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SCHOOL OF ECONOMICS AND BUSINESS

MASTER THESIS

**AN ANALYSIS OF THE MICROFINANCE MARKET IN BOSNIA
AND HERZEGOVINA: DRAWBACKS AND PERSPECTIVES**

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LIST OF ABBREVIATIONS

- AdES** – advanced electronic signature
- AMFI** – Association of Microfinance Institutions in Bosnia and Herzegovina
- BAM** – “Konvertibilna marka”, national currency in Bosnia and Herzegovina
- BARS** – Banking agency of Republika Srpska
- BiH** – Bosnia and Herzegovina
- CBBiH** – Central bank of Bosnia and Herzegovina
- CEFTA** – Central European Free Trade Agreement
- EaSI** – European Union Program for Employment and Social Innovation

EU – European Union
EUSR – European Union Special Representative in Bosnia and Herzegovina
EC – European Commission
EIR – effective interest rate
FBA – Banking agency of the Federation of Bosnia and Herzegovina
FBiH – Federation of Bosnia and Herzegovina
FDI – foreign direct investments
HR – High Representative
IAIS – International Association of Insurance Supervisors
ID&V – identification and verification
LIP I – Local Initiative Project I
LIP II – Local Initiative Project II
MCC – microcredit company
MCF – microcredit foundation
MCO – microcredit organization
MFI – microfinance institution
NEO – National Employment Office of Belgium
NIR – nominal interest rate
NGO – non-governmental organization
PAR>30 – portfolio at risk > 30 days
PCL – provision for credit losses
QES – qualified electronic signature
QSCD – qualified electronic signature creation device
ROA – return on assets
ROE – return on equity
RPE – revenue per employee
RS – Republika Srpska
SAA – Stabilization and Association Agreement
UN – United Nations

INTRODUCTION

Throughout the world, poor and low-income people do not have access to classical banking and other financial services due to the amount of income they receive. According to The World Bank data, in 2017, around 10 per cent of the world's population lived on less than \$1.90 a day, which is considered as extreme poverty (World Bank, 2017). In the past, inadequate income was considered as the main cause of poverty. Recent studies, however, have emphasized that poverty is a multidimensional phenomenon encompassing, among others, lack of resources and assets (material deprivation), poor or lack of access to basic social amenities such as access to education, access to health care service and clean water, absence of employable skills and limited knowledge/information as well as deprivation of basic human rights that has economic, social, and political implications (Parker, 1998).

The war in Bosnia and Herzegovina (hereinafter: BiH), which started in 1990 and ended in 1995 left the country in ruin. The whole economic system collapsed resulting in an enormous rise of unemployment. As a result, poverty in country arose to the level where three in four people were not able to afford basic life necessities. As the idea of microfinance is to help the weakest members of civil society, it appeared as a tool which could support recovery and economic reconstruction of the country. Microfinance institutions (hereinafter: MFIs) initiated their activities in BiH shortly after the Dayton Peace Agreement ended the war, in late 1995. Their primary goal was to help post-war society to respond to urgent needs of demobilized soldiers, displaced persons, returnees and widows. Since then, MFIs in BiH have had a significant role in alleviating poverty and support for development of small and medium entrepreneurship. It enabled many people to start family businesses in the field of agriculture, livestock breeding, organic food production, crafts, etc. In the last 19 years, MFIs have extended loans equalling almost BAM 9 billion on an aggregate basis. Of these loans, 70 per cent were invested in activities that generate income to clients who do not have access to traditional methods of financing (AMFI, 2020). Nowadays most of MFIs in BiH are financial sustainable and operate in a competitive environment. MFIs can be expected to remain providers of financial services in BiH and continue with their operations.

Several independent impact studies on microfinancing in BiH have been conducted. Some studies have addressed its impact on poverty alleviation (Matul & Tsilikounas, 2004; Dunn, 2005; Hartarska & Nadolnyak, 2008) and some have focused on the development of post-conflict society and reconciliation (Ohanyan, 2002; Welle-Strand, Kjollesdal & Sitter, 2010). On the other hand, some authors have questioned the success of microfinancing in BiH (Berryman & Pytkowska, 2005; Bateman, 2007; Bateman, Siniković & Škare, 2012). The results of these impact studies vary from positive, neutral and negative. Still, very few studies have focused on the entire market to elaborate the market as such. Most of them have discussed one characteristic of the market (Lyman, 2005; Chen & Chivakul, 2008).

Therefore, the subject of this research is the microfinance market in BiH. The market is analysed both from outside and inside. First, the business environment in BiH is considered and what reflections it has on microfinance market. Then, legislation that constitutes a regulatory framework for microfinance in BiH is emphasized. The last but not the least, the attitudes of senior managers of MFIs and regulators, and advocates of microfinancing in BiH are examined.

The purpose of the research is to gain an in-depth understanding of the microfinance environment in BiH. It emphasizes drawbacks of the microfinance market that affect both MFIs and regulators as the main stakeholders in the market, and consequently the consumers of financial services. The identification of these obstacles gives an opportunity for all stakeholders to join their forces and overcome them. Therefore, the aim of the research is to showcase perspectives for further development of microfinance in BiH and in which way MFIs, regulators, advocates of microfinance, and other stakeholders should collaborate in order to give microfinance in BiH the new momentum. Finally, the findings could also be useful to stakeholders in other microfinance markets.

The goals stemming from the purpose of the research are: (1) to explore the microfinance environment in BiH, (2) to inspect the obstacles that MFIs encounter on the market, (3) to detect the main issues that regulators address, (4) to examine the attitude of senior managers of MFIs, (5) to suggest solutions both for MFIs and regulators, (6) to provide perspectives for further development of microfinance in BiH.

The methodology of this research includes both theoretical and empirical aspects. The initial theoretical foundations for the research were grounded on relevant literature and a collection of academic sources and research papers obtained from reports, prepared by research scholars and universities, published in technical journals and books. The empirical part of the research, comprehensive analysis of the microfinance market in BiH, was based on primary data and secondary data. Collected data were used as inputs for quantitative and qualitative (descriptive) analysis. For analysis of the market from outside the secondary data were collected from regional and international/global organizations, such are The World Bank, The European Bank for Reconstruction and Development, CIA and others, as well as from official publications issued by regulators of microfinance market in BiH. Analysis of market from inside was conducted using primary data, which were for this purpose gathered through expert in-depth interviews. This research method helped in finding answers to questions like how and why, something which was not possible by using other analytical methods (Saunders, Lewis & Thornhill, 2019, pp. 145-147). Therefore, in-depth interview was selected as the most suitable research method to examine the attitudes of senior managers of MFIs and regulators, and advocates of microfinance in BiH. The interviews were analysed using the thematic analysis method. Thematic analysis enables identifying, analysing, and reporting patterns (themes) within data (Clarke & Braun, 2017). Through analysis of gathered data, four themes were identified, each reflecting one of drawbacks of the microfinance market in BiH.

This thesis first addresses the theoretical background of the microfinance industry, which includes a general description of microfinance, its history and development, other services that are encompassed within that term, and the current debate on topics such as regulation and transformation of MFIs and is covered in Chapter 1. Chapter 2 is focused on microfinance in BiH. An overview of the business environment in BiH is given, for which the PEST analysis is used. Then, the chapter discusses the development of microfinance in BiH and specifically the current situation on the microfinance market, including regulation and supervision of MFIs. SWOT and Porter's 5 forces analyses complement the microfinance market overview. In Chapter 3, the research framework is presented. It includes the research objectives, research design, data collection, data analysis and sample description. Chapter 4 provides an analysis of the gathered data. The data are interpreted as attitudes of senior managers of MFIs and regulators, and advocates of microfinance in BiH as main stakeholders in the market. The attitudes on examined themes are summarized to detect the drawbacks in the market. Finally, based on the findings discussed in the preceding chapters, Chapter 5 highlights the perspectives for further development of microfinance in BiH and it includes recommendations for new services, regulations and approaches.

1 THEORETICAL FOUNDATIONS OF MICROFINANCE

1.1 Concept of microfinance

What is microfinance? It is often defined as financial services for poor and low-income clients offered by different types of service providers (Christen, Lauer, Lyman & Rosenberg, 2012). Other similar definitions of microfinance are used. The Asian Development Bank defines microfinance as the provision of a broad range of financial services such as deposit, loans, payment services, money transfers and insurance to the poor and low-income households and their micro-enterprises (Asian Development Bank, 2000). Parker explains that microfinance refers to the provision of small-scale financial services including microcredit, savings, payment services, microinsurance and other services to the rural and urban poor clients who do not have access to the banking services on sustainable basis (Parker, 1998). By Ledgerwood, microfinance is defined as a development approach that provides financial as well as social intermediation (Ledgerwood, 1999).

Altogether, the real idea of microfinance is to help the weakest members of civil society who are in the most cases poor or are slightly above poverty line. Therefore, microfinance appears as an alternative and organized tool for ensuring access to financial services for marginalized or financially excluded segments of the population. Providers of microfinance services are the financial intermediaries which can be either banks, including commercial banks, cooperative banks, and saving banks, or non-bank intermediaries such as non-governmental organizations (hereinafter: NGOs), foundations, social equity funds, specialized microfinance intermediaries, and government bodies (Cozarenco, 2015). It is very important

that these intermediaries adopt a responsible and social approach to their activities in order to efficiently fight poverty. However, they also have to combat the challenge to serve the interests of the poor while ensuring their own financial sustainability.

Historically, the term “microfinance” was often used more narrowly to refer mostly to microcredits, the concept built on the idea that skilled people in underdeveloped countries, who live outside of traditional banking and monetary systems could gain entry into an economy through the assistance of a small loan. Today, microfinance can be seen through the prism of a wider socio-economic concept, financial inclusion. According to Nanda and Kaur, financial inclusion is defined as the availability and equality of opportunities to access financial services (Nanda & Kaur, 2016). Other authors define financial inclusion as the set of measures put in place to combat banking and financial exclusion of individuals. Financial exclusion can be defined as a gap between the needs and demands of individuals for the supply of financial services, or as obstacles to participation in the financial system. The reasons for total or partial financial exclusion can be found in the lack of personal or household income, poor financial literacy and attitudes of individuals regarding their personal finances (voluntary exclusion). Financially excluded individuals consequently have difficult access to the labour market, basic social welfare services, health and education services, etc. The aim of financial inclusion is to broaden access for individuals to appropriate, affordable and timely financial and non-financial products and services. To ensure that as many people as possible are included in the financial system and that they benefit from it, a range of products and services have been developed. Financial products and services, aside from microcredits, refer to money transfers, microsavings, microinsurance, micropension, etc. while non-financial products and services include training, decision making support, advice and technical expertise, financial education and awareness. Altogether, financial inclusion enables poor people to finance their activities, save, support their families, and protect themselves from the risks of daily life. Without financial inclusion, they have to rely on their own resources to meet their financial needs, such as saving for retirement, investing in their education, taking advantage of business opportunities, and confronting systemic or idiosyncratic shocks (Demirguc-Kunt, Klapper & Panos, 2007).

While great strides have been made in reaching those people who were traditionally ignored by the banking industry, still, close to one-third of adults worldwide (some 1.7 billion people) are still unbanked without an account at a financial institution or through a mobile money provider (Demirguc-Kunt, Klapper, Singer, Ansar & Hess, 2018).

1.2 History of microfinance

MFIs have been around for hundreds of years. One of the earliest was The Irish Loan Fund, started by Jonathan Swift in Ireland in the early 1700s. This donor-financed institution initially began as charity attempting to alleviate the poverty-stricken citizens of rural Ireland.

In fact, at its peak, the organization was lending to 20 per cent of all Irish households on a yearly basis. Over time, various forms of MFIs continued to emerge and serve the rural and the poor. In 1895, during Dutch colonial period in Indonesia, Raden Bei Aria Wirjaatmadja established Help and Savings Bank of the Aristocrats of Purwokerto, in the city of Poerwokerto, Central Java. In the beginnings, it was established as MFI that served native Indonesians and it was the first rural bank. Now known as The Bank Rakyat Indonesia, it is one of the largest state-owned banks in Indonesia.

