks and understand the real level of profitability of the institution´s microfinance activity.

- ✓ Interest rates should be based on their cost structure, including financial and operational costs, the provision for loan losses and increased capital. The institution must also adjust their interest rates in the face of Ghanaian´s macroeconomic changes.

2.3.3.5. LIQUIDITY MANAGEMENT

Assesses KSF´s ability to respond to 1) decreased funding sources and increase in assets, and 2) payment of expenses at a reasonable cost.

- **Productivity of Other Current Assets:** focuses on management of current assets that do not belong to the loan portfolios, especially investments in short-term cash. Thus, KSF classifies the use of its cash, bank accounts and short-term investments by investing in the right time and with high returns, depending on its liquidity needs.

  Treasury management should be consistent with the liquidity needs of the institution for its operations. This indicator penalizes whether their investments are very conservative or very aggressive. The result obtained by KSF is 293%, which means it has very aggressive investment policies with respect to its liquidity needs.

- **Debt Structure:** it analyzes the composition of the liabilities of the institution, including its amount, interest rate, payment terms, and sensitivity to changes in the macroeconomic environment. The institution has a funding strategy that neither minimizes funding costs nor leads to an optimal structure. However, the institution can access commercial loans on the Ghanaian Financial System.

- **Availability of Funds to Meet Loan Demand:** Although the institution has the necessary funds to meet its clients´ credit demands, during the field visit we found that some of KSF´s clients complaints against the institution were about the fact that once the credit was repaid, it use to take too long for the institution to grant them another credit, causing problems to their businesses. This fact deserves a further research to find the causes.

- **Cash Flow Projections:** assess the extent to which the institution is successful in projecting their cash flow needs. The analysis seeks to determine if they have been prepared with sufficient detail and analytical rigor, and whether past projections have been adjusted accurately to the input and output of money.

The calculation made by the institution about its payment needs is based on past experience rather than cash flow projections.

<u>Aspects for improvement and recommendations</u>

- ✓ The institution must prepare cash flow projections which include cash receipts from repayment of loans and other sources as well as money outflows for the disbursement of credit and other expenses for periods of 30, 60 and 90 days.
- ✓ Investments in other current assets must take into account the liquidity needs of the company.

CONCLUSIONS

The scope of this report was to make an in-depth analysis of KSF, studying the institution from different angles and looking at a different factors impacting on it. This has allowed us to understand its current situation and where does it look to be heading in the future.

The microfinance business model developed by KSF over the last 14 years has been based on the execution of a strategy to fight poverty based on deep knowledge of the communities where it operates and using group lending methodology. The future sustainability of the institution in an increasing competitive environment and greater regulatory framework should be a priority.

Overall, by our impression after the visit to KSF´s headquarters in Accra and as the CAMEL analysis revealed, we believe KSF should establish a set of action plans organized in two main areas:

1. **Corporate Governance and more specifically transparency, improvement of internal control procedures and operational quality.**

Good corporate governance contributes to efficient management, boosting the microfinance institution's reputation and integrity and fostering stakeholders trust. We recommend KSF the implementation of a complete policy of good corporate governance. In this regard, the “Principles of Corporate Governance” from the Organization for Economic Cooperation and Development (OECD), described in Annex 13, and the “Guide for the adoption of good governance principles in MFIs, from Fundación Microfinanzas BBVA, (available at http://www.mfbbva.org/english/fundacion/gobiernocorporativo.html) offer universally applicable frameworks to all types of organizations, being both a good starting point for KSF.

Moreover, while recognizing the institution's current efforts to boost transparency in their activities, we believe that it should focus its attention on creating a “culture of transparency” as a strategic choice, conducting a wide and continuous accountability of all its members and all its operations. Microfinance institutions have to be able to transmit to society its added value, and for that, transparency and accountability become key elements.

Regarding the improvement of internal control procedures and operational quality, we recommend KSF to do the following:

- Formalization and establishment of the basic procedures of the entity (human resources, accounting, treasury, etc.).

- The active role of the Board in making decisions based on the monitoring of defined strategic plan with a greater degree of independence from management through the recruitment of members with financial expertise.

- Establishment of a regular and structured tool for measuring KSF´s social impact.

- Human resources management should establish the appropriate training plans for staff.

- The rotation of the external auditor would enhance the institutions independence and transparency.

2. **Management information system:** in order to control and improve the various information processes that occur within the IMF and thereby improve all its operations, KSF should implement a MIS that allow at least:

   - The proper accounting of assets, liabilities and results of the entity.
   - Collections and payments monitoring and its accomplishment with the financial plan.
   - Correct loan portfolio classification.
   - El seguimiento mediante indicadores clave del perfil de riesgo de la cartera de crédito. Monitoring the loan portfolio´s risk profile with key indicators.

The implementation of all the measures mentioned in the report in the medium term, combined with the positive environment for microfinance in Ghana and will enhance the attractiveness of KSF for international and national investors.

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ANNEXES

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ANNEX 1. STRUCTURE OF THE GHANAIAN FINANCIAL SYSTEM[15]