The modern history of microfinance movement started in the 1970s. It began with Professor Muhammad Yunus, Head of the Rural Economics Program at the University of Chittagong in Bangladesh. He experimented with provision of loans to the rural poor, in which he offered small amount (micro) loans to groups of poor women to start businesses and to free themselves from poverty. This was known as the Grameen Bank project. One of the key factors for success of Grameen Bank was the new idea of “group lending”. The model predicted that borrowers organize themselves into a group and act as guarantors for each other. As long as all members in the group repay their loans, the promise of future credit is extended. If any member of the group defaults on a loan, then all members are denied access to future loans. This method ensures transparency, any borrower who defaults is visible to the entire village, which imposes a sense of shame (Sengupta & Aubuchon, 2008). Group lending enabled the Grameen Bank to supply loans without requiring any collateral from the poor which consequently led to high repayment rates and allowed the bank to grow fast. Adoption and replications of the Grameen bank model nowadays exist in many countries all over the world (de Aghion & Morduch, 2004). In 2006, Yunus and the Grameen Bank were jointly awarded the Nobel Peace Prize for their work.

In 2018, around 140 million borrowers benefited from the services of MFIs, compared to just 98 million in 2009. Of these 140 million borrowers, 80 per cent were women, 65 per cent were rural borrowers, and these proportions remained stable over the past 10 years, despite the increase in the number of borrowers. With an estimated credit portfolio of \$124.1 billion, MFIs recorded another year of growth in 2018 with increase of 8.5 per cent compared to 2017 (Convergences, 2020).

1.3 Microcrediting and microloans

The terms microcredit (also microloan) and microfinance are often used synonymously and interchangeably. The microfinance revolution in reality is the microcredit revolution that started in the early 1970s. In 1997, a dozen heads of state joined almost 3,000 participants from 137 countries in Washington, for the world’s first Microcredit summit. During the summit, all agreed on an audacious objective: to reach 100 million of the world’s poorest families, especially the women of those families, with credits for self-employment and other financial and business services by the end of 2005. The declaration of the summit explained microcredits as small loans to poor people for self-employment projects that generate

income, allowing them to care for themselves and their families (Microcredit Summit, 1997). Similarly, the communication from The European Commission (hereinafter: EC) to the European Council, the European Parliament, the European Economic and Social Committee and the Committee of the Regions, defines microcredit as the extension of very small loans (microloan) to entrepreneurs, to social economy enterprises, to employees who wish to become self-employed, to people working in the informal economy and to the unemployed and others living in poverty who are not considered bankable. It stands at the crossroads between economic and social preoccupations. It contributes to economic initiative and entrepreneurship, job creation and self-employment, the development of skills and active inclusion for people suffering disadvantages, where microloans do not exceed EUR 25,000 (European Commission, 2007). In general, microcredit is a small amount of money that is borrowed to low- or no-income individuals (mainly poor) that are excluded from the traditional banking system with the purpose of self-employment or for improvement of their living conditions.

The main features of microcredit are:

- Microcredit is typically much smaller than a conventional bank loan, although there is no universally agreed maximum.
- Generally, it has no collateral or has collateral which is not sufficient to cover the lender's loss in the case of a payment default.
- The borrower is typically a poor or low-income person who has the ambition to develop its entrepreneurial idea.
- The lender uses the common microcrediting methodology (Christen, Lauer, Lyman & Rosenberg, 2012).

By its purpose, there are two types of microloans: microloans for business start-ups and social microloans. Microloans for business start-ups such as family businesses, freelancers, small crafts, etc. are most often used to finance working capital, office equipment, repairs or fixed assets. Social microloans are used to improve living conditions of the household such as paying school fees, buying furniture, clothes etc., on the same terms as a consumption credit. Therefore, it can be said that microloans have a double impact (sometimes referred as “the two sides of the microfinance coin”): an economic impact which allows the creation of income generating activities and a social impact which contributes to financial inclusion and therefore to the social inclusion of individuals.

By lending methodology, there are also two types of microloans: group loans and individual loans. From its beginnings, microloans have been mostly associated with group lending. Under group lending, small groups of borrowers are responsible for the repayment of each other's loans. All group members are treated as being in default when one of them is late with its repayment, and consequently all members are denied for new loans. Because group members act as guarantors, they screen and monitor each other. One disadvantage of group lending is that it often involves time-consuming weekly repayment meetings and exerts

strong social pressure on borrowers, which can be counterproductive (Pitt & Khandker, 1998). This was the main reason why MFIs as of recently have started to offer individual loans as well. The decision to offer either a group or individual loan depends on the loan size, refinancing conditions, and competitive pressure in the microfinance market. When the loan size is rather large, refinancing costs are high, and competition is low, MFIs tend to offer group loans. Otherwise, individual loans are offered. By offering individual loans, MFIs attract relatively more new clients. In general, individual loans tend to be larger than group loans, therefore borrowers prefer individual loans as the wealthier they are (Madajewicz, 2008). Yet, both lending schemes do not differ in repayment rates.

Aside from advantages, microloans also have disadvantages. The main drawback of this concept is the high interest charged on loans. The reason is that the interest rate is the main source of income for the MFI. With the interest rate an MFI must cover the cost of funds, the operating expenses, the loan losses, the expected profits and those needed to expand its capital base and to fund expected future growth, also considering inflation, and taxes (Fernando, 2006). The smaller the loan is, the higher the interest rate must be to cover the operating expenses related to the single loan, because the transaction costs are greater than those for larger loans on a per unit basis. The smaller and less enforceable the collaterals that the client can offer are, the higher the interest rate must be to cover the risk of the loan. Interestingly, although microloan borrowers are often very poor and interest rates are higher than interest rates on bank loans, repayment rates are often higher than the average repayment rates on more conventional forms of financing.

1.4 Microsaving

The microsaving is a microfinance deposit service offered by MFIs, which allows those with lower income to save generally a small amount of money for future use, usually without minimum balance requirements and typically without a service charge. History of microsavings as such can be traced back to 1983 when Bank Rakyat Indonesia launched a microsavings rural project in Indonesia. Robert Vogel called savings the “forgotten half of rural finance” (Vogel, 1984, p. 12). Initially, in the 1980s, the misperception that the poor do not and cannot save was a widespread opinion. Politicians, policymakers, and the public had only a limited or no understanding of the role that microsavings can play in poverty reduction and helping poor people manage vulnerability. Many policymakers and bankers assumed that poor people were too poor to save. Fortunately, over time, as the concept of microcredit evolved to the concept of microfinance and further to the concept of financial inclusion, savings have gained greater prominence.

Saving accounts allow households to save small amounts of money to meet unexpected expenses and plan for future investments such as education and old age (Boachie, 2016). Savings are often the only way poor people can manage vulnerability, both through the savings’ protective function (using accumulated savings to ameliorate the impact of shocks)

as well as through their promotive function (using accumulated savings for education or other future investment to build an asset base, which can then be used to lessen the risk of some hazards and mitigate others). In particular, poor people save for the following needs:

- Life-cycle events: Predictable events, such as childbirth, school fees, marriage and death, cause poor people to require larger amounts of cash than are usually available in the household.
- Emergencies: Unpredictable events create a sudden and unanticipated need for a larger sum of money than can normally be found at home, such as sickness of a family member, the loss of employment, the theft, the war, the floods, fires or other natural disaster.
- Opportunities: There are opportunities that create a demand for funds, such as investing in an existing or new business, or buying land or other productive assets.

The decision on where and how to save always involves making trade-offs between the perceived security, liquidity and returns or cost of each strategy, and depends on the purpose for saving and the context in which one lives (Hulme, Moore & Barrientos, 2009). There are two main options available for poor people who want to save. One is to save informally, and the other is to seek access to the saving services provided by formal financial institutions. For most under-resourced families, getting a small surplus often means saving in an informal way, for example:

- Saving at home, hiding cash at home under a mattress or buried in backyard.
- Investing in-kind such as gold, jewellery, livestock or any physical asset with a productive, protective, or social use value that can be sold.
- Savings with deposit collectors and money guards (often relatives, employers, etc.) who charge a fee to frequently collect and then return savings at the end of a period.
- Participating in small-scale, informal community level savings groups or clubs and saving schemes, such as rotating savings and credit association and accumulating savings and credit associations (Robinson, 2001).

However widely used, most informal mechanisms fail to meet the needs of poor people in a convenient, cost-effective and secure manner. In many cases, informal savings are at high risk, illiquid, indivisible, or impose rigid or uniform terms. Generally, informal savings result in overall less savings compared with the potential of making frequent small deposits in formal saving accounts offered by formal financial institutions such as banks, cooperatives, post offices, insurance companies. Still, formal savings have imperfections, often require minimum deposits/balances, generate financial and other transaction costs and can exclude poor people in other ways (physical and social distances). The poor require local and affordable products to suite their capacity to save and meet their needs for occasional lump sums for emergencies (Rutherford, 2000). Either people save in informal or formal way, there are different obstacles that deter them from doing so. Due to multiple demands on their income, the individuals are de facto unable to make any savings or are limited to save very small amounts. Therefore, the usefulness of the saving accounts may seem questionable to

them. Also, for most people in developing countries, formal microsaving services are not available. The institutions licensed to receive deposits from the public have not entered the microsavings market because the costs of managing a large number of small accounts and tiny transactions are prohibitive. Generally, these institutions have not invested in development of saving products that meet the needs of poor clients. Even when microsaving services are offered to people, they might be inconvenient because the locations of service providers may not be easily accessible, the documentation necessary for opening the accounts may seem intimidating, the organizational culture and staff attitudes of institutions could deter poor people, the fixed costs associated with opening and maintaining the account are too high and cause net returns to drop below informal savings alternatives etc. Finally, many poor people do not use formal microsaving services because of doubts about the security of institutions which provide these services. Poor people want secure, convenient deposit services that allow easy access to their funds. Yet, according to The World Bank, only a quarter of the global poor have an account, and only 43 per cent of this group use their accounts for saving (World Bank, 2005). Therefore, Vogel's assertion from 1984 that savings are the “forgotten half of rural finance” unfortunately still rings true.

1.5 Microinsurance

“Many borrow, more save, and all insure” are the words of Zeller & Sharma (2000). While there is no uniformly accepted definition of microinsurance, according to the International Association of Insurance Supervisors, microinsurance is an insurance that is accessed by low-income populations, provided by a variety of different entities, but run with accordance to generally accepted practices (IAIS, 2015). According to Churchill, microinsurance is the protection of low-income people against specific risks in exchange for regular premium payments proportionate to the likelihood and cost of the risk involved (Churchill, 2006).

At its core, microinsurance is insurance for the low-income population. Poor people have limited or little access to formal insurance and are more vulnerable to the risks than the rest of the population. Sudden adverse events such as severe illness or death of family members, loss of an asset including livestock and housing, in case of low-income households usually are not contemplated and addressed with insurance. These events cause heavy financial or even devastating implications. Consequently, recovering from shocks without any means of risk protection is very difficult and more often impossible. In developing countries, the situation is even worse. Low-income households in these environments are exposed to a variety of significant risks to their wealth and life. In these countries poor usually have little access to health services and often have inadequate informal tools to manage its health insurance coverage. Therefore, microinsurance is a service which provides poor and low-income households the mean to protect themselves against the effects of risk. Aside from hedging the risks, microinsurance gives a sense of security to low-income families. Other benefits include the ability to handle claims in quick and accurate way. Also, small entrepreneurs feel that they are protected by insurance, and are willing to take more risks

and invest, which enables them to develop and grow. To fulfil its mission, the big challenge for microinsurance is to find the right balance between offering adequate protection with affordability for poor households. Also, insurers have to bear in mind that microinsurance policies have to be written in simple language so they can be easily understood as insured have limited financial literacy.

Basically, microinsurance operates the same as conventional insurance. The main difference between conventional insurance and microinsurance is that microinsurance is targeted at low-income households, specifically the working poor who have few or no financial reserves and have irregular income streams. Therefore, microinsurance products are designed differently than traditional insurance products. Insurers develop tailored microinsurance products that accommodate the needs for risk protection of low-income clients, considering their income and the size of the premium. Microinsurance premiums are typically lower compared to conventional insurance and are paid in sporadic instalments. There are a growing number of microinsurance products protecting a variety against numerous risks, but the most common are:

- Credit life insurance is the most common insurance which ensures that the debt is paid off in case of the borrower's death and it protects lenders. Often, alongside credit life insurance, the life or personal accident insurance is offered, and covers the family in case of accidental death of the borrower.
- Property insurance is nearly always linked to a loan and helps the borrower to continue with repayment of the loan in case of natural disasters like flood, fire and other calamity that can badly damage homes and small businesses.
- Agricultural insurance (mainly refers to crop and livestock insurance) covers risks of small farmers in case of rainfall or other weather conditions which can harm or prevent proper crops growth or in case of a disease resulting in the culling of the livestock. The problem with this type of insurance is that it is difficult to calculate the probability of loss because so many factors can influence production. At the same time, premiums that farmers can afford are not usually sufficient to cover claims and administrative costs.
- Health insurance is the insurance service for which there is the greatest demand among poor and low-income households. It necessarily involves the health care provider as third party. The present debate on this type of insurance includes whether this type of insurance should be sold commercially rather than considered as a natural right under a government's social welfare program (Frankiewicz & Churchill, 2012).

The actual delivery of microinsurance products to the clients has to be done carefully, otherwise microinsurance could do more harm than good. Microinsurance products can be offered to the clients through a variety of institutional channels depending on the organization, institution, and provider involved, such as: the partner - agent model in which the microinsurance partner (MFI) is responsible for the delivery and marketing of products to the clients, while the agent (insurance company) retains all responsibility for the design and development thereof; the full-service model where the microinsurance partner (MFI) is

in charge of everything, both the design and delivery of products to the clients, working with external providers to provide the services; the provider-driven model where the service provider is the microinsurance partner, and similar to the full-service model, it is responsible for all operations, delivery, design, and service; and the community-based model where clients are in charge of managing and owning the operations and working with external providers to get the services.

Insurers continuously explore ways to reach segments of the population that have remained underserved and increase the number of low-income households that have access to insurance, particularly in developing countries. Due to its customizability, microinsurance already had success in some countries. According to a Munich Re Foundation report from 2012, the number of microinsurance schemes worldwide increased substantially and reached an estimated 500 million people worldwide (Munich Re Foundation, 2012). Currently, China is the largest emerging market for microinsurance, boasting \$574.9 billion in premiums in 2018 (Insurance Information Institute, 2020).

1.6 The present debate on microfinance

The idea that poverty can be alleviated by providing easy and affordable access to credit and other financial services to poor families has been widely supported in the literature (Evans, Adams, Mohammed & Norris, 1999; Bauer, Chytilova, & Morduch, 2012; Roodman & Morduch, 2013). However, critics argue that microfinance does not alleviate poverty and even has led many borrowers into a debt trap (Bateman, 2007; Mujković, 2010; Bateman, Siniković & Škare 2012; Karlan & Zinman, 2011; Banerjee, Karlan & Zinman, 2015). The studies about impact of microfinance institutions on poverty alleviation are still being conducted. The findings of such studies vary and contribute to further debate as to the extent to which these loans can actually help the poor to escape poverty.

Aside from the above, authors also discuss the regulation of MFIs, whether and how they should be regulated (prudential or non-prudential regulation) (Arun & Murinde, 2010). As MFIs become sustainable, they will most likely migrate toward institutions that are licensed and supervised by financial authorities. Strict regulations and monitoring imposed by financial authorities requires prudential regulation. Prudential regulation aims to ensure financial soundness of regulated institutions to protect the entire financial system as well as small depositors. It includes a variety of requirements in terms of minimum capital, capital adequacy ratio, liquidity, large exposures, loan-loss provisioning, risk-management, governance, reporting, etc. However, prudential regulation means little without effective prudential supervision. Supervision involves monitoring to verify compliance with prudential regulations. Prudential regulation and supervision are generally complex and require a specialized financial authority for their implementation. Ineffective supervision may be worse than none because it gives a false sense of security to borrowers. Moreover, regulation can easily become overbearing and the cost of compliance may become so high

as to defeat the goal of MFIs, namely, giving the world's poorest citizens access to financial services. Therefore, prudential regulations are rarely applied in the microfinance sector. Prudential regulations are imposed only when several institutions are involved in the market or for the protection of small depositors, if MFIs are allowed to receive deposits. In many countries, MFIs are subject to non-prudential regulation. Non-prudential regulation includes measures like compulsory registration with an authority and permission to lend, fraud and financial crime prevention and various types of consumer protection measures. To protect consumers from dishonest lenders and excessively high interest rates, authorities sometimes impose limits (ceiling) on the level of interest rates that financial service providers can charge. Concerns are that out of a desire to make profit, MFIs will charge high interest rates that may pull low-income borrowers in a debt trap. MFIs most often try to avoid these limits by adding commissions and fees to their loans. Many of these extra charges are difficult to comprehend, especially for borrowers in developing countries who have limited financial literacy. For this reason, authorities demand that MFIs, in addition to the (nominal) interest rate (hereinafter: NIR), also calculate and disclose the so-called effective interest rate (hereinafter: EIR). It takes in count the NIR and all other expenses that borrower pays for a loan. It enables borrowers to understand the true cost of a loan and compare costs among providers. On the other hand, an interest rate ceiling could have negative effect both on MFIs and low-income people. For MFIs, a ceiling makes it difficult to cover their costs, especially in rural areas, where risks and operational costs are higher. Therefore, disbursing microloans becomes unattractive and can cause MFIs to leave the market. Consequently, low-income people are left with no access to proper financial services. Because of the MFI narrow loans offer, low-income people are forced to either use products that are not appropriate to their needs and usually force them to borrow more than they need, or to turn to more informal unlicensed, even illegal lenders. At least 76 countries in all regions around the world use some form of restrictions on the level of interest rates. These 76 countries account for more than 80 per cent of global GDP and 85 per cent of global banking sector assets (Ferrari, Masetti & Ren, 2018). However, concerns about the high costs of microfinance and predatory lending practices remain valid.

Of recent, also started trend of MFIs increasingly transform from non-for-profit organizations in traditional for-profit companies. The main difference between these two lies in how they use the funds they net in interest and repayments. A for-profit company, like any other company, distributes its profit to its shareholders. In contrast, a non-for-profit organization takes a more philanthropic stance about profit, using it to expand the number of people it helps, or to create more programs. The most controversial example of such transformation is Compartamos Banco from Mexico. It started in the 1990s as a non-for-profit, and 10 years later, its management decided to transform and become for-profit. Further, in 2007, it went public on the Mexican Stock Exchange, and in initial public offering raised more than \$400 million. In addition, globally speaking, microfinance interest rates exceeded interest rates of conventional banks, what caused even bigger players in the banking industry, such the CitiGroup, Barclays and General Electric to establish

microfinance departments, as they saw the opportunity for additional profit in disbursing loans to low-income households. This trend led to debate whether MFIs should be for-profit or non-for profit oriented. As microfinance began with the goal of helping low-income households in alleviating the poverty, many criticized for-profit approach and business model, including Muhammad Yunus. Critics point out that the original mission of microfinance, helping the poor in poverty alleviation was directly opposed to the fundamental obligation of for-profit companies to their stockholders (Sherratt, 2016). For-profit supporters counter back that commercialization improves efficiency in operations and attracts more capital from profit-seeking investors. The argument behind is that by running as for-profit company, an MFI is able to extend its reach to more people who need a loan. For now, though, both business models in microfinance do co-exist.

2 MICROFINANCE IN BiH

2.1 The macroeconomic environment in BiH

BiH is a country in South-Eastern Europe, situated in the western Balkan Peninsula. It is bordered by Serbia, Croatia and Montenegro. According to the 2013 census, it has a population of 3,531,159 inhabitants, divided in three constitutional nations or ethnicities: Bosniaks, Serbs and Croats, and others (Agency for Statistics of BiH, 2020a). Official languages are Bosnian, Serbian and Croatian with two alphabets, Latin and Cyrillic. By its government type, it is unique because its constitution does not formally prescribe the form of government. Some see BiH as a parliamentary republic, although, due to its complexity, it does not function as an ordinary republic. Its capital and the biggest city is Sarajevo (CIA, 2020).

2.1.1 Analysis of the political and legal environment

In the early 1990s, the Socialist Federal Republic of Yugoslavia was dissolved. To ensure their sovereignty, Slovenia and Croatia declared independence from Yugoslavia in 1991. To the same end, parliamentary representatives of BiH-Muslims and BiH-Croats passed the “Act Reaffirming the Sovereignty of the Republic of Bosnia and Herzegovina” without the votes of the representatives of BiH-Serbs. Following the decision, the BiH-Serbs representatives, fearing for their survival in BiH formed the BiH-Serbs National Assembly, which declared the Republika Srpska (hereinafter: RS) on January 9, 1992. This epilogue led to an armed conflict in BiH. On one side were BiH-Croats and BiH-Muslims who aspired for an independent BiH, and on the other were BiH-Serbs who feared for their survival outside the state union which included Serbia, the home state of the Serbs. On November 21, 1995, in Dayton, the warring parties initialled a peace agreement that ended the war. The final agreement was signed in Paris on December 14, 1995. The war in BiH was the biggest armed conflict in Europe since the end of World War II.

The Dayton Peace Accords ended the war, retained BiH in its internationally recognized boundaries, but it also established the country as a fragile, highly decentralized, and ethnically divided state union. The Dayton Agreement established central authorities competent for foreign, diplomatic and fiscal policy. It established BiH as a complex federal state union with elements of a confederation. BiH is composed of two, roughly equal in size, administrative units called entities: the predominantly Bosniak- BiH Croat led Federation of Bosnia and Herzegovina (hereinafter: FBiH) which is placed on 51 per cent of BiH's territory, which is further divided into 10 cantons, and the predominantly BiH Serb led RS which is placed on 49 per cent of BiH's territory. According to the agreement, entity governments are responsible for overseeing all government functions except foreign, diplomatic and fiscal policy. Additionally, on March 8, 2000, through award of the International Arbitration Tribunal, Brčko District was established, which is organized under the sovereignty of BiH on the territory which is the shared property (condominium) of the entities (Appendix 2). Brčko district is defined as a unit of local self-governance with its own institutions, laws and regulations, authorizing Brčko District authorities to discharge all government functions except foreign, diplomatic and fiscal policy.

At all administrative levels in BiH, the principle of division of power into executive, judicial and legislative has been applied. The functioning of the state, especially its institutions (at all levels), is based on a complicated system of checks and balances, which is designed to protect the interests of three constitutional nations or ethnicities. The agreement also established The Office of the High Representative, under the patronage of the United Nations (hereinafter: UN), to oversee the implementation of the civilian aspects of the agreement. The High Representative (hereinafter: HR) submits regular reports on the situation in and progress of BiH to the UN Security Council. In the past, the HR also served as the European Union Special Representative in BiH (hereinafter: EUSR). Since 2011, mandates of HR and EUSR have been split, so the European Union (hereinafter: EU) strengthened its role in BiH, which included combined presence of the EUSR and EU Delegation. In 2003, BiH received the status of a potential candidate for EU membership. In April 2008, the Stabilization and Association Agreement (hereinafter: SAA) was signed between BiH and the EU but did not take effect before 2015. In the spring 2016, BiH submitted a formal EU candidacy application and actively worked towards meeting the action plan to accelerate the gaining of candidate status. However, despite the progress, BiH is still in line for improvement of its candidate status.

Weaknesses in BiH's political system, such as the overall institutional weakness, excessive politicization and feeble public administration capacity, are the main reasons why BiH is often ranked among the worst countries in the European region and beyond. According to the Transparency International, Corruption Perceptions Index for BiH in 2020 was 35/100 and ranked BiH as the 111th of 180 countries (Transparency International, 2020). The fight against corruption falls within the competence of the entities and the Brčko District, which have adopted sets of anti-corruption laws, however, corruption at all levels of government

and across all segments of society is still an unsolvable problem. The reason for this is the very small number of big corruption cases for which responsibility has been established and which have been prosecuted. In addition to corruption, nepotism is very pronounced, which greatly hinders the professional performance of the entire public sector, although the authorities of both entities have enacted laws to prevent conflicts of interest in the bodies of government.