Table 1. Ghana: Structure of the Financial System, 2000 - 2010

	Dec-00		Dec-05		Dec-09		Dec-10	
	Number	Percent of Total Assets	Number	Percent of Total Assets	Number	Percent of Total Assets	Number	Percent of Total Assets
Commercial Banks	16	76.9	20	70.5	26	75.1	26	75.1
Private	10	39.2	15	42.5	21	52.4	21	53.4
Domestic	5	4.0	6	8.0	8	12.7	8	15.1
Foreign	5	35.2	9	34.6	13	39.8	13	38.3
State-Owned 1/	6	37.7	5	28.0	5	22.6	5	21.7
Rural and Community Banks	113	2.0	121	4.3	134	3.3	135	2.7
Other Banking and Quasi Banking Institutions	33	3.9	34	4.7	46	5.0	47	4.6
Savings and Loan companies	8	0.2	12	1.0	18	1.6	19	1.8
Mortgage Finance Companies	1	1.4	0	0.0	1	0.3	1	0.3
Leasing and Finance Houses	21	1.2	20	2.3	27	3.0	27	2.5
Discount Houses	3	1.1	2	1.4	0	0.0	0	0.0
Nonbank Financial Institutions	57	17.2	80	20.6	113	16.6	134	17.5
Insurance companies	22	□	26	2.8	42	3.9	42	3.6
Life insurance	2	□	5	□	17	1.3	17	1.3
Non-life insurance	18	□	19	□	23	2.5	23	2.3
Reinsurance	2	0.0	2	□	2	0.0	2	0.0
Pension funds	□	12.5	□	17.8	□	12.7	□	12.4
SSNIT 2/	□	12.5	□		□	12.7	□	11.8
Other Public	□	□	□	□	□	0.0	□	□
Private	□	□	□	□	□	0.0	□	□
Securities Industry	35	□	54	□	71	0.0	92	1.5
Broker-dealers	14	□	18	□	22	□	21	0.3
Investment advisors	17	□	28	□	39	□	52	1.2
Custodians	-	□	3	□	4	□	12	□
Trustees	-	□	2	□	2	□	3	□
Total Financial System	254	100.0	291	100.0	364	100.0	387	100.0

[15] Data taken from the "Financial System Stability Assessment Update", International Monetary Fund, May 2011.

ANNEX 2. KEY PRINCIPLES OF MICROFINANCE[16]

1. Poor people need a variety of financial services, not just loans. In addition to credit, poor people want to have deposit services, insurance and money transfer services.

2. Microfinance represents a powerful tool in the fight against poverty. Poor households use financial services to increase revenue, invest in property and reduce their vulnerability to external shocks.

3. Microfinance means building financial systems that serve the needs of the poor. Microfinance will reach its full potential only if they are integrated into the established financial system of the country.

4. Microfinance can and should be sustainable if they are to reach a large number of poor people. Unless microfinance providers charge enough to cover its costs they will always be limited by the scarce and uncertain supply of subsidies from donors and governments.

5. Microfinance is about building permanent local financial institutions that can attract domestic deposits, recycle them as loans and provide other financial services.

6. Microcredit is not always the solution. Other types of support are ideal for those so poor they have no income or means of repayment.

7. Ceilings on interest rates can hurt poor people's access to credit. It costs much more to make several small loans than to do a few large loans. Fixing maximum interest rates prevents MFIs cover their costs and thus cut the supply of credit to poor people.

8. The role of government is as a facilitator, not a direct provider of financial services. Governments can almost never perform well as lenders, however they can establish a supportive policy framework.

9. Funds from donors should complement rather than compete with private sector capital. The grants offered by donors should be a temporary relief boot and is designed to support an institution until it can exploit private funding sources, such as deposits.

10. The crucial limitation to microfinance development is the lack of strong institutions and qualified managers. Donors should focus their support in building institutional capacity.

11. Microfinance works better when it reveals and measures its performance. The disclosure not only helps stakeholders judge the costs and profits, but also to improve performance. MFIs need accurate and comparable reporting on financial performance (Repayment of loans, etc).

[16] These principles were formulated and adopted by CGAP and its 33 member donors, and additionally approved by the Group of Eight (G8) heads of state at the G8 Summit on June 10, 2004.

ANNEX 3. ICRO´s NINE RECOMMENDATIONS TO PROTECT CUSTOMERS

1. Check that the financial institution is licensed under the Bank of Ghana.

2. Read all the information you are given, especially the conditions (fine print).

3. Ask about anything that you don´t not understand.

4. Carefully review any information they give you about the benefits of a product or service (eg. interest rate).

5. Make sure you understand the nature of the risks involved.

6. Make sure you understand the costs involved in the operation.

7. If a deal sounds too good or attractive to be true, check it again with other sources before signing.

8. Contact the ICRO helpline in case of having any doubt.

9. Compare that product or service with the ones of other institutions.

ANNEX 4. DRAFT PROPOSAL FOR THE REGULATION OF SEMI-INFORMAL AND INFORMAL MICROFINANCE SECTORS IN GHANA

This proposed regulation would apply to all individuals and entities providing financial services to the most informal and semi-informal sectors of the economy:

- Susu collectors and Susu companies
- Financial NGOs
- Those that are not included in the scope of the Banking Act of 2004 (Act 673) and the law of non-banking financial institutions, 2007 (Act 774).

As mentioned in the report, in recent years Ghana has increased the number of these financial service providers, and the Bank of Ghana intends to establish a regulation for them, as well as because of the requirements of the microfinance policy in Ghana.

The institutions will be categorized into three TIERS: Tier 2, Tier3 and Tier 4 with different regulatory requirements:

- **Tier 2:** These entities will be subject to compliance with the Banking Act of 2004 after completing a series of requirements:

    - The minimum capital would be 100,000 GH.
    - It will be required to maintain a capital adequacy ratio of 10% for taking customer deposits. Customer deposits held above 5,000 GH should be informed to the Bank of Ghana on a monthly basis.
    - The opening of new offices of these institutions shall be subject to normal approval process by the Bank of Ghana and compliance with capital requirements and formal requirements.
    - Such institutions will have periodic reporting obligations with the Bank of Ghana.
    - A system of penalties for non-compliancy with regulations will be established.

- **Tier 3**: These entities will not be allowed to take deposits.

    - The minimum capital shall be established in about 60,000 GH.
    - Those deposits taken as collateral for a loan must be deposited in an escrow account in a bank or a Savings and Loans Company.
    - Licensing requirements, reporting and penalty system are similar to the entities under Tier 2.

- **Tier 4**: Originally planned for the Susu collectors individuals acting under the organization of an association as GCSCA.

    - No specific capital requirements but will have to create an insurance system coordinated by the association and under the approval of the Bank of Ghana´s approval.
    - They will operate within a geographical area and will not open branches except with the prior written approval of the Bank of Ghana.
    - They will not give loans.

Microfinance institutions belonging to Tier 1 are the formal microfinance services providers and are regulated under the current laws for banking and non-banking institutions.

In June 2010, a meeting was held in Accra in which each participant presented his opinion on this regulation´s draft. Consensus was reached about:

- The urgency of the regulation of this part of the microfinance sector.
- The 4-tier system is the preferred choice for the classification of entities.
- The establishment by the Bank of Ghana of a specialized unit within the inspection unit to focus on service delivery.
- The role of the various associations in the institutions´ regulation and supervision of institutions, must be defined (depending on their capabilities).
- There is a need to reassess capital requirements set in the draft.
- Ongoing monitoring of the institution´s operations must be constant.

ANNEX 5. FINANCIAL DEVELOPMENT OF GHANA

A. Description of the main providers of microfinance services in Ghana

- **Commercial Banks**

There are currently 26 commercial banks, more than half of them with foreign capital. About 35% of bank branches are in Accra, where less than 15% of the population lives. On average, only 40% of bank assets are loans, they prefer to invest in assets such as sovereign state debt (25%). Banks have generally not been interested in serving rural areas and low-income people due to high transaction costs and risk profile of the clients. The percentage of their portfolio dedicated to the agricultural sector is just under 20%. This lack of services to rural people has been partially covered by the Agriculture Development Bank (ADB), owned by the state, which has an important role in providing financial services to agriculture.

- **Rural and Community Banks**

Its owners are members of the rural community and are licensed to provide financial intermediation services in rural areas. Their activities began in 1976 with the aim to mobilize savings and provide loans in areas that were not well served by more conventional banking. These banks expanded during the decade of the 80 thanks to the government support. However, due to poor financial management, weak oversight and the natural disasters occurred in the 90's, the financial position of these entities deteriorated (That financial position was recovered in recent years).

These entities provide commercial loans to individuals or groups, generally for agricultural activities. These are short term-loans generally 4-6 months, with weekly payments and have the guarantee of a saving deposit made by the client in advance.

Since they are formal entities, it is costly in terms of time and transport costs for rural women to access to them. Being people with little financial education, the formal process of a loan can also be a significant obstacle.

Currently, there are approximately 125 banks and 439 branches operating under that name in Ghana. In 2001, an association to strengthen that group of Banks was created, the ARB Apex Rural Bank.

- **Savings and Loan Companies**

Within the formal sector, these companies use the “Susu” traditional methodology to collect deposits from clients daily or weekly. Once clients have demonstrated commitment to the system, those companies will provide them small loans to develop their small and medium enterprises. Unlike the publicly owned rural banks, the "Saving and Loan Companies" are private and are more focused on urban areas.

- **Credit Unions**

Its regulatory framework is currently being developed in order to reflect its dual nature of cooperative and financial institution that provide credit and savings services primarily to its members. The average number of members of each credit union is about 400-500 people. These are set out in the parishes, workplaces and communities across the country. Generally, customers of the Credit Union make periodic deposits into their accounts and can borrow more than what they have saved. The quality of the services they receive is generally poor.

- **Financial NGOs**

Since they are not being regulated directly by the Bank of Ghana, they are not subject to its rules. They are self-regulated. According to GHAMFIN, there are about 50 NGOs providing microfinance services, especially to women entrepreneurs not served by traditional banks. They also conduct training on nutrition, family planning, AIDS prevention, etc… to their clients.

Financial and operational sustainability in the medium and long term are their major obstacles for growth due to the lack of stable funding.

They have developed the "group based micro-lending", mainly to groups of women which have shown high repayment rates. Most of these loans are invested in economic activities such as fishing, trade, palm oil processing, etc.

- **Susu Collectors**

Susu is one of the oldest traditional banking systems found primarily in Africa. A Susu Collector is a person who collects money, usually daily, from its customers. At the end of the month, he returns the entire amount accumulated during the month, after deducting the saving of a day as compensation. They do not pay interests back on the deposit. Occasionally, the Susu collector can also grant loans to its customers before the date of repayment, and may even provide loans of longer duration depending on the customer's credit rating and its own available funds to lend.

The Susu collector visit shops, workplaces, markets and homes every day to collect funds from customers and channel them to a savings plan. He does this because his customers cannot open bank accounts. The approximate number of Susu Collectors in Ghana is 4000[17]. One Susu Collector serves between 200 and 850 customers each day.

- **Money Lenders**

People who receive a physical asset as collateral. The number of money lenders in Ghana has been reduced significantly over the past two decades.

[17] See article published on 25.02.2011 "Susu collectors – an ancient banking system soon ready for Investors"

B. Ghanaian Microfinance Institutions´ Associations

- **GHAMFIN (Ghana Microfinance Institutions Network)**

This is the main microfinance association that works since 1996 as coordinator and "umbrella" of other microfinance associations in the country (Savings & Loans Companies, Rural and Community Banks, Credit Unions, FNGOs, Susu (Savings) Collectors, etc.). Its main goal is to help improve the processes and problems of its members (lack of funds, training, technology, codes of conduct, inadequate operational strategies, conflict resolution mechanisms, etc.).Some of their specific objectives are:

- Establish performance indicators.
- Develop an information bureau for microfinance in Ghana.
- Organize workshops to share best practices among its members.
- Strengthen financial integration between the formal, semi-informal and informal sectors.
- Collaborate with the Government, donors and other regional networks in search of funds.
- Improve information systems of partner members.

- **GCCUA (Ghana Cooperative Credit Unions Association)**

It was established in 1968 as the association of the Credit Union Movement in Ghana. Its aim is creating the right environment for the operations of these entities in the country through their training and promotion.

It applies the prudential financial and operational standards established by the World Council of Credit Unions (WOCCU), which is part since 2009. CUA has 322 associates serving 242,000 individual members throughout Ghana and manage USD 107 MM in total assets.

- **GCSCA (Ghana Cooperative Susu Collectors Association)**

In 1994, the Ghana Cooperative Susu Collectors Association (GCSCA) was established. This partnership aims to improve the development and level of formality of this group through the inclusion of best practices. It imposes certain requirements the persons interested to enter this service. One of his greatest successes has been the partnership with the microfinance unit of Barclays Bank, for which the Bank served as custodian of the money collected by many of the Susu Collectors and increased availability of funds for them to grant their loans. Additionally, Barclays Bank is assisting the association with the training.