According to the Heritage Index of Economic Freedom for 2021, BiH's economic freedom score is 62.9, which makes its economy the 82nd freest. In Europe, BiH is ranked 40th out of 45 countries, and its overall score is below the regional average but slightly above the world average (Heritage Foundation, 2021).

Table 1: Index of economic freedom for BiH, 2021

Rule Of Law		Government Size	
Property Rights	44.1	Tax Burden	93.8
Judicial Effectiveness	33.7	Government Spending	49.5
Government Integrity	42.4	Fiscal Health	97.1
Regulatory Efficiency		Open Markets	
Business Freedom	48.2	Trade Freedom	69.2
Labour Freedom	67.8	Investment Freedom	65.0
Monetary Freedom	84.1	Financial Freedom	60.0

Source: Heritage Foundation (2021).

2.1.2 Analysis of the economic environment

BiH has a transitional economy which relies heavily on the export of metals, energy, textiles and furniture as well as on remittances and foreign aid. A highly decentralized government hampers economic policy coordination and reform, while excessive bureaucracy and a segmented market discourage foreign investment. The foreign direct investments (hereinafter: FDI) in BiH in 2019 amounted to EUR 251 million what is decline of EUR 150 million compared to 2018. At end-2019, total FDI in BiH stood at EUR 7,681 million. The biggest investors in BiH include Austria (EUR 1,392 million), Croatia (EUR 1,244 million) and Serbia (EUR 1,021 million) (Central Bank of BiH, 2020). The Central bank of Bosnia and Herzegovina (hereinafter: CBBiH), designs and controls the implementation of monetary policy. The national currency "Konvertibilna marka" (hereinafter: BAM) was introduced in 1998 and pegged to the EUR through a currency board arrangement, which means that it has a fixed exchange rate (BAM 1: EUR 0.51129). The CBBiH also coordinates the activities of entities' financial sector authorities: The Banking agency of the Federation of Bosnia and Herzegovina (hereinafter: FBA) and The Banking agency of the Republika Srpska (hereinafter: BARS), which oversee banking operations, including operations of MFIs. The banking sector in BiH is dominated by foreign banks, primarily from Austria and Italy, though the largest one is a private domestic bank (CIA, 2020). In

2006 BiH introduced an indirect taxation system, with a value added tax rate of 17 per cent on all goods and services traded.

Since 2009, BiH has recorded constant and stable economic growth, which was briefly halted due to floods in 2014. The country's real economic growth is mostly driven by the growth of manufacturing and electrical energy, gas, steam and air conditioning supply, followed by an increase in international exchange and internal demand, followed by an increase in investments. The total 2019 GDP stood at around EUR 18,047 million, of which the FBiH GDP accounted for 65.67 per cent, the RS GDP accounted for 31.88 per cent, and the Brčko District GDP accounted for 2.45 per cent. In 2019, the GDP per capita reached around EUR 5,178 (Agency for Statistics of BiH, 2021a). According to the purchasing power parity, it was among the lowest in South-Eastern Europe.

Table 2: BiH economic growth indicators, 2015-2019

Economic growth indicator	2015	2016	2017	2018	2019
Total GDP (EUR, mn)	14,618	15,290	16,043	17,100	18,047
GDP FBiH (EUR, mn)	9,556	9,991	10,502	11,240	11,852
GDP RS (EUR, mn)	4,707	4,924	5,153	5,460	5,753
Brčko district (EUR, mn)	355	375	388	400	442
Total GDP growth rate (per cent)	3.1	3.2	3.2	3.7	2.6
Population, mid-year estimate (mn)	3,518	3,511	3,504	3,496	3,485
Gross domestic product per capita (EUR)	4,155	4,355	4,578	4,891	5,178

Source: Agency for statistics of BiH (2021).

The currency board arrangement preserved the trust of the public in BiH's currency, so in 2019, the Consumer Price Index was 1.2 per cent (Agency for Statistics of BiH, 2020b). This exchange rate regime also strengthened trade relations with foreign partners. Since its introduction in 1995, BiH have signed several treaties and agreements with the intent of increasing the volume of foreign trade. In April 2008 BiH signed an SAA with the EU, which entered into force in June 2015. In addition to free trade and close economic ties between the two parties, the SAA also established a close partnership between the BiH and EU in the political area. In June 2013, The Free Trade Agreement between BiH and the EFTA (Switzerland, Norway, Iceland and Liechtenstein) was signed and entered into force in January 2015. In September 2017, BiH became a full member of the Central European Free Trade Agreement (hereinafter: CEFTA), and signed free trade agreements with Albania, Serbia, Moldova, Montenegro, Macedonia and Kosovo. BiH has also signed a free trade agreement with Turkey, securing free access to its consumer market with 85 million people. BiH currently has "observer" status in The World Trade Organization, which was awarded in 1999, and full membership accession negotiations are still ongoing.

The total foreign trade in 2019 amounted to EUR 15,845 million and decreased by 0.6 per cent relative to 2018. In 2019, exports accounted for EUR 5,876 million, a decline of 3.4 per

cent relative to 2018, whereas imports accounted for EUR 9.969 million, an increase of 1.2 per cent relative to 2018 (Agency for Statistics of BiH, 2020c). Those trends in international trade resulted in a higher deficit. In 2019, the trade deficit stood at EUR 4,093 million, an increase of 8.6 per cent relative to 2018. At the same time, the export to import ratio shrank to 58.9 per cent. The trade balance deficit accounted for a large share of the GDP, rendering BiH's social and economic sustainability dependent on imports. The largest volumes of international trade exchange were recorded with the EU member countries, in 2019, it accounted for EUR 10,465 million, or over 66 per cent of BiH's international trade exchange. The total trade exchange in 2019 with CEFTA member countries accounted for EUR 2,210 million. The main export partners were Germany (EUR 857 million), Croatia (EUR 715 million) and Serbia (EUR 669 million). The main import partners were Germany (EUR 1.195 million), Italy (EUR 1.192 million) and Serbia (EUR 1.099 million).

Table 3: BiH trade balance, 2015-2019

Trade balance indicators	2015	2016	2017	2018	2019
Total foreign trade (EUR, mn)	12,700	13,078	14,951	15,939	15,845
Export of goods (EUR, mn)	4,595	4,815	5,653	6,084	5,876
Import of goods (EUR, mn)	8,105	8,263	9,298	9,855	9,969
Trade balance (EUR, mn)	-3,510	-3,448	-3,645	-3,771	-4,093
Export to import ratio (per cent)	56.7	58.3	60.8	61.7	58.9

Source: Agency for statistics of BiH (2020).

The current economic and market environment in BiH is not very favourable and competitive.

Table 4: Doing business in BiH for 2020

Doing business topics	DB 2019 score	DB 2019 rank	DB 2020 score	DB 2020 rank	Change in score	Change in rank
Starting a business	59.6	183	60	184	+0.4	-1
Dealing with construction permits	53.2	167	48.6	173	-4.6	-6
Getting electricity	60.7	130	79	74	+18.3	+56
Registering property	62	99	63.6	96	+1.6	-4
Getting credit	65	60	65	67	0	-7
Protecting minority investors	58.3	72	56	88	-2.3	-16
Paying taxes	60.4	139	60.4	141	0	-2
Trading across borders	91.9	37	95.7	27	+3.8	+10
Enforcing contracts	59.7	75	57.8	93	-1.9	-18
Resolving insolvency	67.8	37	68.2	37	+0.4	0
Ease of doing business	63.8	89	65.4	90	+1.6	-1

Source: World Bank (2019).

Table 4 shows findings of the World Bank's 2020 Doing Business Report. BiH is ranked as the 90th among 190 countries, with a total score of 65.4. It underperformed as compared to the findings of the World Bank's 2019 Doing Business Report, which had ranked it as the 89th with a total score of 65.4. Of particular concern is that BiH, relative to the year before, did worse in almost all doing business areas. Unfortunately, BiH was the lowest ranked country in the Western Balkans in terms of business conditions (World Bank, 2019).

2.1.3 Analysis of the socio-cultural environment

According to the 2013 census, BiH had 3,531,159 inhabitants, of which 1,732,270 were male and 1,798,889 were female. According to age groups, the group 0-14 years accounted for 24.1 per cent, the age group 15-64 accounted for 68.7 per cent, the age group 65+ accounted for 5 per cent of the population, while population whose age could not be determined accounted for 2.2 per cent. In BiH, there are three constituent peoples or ethnicities: Bosniaks, Serbs and Croats. Those who do not declare as members of any of the constituent peoples are called "others". According to the 2013 census data, there were 1,769,592 Bosniaks or 50.11 per cent, 1,086,733 Serbs or 30.78 per cent, 544,780 Croats or 15.43 per cent, and 130,054 persons who declared as "others" or 3.68 per cent of the population. According to 2018 estimates, BiH had a population of around 3.4 million. Since 2008, the population growth rate in BiH has remained negative.

The total number of formally employed in 2019 was 830 thousand persons with employment rate of 35.5 per cent. Of total number of employed in BiH, according to sections of economic activities, 149 thousand persons or 18 per cent is employed in agriculture, 264 thousand persons or 31.7 per cent is employed in industry and 434 thousand persons or 52.3 per cent is employed in services. On the other side, the total number of unemployed in 2019 was 401 thousand persons, unemployment rate was 15.7 per cent. Although unemployment rate according to official reports is on lowest level in couple of past years, the unemployment of youth (age 15-24) is high and for 2019 has rate of 33.8 per cent of this population, which represents one of the greatest economic and social problems of society. Average gross wage paid in 2019 totalled EUR 726.5 while the average net wage paid in 2019 totalled EUR 470.9 (Agency for statistics of BiH, 2020d). At end-2019, the FBiH had 424 thousand pensioners, and the average pension in December 2019 was EUR 212 (Federal Pension and Disability Insurance Institute, 2020). In the RS in December 2019 there were 267 thousand pensioners and the average pension in December 2019 was EUR 195 (Pension and Disability Insurance Fund of RS, 2020). As is obvious, number of pensioners and number of active workers in BiH is almost equal, what asserts that pension systems in BiH (both systems in FBiH and RS) are unsustainable in long term. Also, the existing level of wages and pensions is among the lowest in the region.

According to the most recent Household Consumption and Expenditure Survey, conducted in 2015, over 500,000 of BiH citizens or 170,000 households lived below the poverty line

(Agency for Statistics of BiH, 2018). Poverty rate in BiH is among highest in Europe. Social and other transfers from the budgets of the entities, cantons and Brčko District are not well targeted. According to the BiH Directorate for Economic Planning, 7 per cent of the total GDP of BiH is allocated to social assistance, but is very poorly targeted, where 20 per cent of the poorest receive 36.8 per cent of the total envelope (BiH Directorate for Economic Planning, 2020). According to the UNDP Human development index, the 2019 index for BiH was 0.780, or slightly below average of Europe and Central Asia region (0.791 index). According to this index result, BiH was among countries with high index of human development and is ranked as 73rd of 189 countries (UNDP, 2020).

The most difficult challenge BiH is facing is the emigration of young and educated people, which significantly reduces the quality of the country's human resources. Due to poverty, unemployment, economic crisis and political instability in the country, including personal insecurity, a significant number of young people in search of better living and employment conditions have left the country. According to World Economic Forum's Global competitiveness report for 2019, on scale of 1 to 7 (1= all talented people leaving the country; 7= all talented people staying in the country), BiH scored 1.76, which by "brain drain" ranks BiH in 140th position of 144 countries (World Economic Forum, 2020). Despite these alarming figures, none of the governments in the country has yet adopted any strategy to prevent this type of emigration and retain the country's most significant resource. This is particularly worrying if it is considered the fact that during the war years 1992 to 1995, more than 2 million people left their homes in BiH, of which only about 1 million returnees were registered by 2018.

2.1.4 Analysis of the technological environment

BiH participates in programs for research and development, innovation, education, science and culture such as: Horizon 2020, Creative Europe, Erasmus+ and COSME, implemented under the auspices of the EU. Total spending on research (private and public investments) in 2019 was just under EUR 35 million or mere 0.19 per cent of GDP. There are 74 organizations engaged in research and development employing 2,883 persons with full-time or part-time employment, while 449 were hired under contractual agreement or author contract. In 2019 in BiH was published 1,034 research papers, of which 37.9 per cent was applied research, 40.7 per cent was fundamental research and 21.4 per cent experimental research (Agency for Statistics of BiH, 2021b). According to the Global competitiveness report for 2019, in the field of Patent applications BiH scored 7.8 out of 100, ranking it as the 77th of 141 countries (World Economic Forum, 2020).

BiH has a markedly underdeveloped infrastructure, and one of the reasons for the current situation is the war, which destroyed most of the infrastructure. To illustrate the situation, the 4 largest cities in BiH (Sarajevo, Banja Luka, Mostar and Tuzla), where the only airports with international flights are located, are not connected by highway. BiH has built only 198

kilometres of highways and slightly over 1,000 kilometres of railways (Agency for Statistics of BiH, 2020e).

Another devastating fact is that in 2019 only 64.8 per cent of households had access to a computer. The use of the internet in households in 2019 was also quite low, only 72 per cent. The rate usage of internet by individuals was 70 per cent and just 7.8 per cent of them used internet for internet banking services (Agency for Statistics of BiH, 2020f). In BiH, businesses and governments mostly ignore the ever-growing population of digital technology users. The overall rating of the ICT sector is still low, and compared to the countries of the BiH region, BiH is the worst ranked country on 92nd place of 141 countries according to the Global Competitiveness Report in 2019 (World Economic Forum, 2020).

2.2 Development of microfinance in BiH

The history of microfinance in BiH can be divided into two periods, before and after 2000. The initial period began shortly after the 1995 Dayton Peace Agreement ended the war. In this period the number of MFIs placing loans increased rapidly, which was supported by international donations. This happened in an environment in which the financial sector authorities accepted NGOs placing loans and government officials made the registration process for these NGOs quick and simple (Woodworth, 2006). In 1996, the World Bank launched the Local Initiative Project I (hereinafter: LIP I) as a part of the overall assistance provided by the World Bank for the post-war development and economic reconstruction of BiH. The project had three objectives: it was to respond to urgent needs by targeting demobilized soldiers, displaced persons, returning refugees and widows, to commence a process of establishing financially sustainable MFIs, and further to improve the business and regulatory environments for self-employment, micro-and small enterprises, as well as the regulatory environment for MFIs (World Bank, 2001). In the World Bank report for 2004, the LIP I was evaluated as a successful project with results above initial expectations. Through MFIs which were part of the project, some 20 thousand micro-enterprises had received 50,261 loans with maturity ranging between 6 and 18 months. The average loan sum was small, just \$1,600. Repayment rates were very good. 50 per cent of recipients were females (many of them were war widows), 21 per cent were displaced persons, while 5 per cent were returnees.

The second period is the post-2000 era. In first two years relevant laws were introduced. The aim was to regulate the MFIs that had been developing from the immediate post-war period. The legislation allowed institutional regulation of MFIs and defined MFIs as non-for-profit NGOs and credit-only institutions. Following the LIP I, the World Bank launched the Local Initiative Project II (hereinafter: LIP II). The LIP II came into effect in the spring 2002, with a budget of some \$24 million of which the World Bank/International Development Agency financed \$20 million and the two Entity governments the remainder (Dunn, 2005). The project's aim was to raise incomes of the families, develop businesses and increase

employment through MFIs' activities. The LIP II also focused on facilitating the transformations of non-for-profit NGOs which disburse micro loans into advanced financial institutions. In 2006, the new microfinance legislation was introduced. It required re-registration and transformation of MFIs into one of the two statutory forms: non-for-profit microcredit foundation (hereinafter: MCF) dedicated to work in the local community, or for-profit microcredit company (hereinafter: MCC). Thus, MFIs were transformed from donor-funded non-for-profit NGOs into financially sustainable microcredit organizations (hereinafter: MCOs) with a broader scope and capacity. The law also institutionalized the sector. It passed the responsibility for licensing and supervising MCOs to the entities' financial sector authorities FBA and BARS, operating independently. The establishment of a new legal and institutional framework for MCOs opened the possibility for creating a profitable independent large-scale loan organization. With the time, gradually, existing MFIs and new investors seized this opportunity. In 2019, 13 MCOs (2 MCFs and 11 MCCs) were subject to the BARS regulations, whereas 14 MCOs (11 MCFs and 3 MCCs) were subject to the FBA regulations.

On microfinance in BiH several independent studies were conducted. The subject of these researches was impact that microfinance accomplished in BiH. Some of them were interested in impact on poverty alleviation (Matul & Tsilikounas, 2004; Dunn, 2005; Hartarska & Nadolnyak, 2008) and some put focus on development of post-conflict society and reconciliation (Ohanyan, 2002; Welle-Strand, Kjollesdal & Sitter, 2010). On the other side, some authors emphasized the success of microfinancing in BiH at all (Berryman & Pytkowska, 2005; Bateman, 2007; Bateman, Siniković & Škare, 2012). The results of these impact studies varied from positive, neutral, and negative. Regardless of accomplished impact, MFIs in BiH survived in various forms as financial intermediaries from early days of microfinancing in BiH. Nowadays, MCOs in BiH operate in a very competitive market. Majority of them reached financial sustainability and are some of the largest in Eastern Europe. It can be expected that such MCOs will remain providers of financial services in BiH and continue with operations.

2.3 Regulatory framework for microfinance in BiH

MCOs in BiH are fully regulated. The legal systems of the BiH entities are separate and not related, and so is the regulatory framework for the microfinance. However, as BiH is a single economic space, entity regulations are largely harmonized, and it can be said that MCOs have almost equal legal treatment throughout BiH. The Law on Microcredit Organizations is in force in the RS (RS Official Gazette 64/06 and 116/11), while the FBiH has the Law on Microcredit Organizations applies (FBiH Official Gazette 59/06). These entity laws regulate the establishment, registration, activity, legal form, business operations, management, termination and supervision of MCOs. Both laws define MCO as a non-deposit financial organization whose primarily activity is microlending that is performed with the objective to improve material position of microcredit user, increase of employment, providing support

to enterprise development and making profit. In accordance with both laws, MCO as a legal entity may be established and may operate as a MCF or a MCC. According to their legal form (MCF or MCC), MCOs have different legal treatments and legal obligations, and in addition to the core laws, their operations are regulated by other laws. In the case of MCFs, in addition to the law on microcredit organizations, the entity law on associations and foundations applies, in the case of MCCs, in addition to the law on microcredit organizations, the entity law on companies also applies. Depending on the place of registration (RS or FBiH), the relevant laws (entity or cantonal) apply.

The legal requirements in both entities are identical: MCOs may be established by at least three domestic or foreign individual persons, or at least one domestic or foreign legal entity. These organizations may establish organizational units in another entity. According to both entity laws, the main activity of MCOs is the approval of microcredits, while additional activities include receiving gifts, donations and obtaining funds from any legal source (except receiving deposits), issuing and receiving mortgages on property to secure loans, credit consulting, business consulting, and technical assistance for the purpose of credit activities and business activities of credit users. Upon establishment, the MCF seated in RS is registered in the RS Commercial Courts Register, while the MCF seated in FBiH is registered with the FBiH Federal Ministry of Justice or cantonal ministries of justice. MCCs are entered in the court register also according to where it is seated (RS or FBiH). The law also stipulates that an initial investment of BAM 50 thousand is required for MCFs or BAM 500 thousand for MCC in the form of founding capital, and the total capital of an MCO in its operations must not fall below these thresholds. The law also sets different loan ceilings, loans extended by MCF are capped at BAM 10 thousand, while MCC loans may not exceed BAM 50 thousand. It is also stipulated that MCFs cannot extend loans to related parties. The treatment of the financial business results also differs depending on the form of organization of MCO. MCFs are defined by law as non-for-profit organizations, therefore, positive financial result is reflected in excess income over expenditures. Under the entity laws, direct or indirect distribution of excess income over expenditures to founders, members, responsible persons and employees in MCF and other related parties, donors or third parties is prohibited. MCFs are required to use the realized excess income over expenses only for credit operations. MCCs are defined as for-profit companies, accordingly, a positive financial result of operations is earnings before tax, and MCCs are required to pay corporate income tax. MCCs are free to distribute its profit according to the decisions of their bodies, in the form of dividends or retained earnings. Regardless of the form of organization, the law also prescribes the obligation of MCOs to hire an external auditor for the audit of financial statements, to inform the public about it and publish the auditor's opinion and summary report.

For licensing and supervising MCOs are responsible FBA and BARS (regulators). The competencies of these agencies are detailed out by entity laws and internal regulations. Regulators are also responsible for issuing regulations in the form of decisions and

instructions for MCO operations, which regulate the business in more detail. In accordance with the regulations, depending on the location of the MCO's head office, regulators issue operating licenses for MCO. In case of non-compliance with legal regulations, regulators have the right to revoke the operating license of MCO. If a MCO wishes to operate in both entities, it is required to obtain an operating license from both agencies. In addition, the regulators issue other approvals required for the lawful operations of MCOs.

Supervision and inspection of the financial health and stability of MCOs are performed by the regulators in the form of on-site (on MCO premises) and off-site inspection (analysis of reports submitted by MCOs to the regulators). During on-site inspections, MCOs are required to ensure regulators with full access to their complete documentation. For off-site inspections, MCOs are required to submit quarterly and monthly reports to the regulators, in the prescribed form. The reporting basis consists of quarterly reports: the balance sheet, income statement, report on financing sources, report on sectoral and maturity structure of approved microcredits, report on MCO ownership structure, report on MCO business units, report on collection from guarantors/co-borrowers or mortgages, report on loans extended to related parties, report on the size and manner of formation of loan loss provisions, report on the number and qualifications of employees. On a monthly basis, MCOs submit to the agencies a report on weighted NIR and EIR, as well as anti-money laundering and terrorist financing reports.

2.4 The microcrediting market in BiH

As of December 31, 2019 in BiH operated 27 MCOs (Appendix 3). Total gross assets of all MCOs in BiH as of December 31, 2019 amounted to BAM 1,001,504 thousand, of which total gross loans amounted to BAM 804,529 thousand or 80.4 per cent. Total non-performing loans (by decrees loans with repayment delay more than 16 days) amounted to BAM 15,068 thousand or 1.87 per cent of total gross loans. Of the same date, average amount of approved micro loan was BAM 2,778 (Banking agency of RS, 2020; Banking agency of FBiH, 2020).

2.4.1 Microcrediting in RS

As of December 31, 2019 in RS operated 13 MCOs (11 MCCs and 2 MCFs) which head offices were located in RS, through over 142 organizational units. Aside of this, 125 organizational units of MCOs which head offices were in FBiH, also operated in RS (their performance is included in analysis of MCOs seated in FBiH). As of December 31, 2019 MCOs seated in RS, in total employed 538 persons (Banking agency of RS, 2020).

According to data from BARS, concentration ratio as share of the biggest MCO in total gross loan portfolio shows that one MCC was dominant with 71.8 per cent share. Four-firm concentration ratio, as share of the four largest MCOs in RS in total gross loan portfolio, amounted to 90.7 per cent. It is obvious that a small number of MCOs account for the major

share in the market, hence for microcrediting market in RS can be said that is very concentrated.

2.4.1.1 Balance sheet

Total gross assets of MCOs seated in RS as of December 31, 2019 amounted to BAM 365,073 thousand. In the asset structure the biggest share had total gross loans which amounted to BAM 296,228 thousand or 81.1 per cent of total assets. The cash funds amounted to BAM 20,298 thousand or 5.5 per cent of assets. Office space and other fixed assets amounted to BAM 4,260 thousand or 1.1 per cent of total assets. The value of long-term investments amounted to BAM 36,112 thousand or 9.9 per cent of assets. Other assets amounted to BAM 8,175 thousand or 2.4 per cent of total assets. Provisioning for loan losses and other losses amounted to BAM 5,325 thousand. Total net assets amounted to BAM 359,748 thousand. The aggregate balance sheet of MCOs seated in the RS as of December 31, 2019 is shown in the table 5.