- **ASSFIN (Association of Financial NGOs)**

It was created in 2005 as the Association of Microfinance NGOs in order to regulate the activities of its associate members and assist them in their development through training activities. In this sense, the association has conducted various workshops on various topics (financial management, governance, etc.).

It also aims at establishing performance indicators and to create a favorable environment for financial NGOs´ self-regulation in order them to comply with local and international best practices in microfinance.

- **ARB APEX BANK**

It is a kind of "small" Central Bank for "Rural and Community Banks." It is primarily funded through the "Rural Financial Services Project" (PSBR), a project of the Government to increase financial intermediation in rural areas.

C. Support Institutions

- **MASLOC (Microcredit and Small Loans Centre)**

This association is one of the instruments used from the Government for achieving the objectives of poverty reduction. It was created in 2006 and was initially equipped with a contribution of USD 50MM. Over the years, MASLOC established itself not only as a microfinance institution that disburses small loans to different sectors of the economy but as an institution that has also provided training and advisory services to small entrepreneurs, as well as the collaborating institutions.

- **MiDA (Millenium Development Authority)**

It is the mechanism established in 2006 in Ghana to oversee and develop the implementation of the program aimed at reducing poverty through growth. It develops the objectives set in the programs of the American agency "The Millennium Challenge Corporation" (MCC) responsible for development aid. The aid programs are intended primarily to agriculture, improvement of rural areas and transportation.

- **SPEED (Support Programme for Enterprise Empowerment and Development)**

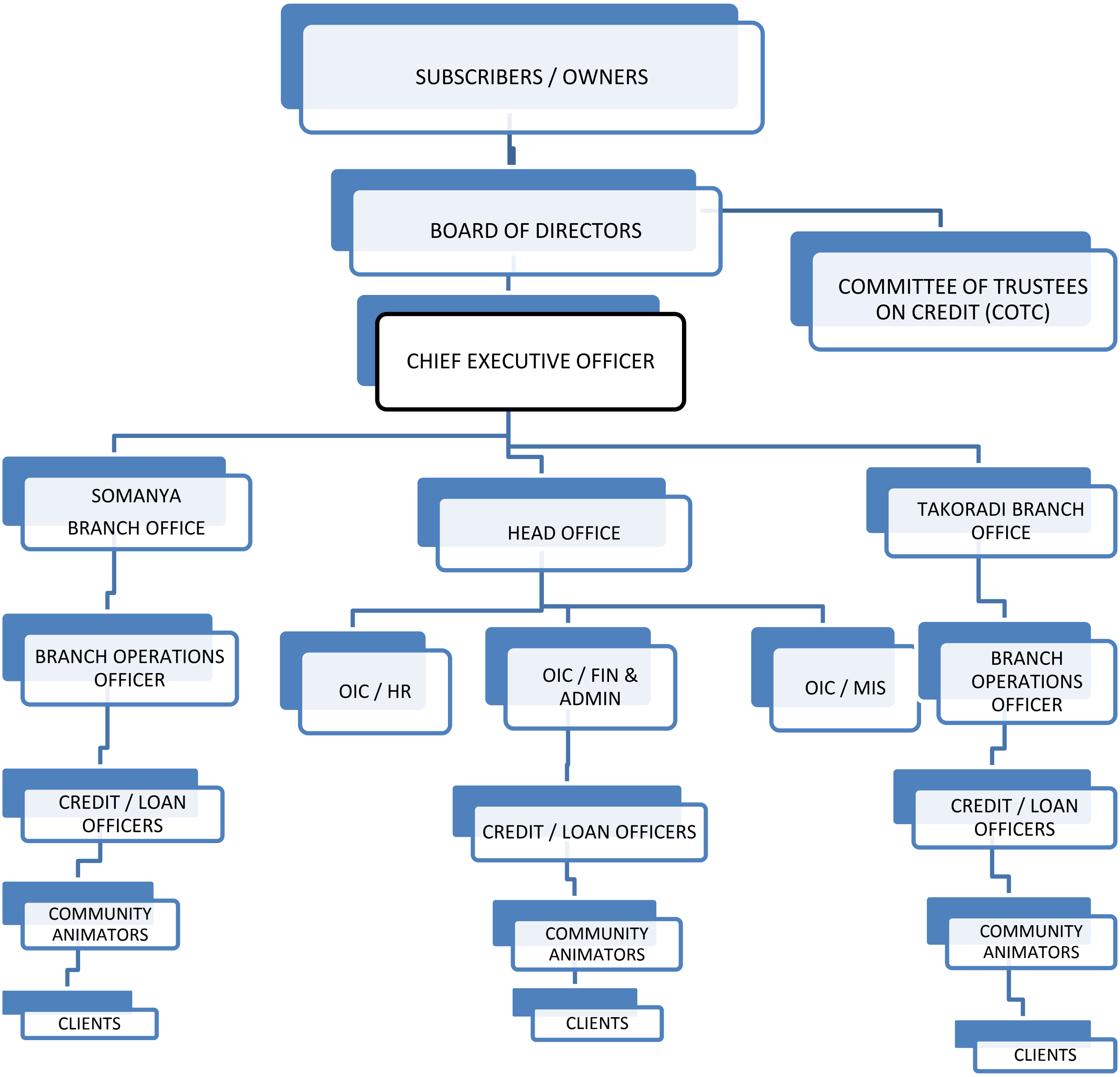
This support program is the continuation of a 1999 program for the promotion of small and medium enterprises, with the collaboration of the Government of Ghana and state agencies for development aid from Germany and Denmark. They offer technical assistance on training issues related to credit methodology, financial management, etc. and direct financial assistance to small businesses through the "Rural Banks".

- **SIF (Social Investment Fund)**

It was established in 1998 by an agreement between the Government of Ghana, the African Development Bank and the United Nations Development Programme. Its main objective is to alleviate poverty through its intervention in depressed areas (both urban and rural areas).

*In addition to the above institutions, the Bank of Ghana has undertaken various development assistance programs for small entrepreneurs. Some of the achievements and challenges of these programs are included in the next section.

ANNEX 6. KSF´s ORGANIZATION CHART (Pending of approval)



ANNEX 7. GRAMEEN MODEL[18]

Grameen Bank, created in the mid 70´s is probably the best-known microfinance institution in the world, achieving a major success providing financial resources to the poorest people in Bangladesh. The founder was Muhammand Yunnus.

The institution has always had the dual aim of reducing poverty through microcredit and the pursuit of economic-financial benefits [19].

According to Yunnus, if individuals obtain access to credit, they will be able to identify and implement viable economic activities and generate income to get out of extreme poverty. Thus, Grameen Bank provides credits based on the potential of people, without requiring physical collateral.

To be a customer or borrower of Grameen Bank, a person must pass a series of eligibility requirements. At first, the bank only accepts as eligible members those who possess a small number of hectares of arable land. Second, customers -potential borrowers are required to conduct a training program for 7 days. The goal is to educate these potential customers in the laws and regulations of the bank.

The philosophy that inspired Yunnus is based on that microloans do not only have an economic effect. They also have a powerful psychological effect: improved self-esteem and appreciation of their own capabilities. This has created the "16 decisions" that are nothing more than a list of principles that its clients are committed to follow to become members of the bank.

1. We will follow and promote the 4 principles of the Grameen Bank - discipline, unity, courage and work - in all areas of our lives
2. We will bring prosperity to our families.
3. We will not to live in a damaged house. We will try to repair our homes and build new homes at the first opportunity we have.
4. We will cultivate vegetables the whole year. We will eat all we need and sell the surplus.
5. During times of sowing, we will plant as many seeds as possible.
6. We propose not to have numerous families. It will minimize our expenses. We will take health care.
7. We will educate our children and ensure that we can earn enough to pay for their education.
8. We will always keep clean our children and our environment.
9. We will build and use latrines with septic tanks.
10. We will drink water drawn from boreholes. If not available, we will boil water or use a light for disinfection.
11. We will not accept any dowry when they marry our sons, nor give any when they marry our daughters. We will keep our heart free from the scourge of dowry. We do not practice any child marriage.
12. We will not commit any injustice and we will oppose those who try to commit them.
13. We will invest on a larger collective scale in order to get higher income.
14. We will always be willing to help. If someone is having trouble, we all will help him/her.

[18]Maricruz Lacalle, Javier Marquez, Jaime Duran, Silvia Rico,Laura Lamb, "The Grameen Bank,"Monographs Series No. 8 - Nantik Lum Microfinance Forum, February 2007.
[19] "Reaching the poor is a non-negotiable mission. Achieving sustainability is a strategic objective. "(Yunus, 1998)

15. If we find out that the discipline has been violated in any center, we will be there to help restore it.
16. We will introduce physical exercise in all our centers. We will take part collectively in all social activities.

Grameen Bank experience has shown that clients compliance with these principles, helps them improve their standard of living and welfare, and prepares them to cope successfully with their future debts.

To receive a microloan, potential borrowers should be organized in support groups formed by five people. Given the small size of the groups, members are well aware of their activities, reducing the possibility of any misuse of funds. The group members provide mutual support, while putting pressure on the rest for the loans to be properly used and that refunds are made on the due dates. Thus, the group acts as collateral for bank loans.

Each group should meet once a week with the bank officer assigned. These meetings are held at centers established in the localities where various groups meet at a time. The monitoring of the groups is done, new proposals for loans are studied, weekly payments fees are reimbursed and savings deposits required are done.

Some particular characteristics of Grameen Bank are listed below:

- Any borrower who receives his/her first microcredit would be required to purchase one share of the bank.
- Women have a strong presence on the Board of Directors of the Bank.

ANNEX 8. ADDITIONAL PROGRAMS OFFERED BY KSF SINCE ITS CONSTITUTION

PCIP: Public Catering Improvement Project. It was conducted in Daboase in 1997, in the Wassa Mpohor East District, in collaboration with the National Secretariat Service and the Lower Pra Rural Bank. They collaborated also with the growth and nutrition program for children sponsored by UNICEF.

BEAM: it was a basic hygiene education and promotion of micro nutrients program tested in Yilo Krobo District, along with the management team of the health district (DHMT) in 1999. It was aimed at mothers and infants to encourage the use of substitutes for extra protein in the diet. Save the Children UK funded the project and helped 575 women.

ORACLE: The Project of Organic Agriculture and Lending Education took place in 2000. The project partners were the Centre for Biodiversity Utilization and Development (CBUD) of the Kwame Nkrumah University of Science and Technology in collaboration with the Organic Agriculture Network of Ghana (GOA). The project promoted the use of improved leafy vegetables, prekese and snail farming methods, along with other techniques to improve agriculture.

READY: This program involves the identification and provision of business skills for young people in rural areas of Ghana. This is a program which linked 30 schools in which there is an average of 20 graduate students annually. They receive training in beekeeping, fish farming, horticulture, carpentry, bricklaying, hairdressing and dressmaking.

SANKOFA: This savings program is based on the traditional concept in Ghana called "susu". Members of these schemes contribute a fixed amount of money to a pool at regular intervals for a specific period. The amount is rotated among the contributors on a monthly basis. With the strategy of Sankofa the amount is used to purchase a tangible asset that serves to acquire new skills to generate income. About 500 people with disabilities have benefited from this program, 450 of whom are women.

TEACH I: This project was aimed to develop business skills and improving health infrastructure. It was carried out in Accra. The project seeks to improve income and health status of women traders, especially cooked food vendors. The promoter of this project is the German Development Service (DED).

TEACH II: The program focused on prevention and behavior change to address HIV / AIDS. It was held in the Krobo District of Ghana, area presenting an infection rate higher than the national average. The project was funded by the Ghana AIDS Commission and the District of Yilo Krobo. Around 1,200 women benefited from the program.

ANNEX 9. THE ACCIÓN CAMEL

CAMEL Methodology[20] was originally approved in the U.S. to assess the financial strength and management of banking institutions. It focuses on five areas of management and financial performance: Capital Adequacy, Asset Quality, Management, Earnings and Liquidity Management.

Based on the conceptual framework of the original CAMEL, ACCION International developed its own model of analysis to reflect the challenges and conditions of the microfinance industry.