Table 5: Aggregate balance sheet of MCOs seated in RS, 2019 (BAM thousand)

		MCCs	MCFs	Total
Assets (Property)				
1.	Cash Funds	20,157	141	20,298
2.	Placements to banks	0	0	0
3.	Loans	293,311	2,917	296,228
4.	Office space and other fixed assets	4,100	160	4,260
5.	Long-term investments	36,112	0	36,112
6.	Other assets	8,024	151	8,175
7.	Total assets (gross)	361,704	3,369	365,073
8.	Provisioning (8a.+8b.)	5,249	76	5,325
8a.	Loan provisioning	3,438	71	3,509
8b.	Provisioning for asset items except loans	1,811	5	1,816
9.	Total assets (net: 7.-8.)	356,455	3,293	359,748
Liabilities (Obligations)				
10.	Obligations per loans taken	212,858	619	213,477
11.	Other liabilities	19,151	1,579	20,730
12.	Capital	124,446	1,095	125,541
	Total Liabilities	356,455	3,293	359,748
	Off-balance sheet records	53,721	28	53,749

Source: Banking Agency of RS (2020).

In the liabilities structure, obligations per loans taken, as a main funding source of MCOs, amounted to BAM 213,477 thousand, with the share of 59.3 per cent in total liabilities. Obligations per long-term loans taken or borrowed cash funds amounted to BAM 208,683 thousand or 97.8 per cent of total obligations per loans taken, while obligations per short-term taken or borrowed cash funds amounted to BAM 4,794 thousand. In the structure of

total obligations per loans taken, obligations of MCCs represented almost all obligations with share of 99.7 per cent.

Table 6: Maturity structure of loans taken of MCOs seated in RS, 2019 (BAM thousand)

		MCCs	MCFs	Total
1.	Obligations per short-term loans taken	4,730	64	4,794
2.	Obligations per long-term loans taken	208,128	555	208,683
	Total obligations per loans taken	212,858	619	213,477

Source: Banking Agency of RS (2020).

Other liabilities amounted to BAM 20,730 thousand or 5.7 per cent of total liabilities. Gross assets per employee in MCOs seated in RS, as of December 31, 2019 amounted to BAM 678.6 thousand.

Capital of MCOs seated in RS as of December 31, 2019 amounted to BAM 125,541 thousand or 34.9 per cent of total liabilities. MCOs founding capital amounted to BAM 54,945 thousand or 43.8 per cent of MCOs capital. Apart from founding capital, significant share in the MCOs capital structure accounted to undistributed profit of MCCs in the total amount of BAM 65,862 thousand or 52.5 per cent of MCOs capital. Legally required reserves amounted to BAM 4,297 thousand or 3.4 per cent of MCO capital.

Table 7: Structure of capital/holding of MCOs seated in RS, 2019 (BAM thousand)

		MCCs	MCFs	Total
1.	Founding capital	54,269	676	54,945
2.	Share premium	0	0	0
3.	Undistributed profit	65,862	/	65,862
4.	Excess income over expenses	/	408	408
5.	Legally required reserves	4,286	11	4,297
6.	Other reserves	29	0	29
	MCC capital/MCF holding	24,446	1,095	125,541

Source: Banking Agency of RS (2020).

According to data from tables 5 and 7, equity to asset ratio, that indicates how effectively MCOs fund asset requirements without using debt, amounted to 0.3. This result (below 0.5) suggests that MCOs are leveraged, and primarily use debt to acquire assets, which can be viewed as an indication of greater financial risk. The debt to equity ratio amounted to 1.7 which means that for BAM 1 in equity, the MCOs have BAM 1.7 in leverage, and shows that MCOs leveraged own funds to finance loan portfolio. It indicates that MCOs are more risk-taking oriented and tilted toward debt financing, but also issues that MCOs could be in trouble because of inability to absorb sudden losses.

2.4.1.2 Microloan portfolio and its quality

Total gross microloan portfolio of MCOs seated in RS, as of December 31, 2019 amounted to BAM 296,228 thousand. In the structure of total gross loan portfolio, loans issued by MCCs amounted to BAM 293,311 thousand or 99 per cent total gross microloan portfolio, while loans issued by MCFs amounted to BAM 2,917 thousand or just 1 per cent of total gross microloan portfolio. Microloan portfolio of organizational units of MCOs seated in RS which operate in FBiH (4 MCOs with 44 organizational units) as of December 31, 2019. amounted to BAM 97,044 thousand or 32.8 per cent of total gross microloan portfolio of MCOs with seat in RS (Banking Agency of RS, 2020).

Table 8: Maturity structure of microloans of MCOs seated in RS, 2019 (BAM thousand)

No.	Microloans	Short-term loans	Long-term loans	Receivables due	Total
1.	Legal entities				
a)	Service industry	295	1,593	4	1,892
b)	Trade	171	1,005	45	1,221
c)	Agriculture	76	90	0	166
d)	Manufacture	171	936	12	1,119
e)	Other	85	129	5	219
	Total 1:	798	3,753	66	4,617
2.	Individual persons				
a)	Service industry	2,828	33,711	87	36,626
b)	Trade	986	6,803	52	7,841
c)	Agriculture	6,400	78,639	185	85,224
d)	Manufacture	346	4,124	12	4,482
e)	Housing	444	15,392	31	15,867
f)	Other	27,485	111,632	2,454	141,571
	Total 2:	38,489	250,301	2,821	291,611
	Grand total (1+2)	39,287	254,054	2,887	296,228

Source: Banking Agency of RS (2020).

As of December 31, 2019 based on the loan maturity structure, long-term loans amounted to BAM 254,054 thousand or 85.8 per cent of total loans, while short term loans amounted to BAM 39,287 thousand or 13.3 per cent of total loans. Receivable due amounted to BAM 2,887 thousand or 0.9 per cent of total loans. Observing the sector structure, loans extended to legal entities amounted to BAM 4,617 thousand or just 1.6 per cent of total loans. Loans extended to individual persons (small entrepreneurs included) amounted to BAM 291,611 thousand or 98.4 per cent of total loans. In total MCOs loans, according to branch concentration structure, the highest share held loans placed for other purposes (mostly senior citizen loans, financing of general consumption of natural persons, cash non purpose loans and similar) with amount of BAM 141,790 thousand or 47.9 per cent of total loans. Loans for financing of agriculture (mostly individual person loans) amounted to BAM 85,390

thousand or 28.9 per cent of total loans, service industry loans amounted to BAM 38,518 thousand or 13 per cent of total loans. Individual persons housing loans amounted to BAM 15,867 thousand and participated in total loans with share of 5.3 per cent. Loans for financing of other activities amounted to BAM 14,663 thousand and accounted to 4.9 per cent of total loans.

MCOs are obliged to allocate all loans and other receivables into certain groups by applying the criteria of number of days in default and to allocate provisioning for loan losses and other losses for each group on the burden of business operations.

Table 9: Loan loss provisioning for microloan portfolio of MCOs seated in RS, 2019 (BAM thousand)

No	Days in default	Prov. rate (per cent)	Loan amt.	Interest		Amt. of other asset items	Prov.			Total prov.
				Prov. rate (per cent)	Interest amt.		Per loans	Per interest due	Per other asset item	
1	2	3	4	5	6	7	8= $\frac{4 \times 3}{100}$	9= $\frac{6 \times 5}{100}$	10= $\frac{7 \times 3}{100}$	11=8+9+10
1.	0	0	286,731	0	522	75	0	0	0	0
2.	1-15	2	2,510	2	63	38,764	49	0	772	821
3.	16-30	15	3,248	100	91	0	486	91	0	577
4.	31-60	50	1,172	100	72	0	587	72	0	659
5.	61-90	80	904	100	62	0	724	62	0	786
6.	91-180	100	1,663	100	445	374	1,663	445	374	2,482
Total:			296,228		1,255	39,213	3,509	670	1,146	5,325

Source: Banking Agency of RS (2020).

As of December 31, 2019 loans without repayment delay amounted to BAM 286,731 thousand or 96.8 per cent of total loans. Loans with repayment delay from 1 to 15 days in the amount of BAM 2,510 thousand accounted to 0.8 per cent of total loans. Loans from these two groups are considered as performing (good) loans, and together they had share of 97.6 per cent of total loans. Portfolio at risk > 30 days (hereinafter: PAR>30) amounted to 1.3 per cent. PAR>30 of MCOs seated in RS is lower by 13.8 per cent related to PAR>30 of MFIs in Eastern Europe and Central Asia region, while it is by 4.7 per cent lower related to PAR>30 MFIs globally (Microfinance Information Exchange, 2019). Total loan loss provisioning amounted to BAM 3,509 thousand. Provisioning per interest receivables amounted to BAM 670 thousand. Provisioning for other assets items amounted to BAM 1,146 thousand. Total provisioning for all asset's positions amounted to BAM 5,325 thousand. Provision for credit losses ratio, the provision for credit losses as a percentage of net loans which shows riskiness of loans written by the bank or other financial institution in comparison to their peers, (hereinafter: PCL ratio), amounted to 1.2 per cent. It can be said

that PCL ratio in microcredit sector in RS is low, suggesting that MCOs don't have tendency to underwrite risky loans.

2.4.1.3 Interest rates on microloans

Average NIR on total loans disbursed in 2019, by MCOs seated in the RS was 17.43 per cent, while weighted EIR was 22.56 per cent. Difference between these two equals to 5.13 per cent which indicates that costs which borrowers have to pay in process of getting loan are high. These costs are usually fees which MCOs calculate later on, while in marketing campaigns these additional costs are not shown or are blurred. Income per fees of MCOs seated in RS as of December 31, 2019. amounted to BAM 10,823 thousand or 18.7 per cent of total income.

Table 10: Weighted NIR and EIR on loans disbursed by MCOs seated in RS, 2019

No.	Microloans	Nominal interest rates (per cent)	Effective interest rates (per cent)
1.	Short-term loan weighted interest rates	15.89	23.73
a)	Service industry	15.13	20.05
b)	Trade	13.97	16.58
c)	Agriculture	16.42	19.60
d)	Manufacture	16.35	19.47
e)	Housing	19.59	28.88
f)	Other	15.89	25.72
2.	Long-term loan weighted interest rates	18.02	22.12
a)	Service industry	17.15	19.85
b)	Trade	16.60	18.70
c)	Agriculture	16.28	18.58
d)	Manufacture	16.27	18.40
e)	Housing	18.47	22.98
f)	Other	19.09	24.45
	Total loan weighted interest rates	17.43	22.56

Source: Banking Agency of RS (2020).

2.4.1.4 Financial performance

Total income of MCOs seated in RS as of December 31, 2019 amounted to BAM 57,947 thousand. According to total income structure, interest income and similar income amounted to BAM 56,691 thousand or 97.8 per cent of total income. The interest income and similar income are structured of interest income in amount of BAM 45,868 thousand or 79.2 per cent of total income and of other similar income (income per fees) in amount of BAM 10,823 thousand or 18.7 per cent of total income. MCO operating income amounted to BAM 713 thousand, while generated extraordinary income (mostly per collection of written-off loan

interest, default interest and court proceedings costs) amounted to BAM 543 thousand, what is altogether 2.2 per cent of total income. It is obvious that MCOs seated in RS had significant income generated by various fees. It could suggest that in marketing of products the low interest rate is emphasized while the high fees and total costs of loan may be blurred. As of December 31, 2019, total expenses of MCOs seated in RS amounted to BAM 41,602 thousand. In total expenses, interest expenses and similar expenses amounted to BAM 9,923 thousand or 23.8 per cent of total expenses. Operating expenses amounted to BAM 29,583 thousand or 71.1 per cent of total expenses. Operating expenses were comprised of salary and contribution costs amounting to BAM 16,101 thousand or 38.7 per cent of total expenses, office space, other fixed assets and utilities costs in the amount of BAM 3,358 thousand or 8.1 per cent of total expenses, and other operating expenses (costs of marketing, lease, amortization, court proceedings costs per dispute resolution and similar) in the amount of BAM 10,124 thousand or 24.1 per cent of total expenses. Expenses for loan loss provisions and other losses amounted to BAM 2,013 thousand or 4.9 per cent of total expenses. Extraordinary expenses amounted to BAM 83 thousand or 0.2 per cent of total expenses. As of December 31, 2019 MCCs recorded net profit in amount of BAM 14,309 thousand, while for the same period MCFs recorded net excess income over expenses in amount of BAM 194 thousand. In summary, MCOs seated in RS as of December 31, 2019, generated positive net financial result in the amount of BAM 14,503 thousand.