The method evaluates 21 key indicators. Eight of them have a quantitative approach and weighted 47% of the rating, the remaining thirteen are qualitative and 53% weighted. The score at the end is a number on a scale of zero to five, five being the measure of excellence. Like rating agencies, the numerical score, in turn, corresponds to analphabetic rating (AAA, AA, A, BBB, BB, B, C, D, and unclassified).

MFI's financial statements are the basis of quantitative analysis. Once compiled, these must be fitted with two objectives: to give them the general format of the institutions of financial intermediation and thus make them comparable to the financial statements of similar institutions.

The ACCIÓN CAMEL performs six adjustments to the financial statements: the scope of microfinance activity, provision of portfolio losses on loans, loan loss provisions (write-offs), explicit and implicit subsidies, the effects of inflation, revenues from accrued interest.

The 5 areas of review in the ACCIÓN CAMEL are described below:

1. **Capital Adequacy:** The objective is to measure the financial soundness of the MIF and whether the risks involved are adequately compensated with capital and reserves, so they can absorb losses.

   One indicator is the **level of leverage:** the ratio of weighted assets by risk level and its heritage. Another indicator is the ability to raise capital, which qualitatively assesses the ability of the MFI in response to a need to replenish or increase the assets in a given time. A third indicator is the adequacy of reserves, a quantitative measure of bad loans and the extent to which the institution is able to absorb losses.

2. **Asset Quality:** The analysis is divided into three components: portfolio quality, the portfolio classification system and fixed assets. This area includes two quantitative indicators: portfolio risk, which measures non-performing loans over 30 days, and bad loans policies, which shows the portfolio punished according to the criteria CAMEL.

   The portfolio classification system involves the review of the terms of the debt portfolio and the assessment of the institution´s policies associated with the portfolio at-risk.

   Within fixed assets, the first indicator is the productivity of long-term assets, which evaluates the MFI's policies for investment in fixed assets. The second indicator

[20] The ACCIÓN CAMEL, Technical Note. ACCION Internacional. September 1998.

concerns the infrastructure of the institution, which is evaluated to determine if it meets the staff and customer´s needs.

3. **Management:** This area of analysis has five qualitative indicators.

    a) Governance, focuses on analyzing the features, diversity, experience, expertise, independence and flexibility of the Board when taking decisions.

    b) Human resources, assesses whether this department provides clear guidance and support to the staff, including hiring and training new staff, incentives, and performance evaluation system.

    c) Processes, control and audit, focuses on the extent to which the MFI has entered into key processes and the effectiveness of the organization´s risk controls.

    d) Management Information system, assesses whether the systems are automated and operate effectively and efficiently.

    e) Strategic planning and budgeting examines how the organization performs a process for generating short and long term financial projections and if the plan is 1) updated as needed, and 2) used in the process of decision making.

4. **Earnings:** There are three qualitative and one quantitative indicators to measure the profitability of the MFI.

    a) ROE measures the ability of the institution to maintain and increase their wealth through income from operations. Operational efficiency measures and monitors progress toward achieving a cost structure that is closer to the level reached by formal financial institutions.

    b) ROA measures the extent to the assets of the MFI are used or the institution's ability to generate revenue for a givenasset base.

    c) Interest rate policy measures the degree to which the entity's management analyzes and adjusts interest rates depending on the institution's loan portfolio. It is based on the cost of funds, the profitability objective and the macroeconomic environment.

5. **Liquidity Management:** Evaluates the MFI's ability to respond to 1) decreased funding sources and increase in assets and 2) cost´s payment at a reasonable price. Its indicators are the following

    Under the **liability structure**, we analyze the composition of the liabilities of the institution, including the amount, the interest rate, payment terms, and sensitivity to changes in the macroeconomic environment. The types of guarantees required by the banks, financing sources available to the MFI, and the diversification of resources are also analyzed.

    The availability of funds to meet credit demands measures the degree to which the institution disburses loans in a timely and agile way.

Cash flow projections assess the extent to which the institution is successful in projecting their cash flow needs. The analysis seeks to determine if they have prepared in sufficient detail and analytical rigor and whether past projections have been adjusted to accurately input and output of money.

The **productivity of other current assets** focuses on the management of current assets that do not belong to the loan portfolio, especially short-term cash investments. The MFI will be classified according to weather it maximizes the use of cash, bank accounts and short-term investments by investing in the right time and with high returns and being consistent with its liquidity needs.

ANNEX 10. KSF´s FINANCIAL STATEMENTS WITHOUT CAMEL´S ADJUSTMENTS

KSF FINANCIAL STATEMENTS	2010			2009			2008		
BALANCE SHEET									
Liabilities with Others	372.793	31%	51%	246.556	26%	(15%)	291.723	30%	9%
Accounts Payable (Sundry Creditors)	25.477	2%	83%	13.911	1%	(37%)	22.141	2%	51%
Subscription (ASSFIN/GHAMFIN)	267	10%	N/A	0	0%	N/A	0	0%	N/A
TAX – PAYE	286	10%	N/A	0	0%	N/A	0	0%	N/A
Utilities – (Telephone: Takoradi)	235	8%	(22%)	300	11%	(1%)	303	7%	(64%)
Legal Fees	415	15%	0%	415	15%	47%	282	6%	N/A
Auditors	334	12%	67%	200	7%	0%	200	4%	N/A
Provident Fund	1.243	45%	(33%)	1.849	67%	(50%)	3.677	82%	89%
Accruals	2.781	0%	1%	2.764	0%	(38%)	4.461	0%	60%
Total Liabilities	**401.051**	**33%**	**52%**	**263.232**	**27%**	**(17%)**	**318.325**	**32%**	**12%**
Share Capital	390.175	48%	0%	390.175	56%	0%	390.175	58%	0%
Reserves	422.199	52%	37%	307.324	44%	10%	280.121	42%	40%
Total Equity	**812.374**	**67%**	**16%**	**697.499**	**73%**	**4%**	**670.296**	**68%**	**14%**
TOTAL LIABILITIES & EQUITY	**1.213.425**			**960.731**			**988.621**		
Cash	6.760	1%	333%	1.561	0%	(96%)	35.571	4%	(47%)
Short Term Investments	20.033	2%	185%	7.022	1%	5%	6.678	1%	(67%)
Outstanding Loan Portfolio	115.511	9%	182%	40.968	4%	(54%)	89.193	10%	324%
Current Loans	1.097.161	89%	23%	889.431	94%	11%	803.233	89%	49%
Loans Overdue 91 to 180 days	21.985	2%	69%	12.994	1%	26%	10.343	1%	62%
Total Loan Portfolio	1.234.657	107%	31%	943.394	106%	4%	902.769	103%	60%
Loan Loss Reserve	(85.284)	(7%)	57%	(54.442)	(6%)	107%	(26.282)	(3%)	87%
Net Loan Portfolio	1.149.373	95%	29%	888.951	93%	1%	876.487	89%	59%
Fixed Assets	6.908	1%	(35%)	10.567	1%	(32%)	15.590	2%	(93%)
Other Assets	30.351	3%	(42%)	52.630	5%	(3%)	54.296	5%	112%
TOTAL ASSETS	**1.213.425**		**26%**	**960.731**		**(3%)**	**988.622**		**13%**

P&L	2010			2009			2008		
Loan Portfolio	127.190	94%	43%	88.918	66%	(16%)	105.973	79%	27%
Fees - Clients Registration/Membership	7.556	6%	3%	7.344	5%	(41%)	12.398	9%	18%
Financial revenue from loan portfolio	134.746	97%	40%	96.261	98%	(19%)	118.371	96%	26%
Financial Revenue from Investment	3.683	3%	77%	2.080	2%	(52%)	4.363	4%	N/A
TOTAL INCOME	**138.429**		**41%**	**98.342**		**(20%)**	**122.734**		**31%**
Personnel expenses	19.430	14%	(67%)	59.205	60%	87%	31.717	26%	14%
Other adminstrative expenses	10.580	8%	(72%)	37.775	38%	(32%)	55.253	45%	40%
Administrative Expenses	**30.010**	**22%**	**(69%)**	**96.980**	**99%**	**12%**	**86.970**	**71%**	**29%**
Interest and fee expenses on funding liabilities	24.038	17%	63%	14.741	15%	20%	12.321	10%	146%
Interest on deposits	12.138	9%	122%	5.460	6%	77%	3.082	3%	5%
Provision for Loan Losses	30.841	22%	10%	28.160	29%	130%	12.231	10%	(13%)
Financial Expenses	**67.018**	**48%**	**39%**	**48.361**	**49%**	**75%**	**27.633**	**23%**	**26%**
Total Financial, Loan Loss and Operating expenses	**97.027**	**70%**	**(33%)**	**145.341**	**148%**	**27%**	**114.604**	**93%**	**28%**
NET OPERATING INCOME (LOSS) BEFORE TAXES	**41.402**	**30%**	**(188%)**	**(46.999)**	**(48%)**	**(678%)**	**8.130**	**7%**	**75%**
Income tax expenses, continuing operations	0	0%	N/A	0	0%	(100%)	5.795	5%	N/A
NET OPERATING INCOME (LOSS) AFTER TAXES	**41.402**	**375%**	**(188%)**	**(46.999)**	**(335%)**	**(2112%)**	**2.335**	**11%**	**(50%)**
Grant and Donations	46.914	34%	9%	43.174	44%	172%	15.892	13%	1%
Other non-operating income	37.154	27%	20%	31.028	32%	(47%)	58.701	48%	75%
Total Non-Operating Revenue and Expenses	**84.067**	**61%**	**13%**	**74.202**	**75%**	**(1%)**	**74.593**	**61%**	**52%**
NET INCOME (LOSS)	**125.469**	**91%**	**361%**	**27.203**	**28%**	**(65%)**	**76.928**	**63%**	**43%**

ANNEX 11. KSF´s FINANCIAL STATEMENTS WITH CAMEL ADJUSTMENTS

KSF FINANCIAL STATEMENTS		2010			2009			2008	
BALANCE SHEET - ADJUSTED		**2010**			**2009**			**2008**	
Liabilities with Others		372.793	33%	51%	246.556	27%	(15%)	291.723	32%
Accounts Payable (Sundry Creditors)		25.477	2%	83%	13.911	2%	(37%)	22.141	2%
Accruals	5	2.781	0%	1%	2.764	0%	(38%)	4.461	0%
Total Liabilities		**401.051**	**35%**	**52%**	**263.232**	**29%**	**(17%)**	**318.325**	**35%**
Share Capital		390.175	53%	0%	390.175	61%	0%	390.175	67%
Reserves		346.265	47%	37%	252.317	39%	32%	191.833	33%
Total Equity	6	**736.439**	**65%**	**15%**	**642.491**	**71%**	**10%**	**582.007**	**65%**
TOTAL LIABILITIES & EQUITY		**1.137.490**			**905.724**			**900.333**	
Cash	3	6.760	1%	333%	1.561	0%	(96%)	35.571	4%
Short Term Investments		20.033	2%	185%	7.022	1%	5%	6.678	1%
Outstanding Loan Portfolio		1.212.672	98%	30%	930.400	99%	4%	892.427	99%
Current Loans		0	0%	N/A	0	0%	N/A	0	0%
Loans Overdue 91 to 180 days		8.991	1%	5%	8.586	1%	12%	7.693	1%
Total Loan Portfolio		1.234.656	115%	31%	943.394	113%	4%	902.769	115%
Loan Loss Reserve		(162.758)	(15%)	47%	(110.793)	(13%)	(3%)	(114.347)	(15%)
Net Loan Portfolio		1.071.899	94%	29%	832.600	92%	6%	788.422	88%
Fixed Assets	2	9.188	1%	(25%)	12.255	1%	(21%)	15.590	2%
Other Assets	4	29.610	3%	(43%)	52.285	6%	(3%)	54.073	6%
TOTAL ASSETS		**1.137.490**		**26%**	**905.724**		**1%**	**900.333**	