Table 11: Aggregated income statement of the MCOs seated in RS, 2019 (BAM thousand)

	MCCs	MCFs	Total
Interest income and similar income			
a) Interest income and similar income	55,928	763	56,691
b) Operating income	667	46	713
c) Extraordinary income	542	1	543
1. Total income (a+b+c)	57,137	810	57,947
Expense			
a) Interest expense and similar expense	9,805	118	9,923
b) Operating expense	29,177	406	29,583
c) Expenses for loan loss provisioning and other losses	1,946	67	2,013
d) Extraordinary expense	83	0	83
2. Total expense (a+b+c)	41,011	591	41,602
3. MCOs financial result before tax (1-2)	16,126	219	16,345
4. Tax	1,817	25	1,842
Total MFIs financial result	14,309	194	14,503

Source: Banking Agency of RS (2020).

Based on data from tables 5 and 11, the operational and financial metrics of MCOs seated in RS, as of December 31, 2019 were:

- net interest margin, the difference between interest income generated divided with earning based assets (net loans) and interest expenses divided with debts, amounted to

14.5 per cent. It shows that MCOs were investing its funds efficiently and earned on interest from its credit products compared to the interest they paid out on debts.

- return on asset (hereinafter: ROA), ratio of net positive financial result to assets was 4 per cent. It means that MCOs seated in RS by BAM 1 of net assets made BAM 3 of positive net financial result. This result indicates that MCOs had a loan portfolio with very high yields. This may be a consequence of potential market irregularities, while on the other hand, it may indicate that MCOs are willing to extend loans with higher risk. ROA of MCOs seated in RS is for 3.7 per cent higher in regard to ROA of MFIs in Eastern Europe and Central Asia region, while it is for 2 per cent higher in regard to ROA of MFIs globally (Microfinance Information Exchange, 2019).
- return on equity (hereinafter: ROE), ratio of net positive financial result to equity was 11.5 per cent. It means that MCOs seated in RS by BAM 1 of equity made BAM 10.5 of net positive financial result. This result indicates that senior executives in MCOs effectively generated profit from the money that MCOs' owners invested in equity. ROE of MCOs seated in RS is for 9 per cent higher in comparison to ROE of MFIs in Eastern Europe and Central Asia region, while it is equal to ROE of MFIs globally (Microfinance Information Exchange, 2019).

The efficiency ratio which assesses the efficiency of MCOs' operations by dividing non-interest expenses with its revenue, for MCOs seated in RS, as of December 31, 2019 amounted to 54.7 per cent. It shows that on every BAM 1 of revenue MCOs had BAM 0.55 of non-interest expenses, which is little above bottom line of optimal level of 50 per cent. Since non-interest expenses are in the numerator and revenue is in the denominator, reduction or control over non-interest expenses, such as marketing or operational expenses, could increase MCOs' efficiency.

Revenue per employee (hereinafter: RPE), assessing productivity of the average employee by determining the revenue generated by each individual working, MCOs seated in RS, as of December 31, 2019 amounted to BAM 107.7 thousand, while net positive financial result (profit) per employee amounted to BAM 26.9 thousand.

2.4.2 Microcrediting in FBiH

As of December 31, 2019, 14 MCOs (3 MCCs and 11 MCFs) with head offices seated in FBiH had operating licenses for FBiH. There was a total of 374 organizational units of MCOs seated in the FBiH. As of December 31, 2019, MCOs seated in RS performed their operations on territory of FBiH through 48 organizational units (their performance is included in analysis of MCOs seated in RS). As of December 31, 2019 MCOs seated in FBiH, in total employed 1,522 persons.

According to data from FBA, concentration ratio as share of the biggest MCO in total gross loan portfolio shows that the biggest share had one MCF with 27.5 per cent. On the other

side, one MCC owned by one MCF (both operating in FBiH independently) as a group of related legal entities had 34.9 per cent share in total gross loan portfolio. Four-firm concentration ratio of the four largest MCOs in FBiH amounted to 76.8 per cent. Compared to RS, concentration ratio of market in FBiH is lower, but also high. Therefore, it can be said that market in FBiH is concentrated but also consolidated.

2.4.2.1 Balance sheet

The total gross assets of MCOs seated in FBiH amounted to BAM 635,468 thousand. In the assets structure, cash funds amounted to BAM 48,877 thousand or 7.7 per cent. The placements to banks amounted to BAM 2,150 thousand or 0.4 per cent. The biggest share had gross loans portfolio which amounted to BAM 508,301 thousand or 79.9 per cent of total assets. Other balance sheet positions the Office space and other fixed assets amounted to BAM 33,253 thousand or 5.2 per cent of total assets, while the long-term investments amounted to BAM 33,061 thousand or 5.2 per cent of total assets. Other assets amounted to BAM 9,826 thousand or 1.6 per cent of total assets. Loan loss provisioning amounted to BAM 3,912 thousand and provisioning for asset items except loans amounted to BAM 258 thousand, provisioning in total amounted to BAM 4,170 thousand. Total net assets amounted to BAM 631,298 thousand. The aggregate balance sheet of MCOs seated in FBiH as of December 31, 2019 are shown in the table 12.

Table 12: Aggregate balance sheet of MCOs seated in FBiH, 2019 (BAM thousand)

	MCCs	MCFs	Total
Assets (Property)			
1. Cash Funds	13,281	35,596	48,877
2. Placements to banks	0	2,150	2,150
3. Loans	140,870	367,431	508,301
4. Office space and other fixed assets	5,748	27,505	33,253
5. Long-term investments	0	33,061	33,061
6. Other assets	2,692	7,134	9,826
7. Total assets (gross)	162,591	472,877	635,468
8. Provisioning (8a.+8b.)	1,411	2,759	4,170
8a. Loan provisioning	1,312	2,600	3,912
8b. Provisioning for asset items except loans	99	159	258
9. Total assets (net: 7.-8.)	161,180	470,118	631,298
Liabilities (Obligations)			
10. Obligations per loans taken	105,883	195,860	301,743
11. Other liabilities	9,982	25,257	35,239
12. Capital	45,315	249,001	294,316
Total Liabilities	146,971	470,118	631,298
Off-balance sheet records	2,555	99,681	102,236

Source: Banking Agency of FBiH (2020).

In the total liabilities structure obligations per loans taken amounted to BAM 301,743 thousand or 47.8 per cent of total liabilities. Obligations per long-term loans taken or borrowed cash funds amounted to BAM 162,296 thousand or 53.8 per cent of total obligations per loans taken, while obligations per short-term taken or borrowed cash funds amounted to BAM 139,447 thousand. In the structure of total obligations per loans taken, obligations of MCFs amounted to BAM 195,860 thousand what represented 64.9 per cent, and the obligations of MCCs amounted to BAM 105,883 thousand.

Table 13: Maturity structure of loans taken of MCOs seated in FBiH, 2019 (BAM thousand)

		MCCs	MCFs	Total
1.	Obligations per short-term loans taken	56,995	82,452	139,447
2.	Obligations per long-term loans taken	48,888	113,408	162,296
	Total obligations per loans taken	105,883	195,860	301,743

Source: Banking Agency of FBiH (2020).

Other liabilities amounted to BAM 35,239 thousand or 5.6 per cent of total liabilities.

Capital of MCOs seated in FBiH as of December 31, 2019 amounted to BAM 294,316 thousand or 46.6 per cent of total liabilities. The highest share in MCOs capital had excess income over expenses of MCFs in amount of BAM 196,939 thousand or 66.9 per cent of MCOs capital. The undistributed profit of MCCs amounted to BAM 9,187 thousand or 3.1 per cent of MCOs capital. Altogether, net financial result of MCOs seated in FBiH retained amounted to BAM 206,126 thousand or 70 per cent of MCOs capital. Donated capital of MCFs (post-war international help for MFIs) amounted to BAM 48,076 thousand or 16.3 per cent of total capital. MCOs founding capital amounted to BAM 35,468 thousand or 12 per cent of MCOs capital. Legally required reserves amounted to BAM 2,528 thousand, while other reserves amounted to BAM 2,118 thousand, what is altogether 0.7 per cent of MCOs capital.

Table 14: Structure of capital of MCOs seated in FBiH, 2019 (BAM thousand)

		MCCs	MCFs	Total
1.	Donated capital	0	48,076	48,076
2.	Founding capital	31,600	3,868	35,468
3.	Share premium	0	0	0
4.	Undistributed profit	9,187	/	9,187
5.	Excess income over expenses	/	196,939	196,939
6.	Legally required reserves	2,528	0	2,528
7.	Other reserves	2,000	118	2,118
	MCC capital / MCF holding	45,315	249,001	294,316

Source: Banking Agency of FBiH (2020).

Compared to the capital structure of MCOs seated in RS, the biggest difference is donated capital. In immediate post-war period world power states infused significant funds for reconstruction and development of BiH. Part of these funds was directed toward MCOs, founded by international NGOs. Donated capital refers to initial capital of these MCOs which was infused to begin loan disbursement. All these international NGOs were seated in FBiH, which is reason why MCOs in RS do not have donated capital category in their books. Later, these NGOs left FBiH, while MCOs remained and were left by international NGOs to management of MCOs to keep their operations with purpose of further development and self-sustainability of MCOs. The category of donated capital remained in the books of such MCOs (Banking agency of FBiH, 2013). As of December 31, 2019 in FBiH operated 9 MCFs which had category of donated capital in their books. Regardless of this capital category, total capital of MCOs seated in FBiH, as of December 31, 2019 was more than twice larger than capital of MCOs seated in RS, although in both entities was seated almost the same number of MCOs. It suggests that average capital base of one MCO seated in FBiH is higher than of one seated in RS. This can qualify MCOs seated in FBiH as steadier and provide them with easier access to additional funds, both in BiH and internationally.

The equity to asset ratio, amounted to 0.4 which is for 0.1 greater than same ratio of MCOs seated in RS. The result is also below 0.5 (result below 0.5 suggests that MCOs are leveraged) thus can be considered that MCOs seated in FBiH are moderately leveraged and use debt and equity in approximately equal ratios to acquire assets. The debt to equity ratio amounts to 1 which means that for BAM 1 in equity, the MCOs had BAM 1 in leverage. The result was for 0.7 lower than the ratio for MCOs seated in RS. It shows that MCOs in FBiH are moderate to risk taking, and equally oriented to debt and equity financing for its operations.

2.4.2.2 Microloan portfolio and its quality

Total gross microloan portfolio of MCOs seated in FBiH, as of December 31, 2019 amounted to BAM 508,301 thousand. In the structure of total gross loan portfolio, loans issued by MCC amounted to BAM 140,870 thousand or 27.7 per cent total gross microloan portfolio, while loans issued by MCFs amounted to BAM 367,431 thousand and represented 72.3 per cent of total gross microloan portfolio. Organizational units of MCOs seated in FBiH which operate in RS (8 MCOs with 125 organizational units) as of December 31, 2019 had a microloan portfolio in amount of BAM 163,400 thousand or 32.1 per cent of total gross microloan portfolio of MCOs with seat in FBiH (Banking Agency of FBiH, 2020).

Based on the maturity structure of the loans, the share of long-term loans was dominant with amount of BAM 473,571 thousand or 93.2 per cent of total loans, while short-term loans amounted to BAM 33,420 thousand or 6.6 per cent out of total loans. Receivable due amounted to BAM 1,310 thousand or just 0.2 per cent of total loans. Based on the sector structure, loans extended to legal entities amounted to BAM 13,660 thousand or 2.7 per cent

of total loans. Loans extended to individual persons (small entrepreneurs included) amounted to BAM 494,641 thousand or 97.3 per cent of total loans. According to branch concentration structure, in total loans, the highest share had loans extended for agriculture which amounted to BAM 164,672 thousand or 32.4 per cent of total loans. Loans for purposes of housing (individual person loans) amounted to BAM 112,549 thousand or 22.1 per cent of total loans. Loans for other purposes (senior citizen loans, financing of general consumption of natural persons, cash non purpose loans and similar) amounted to BAM 100,209 thousand or 19.7 per cent of total loans. Loans for financing of services amounted to BAM 102,101 thousand or 20 per cent of total loans. Loans for financing of other branches such as trade and manufacture amounted to BAM 28,770 thousand and accounted to 5.8 per cent of total loans. When sectoral and maturity structure of microloans is observed, similarly to loans of MCOs seated in RS, majority of loans refer to long-term microloans approved to individual persons.