P&L - ADJUSTED		**2010**			**2009**			**2008**	
Financial revenue from loan portfolio		134.349	83%	40%	96.140	74%	(19%)	118.147	65%
BDS Fees (Business Developement Services)		23.181	14%	(25%)	31.028	24%	(47%)	58.701	32%
Financial Revenue from Investment	11	3.683	2%	77%	2.080	2%	(52%)	4.363	2%
TOTAL INCOME		**161.214**		**25%**	**129.249**		**(29%)**	**181.212**	
Personnel expenses		14.672	9%	(17%)	17.688	14%	(29%)	25.062	14%
Other adminstrative expenses		15.338	10%	(81%)	79.292	61%	17%	67.703	37%
Administrative Expenses		**30.010**	**19%**	**(69%)**	**96.980**	**75%**	**5%**	**92.765**	**51%**
Interest and fee expenses on funding liabilities		75.544	47%	154%	29.767	23%	13%	26.390	15%
Interest on deposits		12.138	8%	122%	5.460	4%	77%	3.082	2%
Provision for Loan Losses		51.965	32%	(1562%)	(3.554)	(3%)	(104%)	100.296	55%
Other CAMEL financial adjustments		69.098	43%	(37%)	109.727	85%	N/A	0	0%
Financial Expenses		**208.745**	**129%**	**48%**	**141.400**	**109%**	**9%**	**129.768**	**72%**
Total Financial, Loan Loss and Operating expenses		**238.754**	**148%**	**0%**	**238.380**	**184%**	**7%**	**222.533**	**123%**
NET OPERATING INCOME (LOSS) BEFORE TAXES		**(77.540)**	**(48%)**	**(29%)**	**(109.131)**	**(84%)**	**164%**	**(41.321)**	**(23%)**
Income tax expenses, continuing operations		0	0%	N/A	0	0%	N/A	0	0%
NET OPERATING INCOME (LOSS) AFTER TAXES		**(77.540)**	**(58%)**	**(29%)**	**(109.131)**	**(114%)**	**164%**	**(41.321)**	**(35%)**
Grant and Donations / Directors Contributions		60.886	38%	41%	43.174	33%	172%	15.892	9%
Total Non-Operating Revenue and Expenses		**60.886**	**38%**	**41%**	**43.174**	**33%**	**172%**	**15.892**	**9%**
NET INCOME (LOSS)		**(16.654)**	**(10%)**	**(75%)**	**(65.957)**	**(51%)**	**159%**	**(25.429)**	**(14%)**

ANNEX 12. DRAFT OF POLICIES DEVELOPED BY KSF (pending of approval by the Board)

- **Staff Selection and Promotion Policy:** The goal is that each position within the institution is covered by the right person receiving a salary accordingly. They have established three categories of personnel, each of which establishes what are the education requirements:

    - Management
    - Senior Staff
    - Junior Staff

  The manual lists the requirements for each category. As a rule, to be hired by KSF, the person must: 1) be in good physical and mental health. The employee must submit a medical report to the entity, 2) do not have any criminal record, 3) meet the requirements of the vacancy to be filled, 4) conduct an interview with the CEO of the institution.

  The employee must complete a trial period of 6 months. The determination of wages and status of the person depend on their education, professional experience, recommendations made by other people, etc.

  Salary increases and promotions will depend on the confidential assessment of each employee at end of the year. As a general rule, a person should be promoted at least once every three years if you had a good rating and has not received sanctions. Similarly, the document delivered, does not contain the criteria determining an employee's performance.

- **Discipline Policy:** It records the employee's obligations and the general rules of expected behavior. Similarly, it has the detail of the different penalties depending on the observed behavior.

- **Study Leave Policy:** It envisages situations in which KSF continues paying the employee and situations in which it does not. The former are to those employees with a very good performance and having worked at least three years in the institution, or whose experience is very important to KSF. It requires the employee to provide a financial guarantee to compensate the institution.

Within these personnel policies, the maintenance of an updated file for each employee is not required.

In addition to the operational policies delivered by KSF, the institution has the following policies:

- **Funding Policy:** KSF considers the possibility of seeking funds to finance its operations from institutions like the Bank of Ghana, other banks and NGOs, but always under good type and term conditions. The fate of the funds raised will be lending and, whenever possible, the acquisition of fixed assets. It is expected that any request for funds must be approved by the Board.

- **Investments Policy:** It sets whether to invest in assets for the liquidity management of the institution (treasury bills, shares from other companies or banking institutions and overnight deposits). At least 95% of it must be invested in treasury bills and treasury notes. Investments must be approved by the Board.

- **Credit Policy:** The manuals supplied are:
    - General Credit Policy
    - Credit policy for payroll workers
    - Commercial Credit Policy
    - Credit policy for coconut farmers.
    - Credit Policy for members of the Board.
    - Credit Policy for members of the staff.
    - During the visit to the office we had access to the “Community Animation Manual”.

- **Fixed Asset Policy:** The objective of this policy is to record all fixed asset transactions at the time that they occur and ensure that information of the assets of the entity are available if required. It establishes a policy of depreciation for each asset class, but it does not match exactly with those reflected by the external auditor's report.

ANNEX 13. OECD´s PRINCIPLES OF CORPORATE GOVERNANCE

The main areas of the OECD´s Principles are the following:

I. Ensuring the Basis for an Effective Corporate Governance Framework

The corporate governance framework should promote transparent and efficient markets, be consistent with the rule of law and clearly articulate the division of responsibilities among different supervisory, regulatory and enforcement authorities.

II. The Rights of Shareholders and Key Ownership Functions

The corporate governance framework should protect and facilitate the exercise of shareholders' rights.

III. The Equitable Treatment of Shareholders

The corporate governance framework should ensure the equitable treatment of all shareholders, including minority and foreign shareholders. All shareholders should have the opportunity to obtain effective redress for violation of their rights.

IV. The Role of Stakeholders in Corporate Governance

The corporate governance framework should recognize the rights of stakeholders established by law or through mutual agreements and encourage active co-operation between corporations and stakeholders in creating wealth, jobs, and the sustainability of financially sound enterprises.

V. Disclosure and Transparency

The corporate governance framework should ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership, and governance of the company.

VI. The Responsibilities of the Board

The corporate governance framework should ensure the strategic guidance of the company, the effective monitoring of management by the board, and the board's accountability to the company and the shareholders.