Table 15: Sectoral and maturity structure of microloans of MCOs seated in FBiH, 2019 (BAM thousand)

No.	Microloans	Short-term loans	Long-term loans	Receivables due	Total
1.	Legal entities				
a)	Service industry	237	7,539	50	7,826
b)	Trade	165	2,711	18	2,894
c)	Agriculture	21	827	0	848
d)	Manufacture	122	1,850	5	1,977
e)	Other	19	95	1	115
	Total 1:	564	13,022	74	13,660
2.	Individual persons				
a)	Service industry	4,586	89,487	202	94,275
b)	Trade	1,083	13,389	46	14,518
c)	Agriculture	6,544	157,014	266	163,824
d)	Manufacture	488	8,869	24	9,381
e)	Housing	3,152	109,235	162	112,549
f)	Other	17,003	82,555	536	100,094
	Total 2:	32,856	460,549	1,236	494,641
	Grand total (1+2)	33,420	473,571	1,310	508,301

Source: Banking Agency of FBiH (2020).

Same as in RS, MCOs with seat in FBiH are required to allocate all loans and other receivables into certain groups by applying the criteria of number of days in default and to allocate provisioning for loan losses and other losses for each group on the burden of business operations. Compared to MCOs with seat in RS, MCOs with seat in FBiH although as of December 31, 2019 had greater gross microloan portfolio, they also had smaller total amount of regulatory provisioning per all positions amounted.

Table 16: Loan loss provisioning for microloan portfolio of MCOs seated in FBiH, 2019
(BAM thousand)

No	Days in default	Prov. rate (per cent)	Loan amt.	Interest		Amt. of other asset items	Prov.			Total prov.
				Prov. rate (per cent)	Interest amt.		Per loans	Per interest due	Per other asset item	
1	2	3	4	5	6	7	8=(4x3)/100	9=6x5/100	10=(7x3)/100	11=8+9+10
1.	0	0	498,565	0	5	397	0	0	0	0
2.	1-15	2	2,713	2	35	0	56	0	0	56
3.	16-30	15	2,645	100	33	0	412	35	0	447
4.	31-60	50	1,489	100	47	0	747	47	0	794
5.	61-90	80	965	100	46	0	773	46	0	819
6.	91-180	100	1,924	100	132	0	1,924	130	0	2,054
Total:			508,301		298	397	3,912	258	0	4,170

Source: Banking Agency of FBiH (2020).

In the overall portfolio, loans which are not defaulted as of December 31, 2019. amounted to BAM 498,565 thousand or 98 per cent of portfolio. Loans with repayment delay from 1 to 15 days amounted to BAM 2,713 thousand or 0.5 per cent of portfolio and loans with repayment delay from 16 to 30 days amounted to BAM 2,645 thousand and account for 0.5 per cent of the overall portfolio. PAR>30 amounted to BAM 4,378 thousand or just 1 per cent. PAR>30 for portfolio of MCOs in FBiH was for 0.3 per cent lower in comparison to PAR>30 for portfolio of MCOs seated RS. Compared to PAR>30 of MFIs in Eastern Europe and Central Asia region PAR>30 for portfolio of MCOs in FBiH was for 14.1 per cent lower, while compared to PAR>30 of MFIs in global level is for 5 per cent lower (Microfinance Information Exchange, 2019). Total loan loss provisioning amounted to BAM 3,912 thousand. Provisioning per interest receivables amounted to BAM 258 thousand. For other items assets as of December 31, 2019 MCOs in FBiH did not have provisioning. Total amount of regulatory provisioning per all positions amounted to BAM 4,170 thousand. PCL ratio, the provision for credit losses as a percentage of net loans, amounted to 0.8 per cent. It can be said that PCL of MCOs seated in FBiH is very low, suggesting that MCOs have a great repayment of the loans.

2.4.2.3 Interest rates on microloans

Average weighted NIR on portfolio disbursed by MCOs seated in FBiH in 2019, was 19.51 per cent, while average weighted EIR was 24.38 per cent. Difference between these two is 4.87 per cent, what is for just 0.26 per cent lower than in case of MCOs seated in RS. Although this difference is small, it can be said that MCOs seated in FBiH charge less fees for approval of loan than MCOs seated in RS. Still, in comparison to MCOs seated in RS, average weighted NIR on whole portfolio of MCOs seated in FBiH was higher for 2.08 per

cent, while average weighted EIR on whole portfolio of MCOs seated in FBiH was higher for 1.82 per cent. These differences suggest that, in the end, loans disbursed by MCOs seated in FBiH are in average pricier than loans disbursed by MCOs seated in RS.

Table 17: Weighted NIR and EIR on loans disbursed by MCOs seated in FBiH, 2019

No.	Microloans	Nominal interest rates (per cent)	Effective interest rates (per cent)
1.	Short-term loan weighted interest rates	20.80	31.85
a)	Service industry	20.03	26.80
b)	Trade	20.01	27.46
c)	Agriculture	19.52	26.17
d)	Manufacture	19.29	25.95
e)	Housing	19.28	24.44
f)	Other	16.47	48.87
2.	Long-term loan weighted interest rates	24.81	35.21
a)	Service industry	19.29	23.09
b)	Trade	18.81	22.07
c)	Agriculture	19.41	23.25
d)	Manufacture	18.12	21.30
e)	Housing	18.77	22.17
f)	Other	18.87	22.21
	Total loan weighted interest rates	20.05	24.22

Source: Banking Agency of FBiH (2020).

2.4.2.4 Financial performance

As of December 31, 2019 total income of MCOs seated in FBiH amounted to BAM 111,381 thousand, of which interest income and similar income amounted to BAM 91,470 thousand and accounted to 82.1 per cent of total income. Interest income amounted to BAM 90,258 thousand what was 98.67 per cent of interest income and similar income, and 81.03 per cent of total income. Operating income amounted to BAM 8,813 thousand and accounted to 7.9 per cent of total income. Aside of total income from ordinary business operations, MCOs generated extraordinary income in the amount of BAM 11,098 thousand or 10 per cent of total income (mostly per collection of written-off loan interest, default interest and court proceedings costs). Total expenses of MCOs seated in FBiH as of December 31, 2019. amounted to BAM 91,262 thousand. In the structure of total expenses, interest expenses and similar expenses amounted to BAM 12,834 thousand or 14 per cent of total expenses. Operating expenses amounted to BAM 72,075 thousand or 79 per cent of total expenses. In the structure of operating expenses, the biggest share had expenses for salary and contribution costs, altogether amounting to BAM 47,990 thousand what was 66.6 per cent of operating expenses and 52.6 per cent of total expenses. Expenses for loan loss provisions and other losses amounted to BAM 5,622 thousand or 6.1 per cent of total expenses. Extraordinary expenses amounted to BAM 731 thousand or 0.9 per cent of total expenses.

MCCs net profit recorded as of December 31, 2019 amounted to BAM 3,211 thousand. Excess income over expenses of MCFs amounted to BAM 16,278 thousand. Overall positive net financial result of all MCOs seated in FBiH amounted to BAM 19,489 thousand, what is for BAM 4,986 thousand more than MCOs seated in RS recorded for same period. From table 18 is obvious that MCFs seated in FBiH does not calculate and pay tax on achieved excess income over expenses. The reason is that by tax laws in FBiH the excess income over expenses is not perceived as earnings before tax, what is not case of tax laws in RS, although the net financial results of MCFs cannot be paid out as a dividend to their owners, rather has to be retained and used for further loan disbursement.

Table 18: Aggregated income statement of the MCOs seated in FBiH, 2019 (BAM thousand)

	MCCs	MCFs	Total
Interest income and similar income			
a) Interest income and similar income	24,133	67,337	91,470
b) Operating income	1,993	6,820	8,813
c) Extraordinary income	265	10,833	11,098
1. Total income (a+b+c)	26,391	84,990	111,381
Expense			
a) Interest expense and similar expense	4,655	8,179	12,834
b) Operating expense	15,940	56,135	72,075
c) Expenses for loan loss provisioning and other losses	1,883	3,739	5,622
d) Extraordinary expense	72	659	731
2. Total expense (a+b+c)	22,550	68,712	91,262
3. MCOs financial result before tax (1-2)	3,841	16,278	20,119
4. Tax	630	/	630
Total MFIs financial result	3,211	16,278	19,489

Source: Banking Agency of FBiH (2020).

By data from tables 12 and 18, the operational and financial metrics of MCOs seated in FBiH, as of December 31, 2019 were:

- net interest margin, the difference between interest income generated relative to earning based assets and interest expenses relative to debts, amounted to 13.7 per cent. It shows that MCOs were investing its funds efficiently and earned on interest from its credit products compared to the interest they paid out on debts. The result is close to the result of MCOs seated in RS, difference is just 0.8 per cent.
- ROA as ratio of net positive financial result to assets amounted to 3 per cent. In comparison to same ratio calculated for MCOs seated in RS, it is lower for 1 per cent. It means that MCOs seated in RS for every BAM 1 engaged in made in net positive financial result BAM 1 more than MCOs seated in FBiH. Although ROA for MCOs seated in FBiH is lower than same ratio for MCOs seated in RS, return of BAM 2.08 for every BAM 1 in assets is high. Such high result shows that MCOs seated in FBiH like

MCOs seated in RS possess high-yield assets, relatively their portfolio is structured of loans with high interest rates. ROA for MCOs seated in FBiH is for 2.7 per cent higher compared to ROA for MFIs in Eastern Europe and Central Asia region, while it is for 1 per cent higher compared to ROA for MFIs globally (Microfinance Information Exchange, 2019).

- ROE as ratio of net positive financial result to equity amounted 6.6 per cent, what is for 4.9 per cent lower than ROE of MCOs seated in RS. This ROE shows that MCOs seated in RS materialized BAM 3.9 for every BAM 1 of equity more than MCOs seated in FBiH, in other words they employed their equity more efficient. ROE of MCOs seated in FBiH is for 4.1 per cent higher than ROE for MFIs in Eastern Europe and Central Asia region, while it is for 4.9 per cent lower than ROE for MFIs globally (Microfinance Information Exchange, 2019).

The efficiency ratio as relation of non-interest expenses to revenues, for MCOs seated in FBiH, as of December 31, 2019 amounted to 70.4 per cent, which is well above optimal level of 50 per cent. It shows that on every BAM 1 of revenue MCOs had BAM 0.70 of non-interest expenses. RPE ratio, as revenue generated by average employee of MCO seated in FBiH, as of December 31, 2019 amounted to 73.2 thousand KM. This is significantly lower compared to RPE of MCOs seated in RS (BAM 107.7 thousand).

2.5 Porter 5 forces and SWOT analyses of microcrediting market in BiH

As mentioned, as of December 31, 2019, 27 MCO had operating licenses. It is a significant number of financial institutions of that kind given the size of the country and population in BiH. Concentration ratios in both entities exceed 80 per cent, which means that the market is highly concentrated and consolidated. Despite, the 2019 growth rate reflected in the growth rate of loans extended, was 17 per cent in the RS (Banking agency of RS, 2020), the FBiH saw more moderate growth but still high 11 per cent (Banking agency of FBiH, 2020). The reasons for this level of growth may be the accessibility of products and the efficiency of MCOs' procedures compared to banks, while on the other hand this growth may indicate the need of an increasing number of individuals for financing of social character. Given the number of MCOs and products that are very similar in nature, it is very difficult to make a differentiated product without competitors copying it. For this reason, the market position is improved by attracting customers with lower product costs and better service. Given all the above, it can be said that rivalry among existing competitors is high.

In the case of MCOs, the suppliers are banks and other investors from whom MCOs borrow money for their business. Although MCOs are not allowed to collect deposits by law, they can diversify their financing sources. MCOs can raise funds through borrowing from commercial or investment banks, through international investment funds, borrowing on the securities market through issues of securities (bonds), as well as direct borrowing from individuals or legal entities interested in investing their surplus funds in MCOs. Given that

MCOs have multiple opportunities to secure required financing, the bargaining power of suppliers can be considered as low.

On the demand side, buyers i.e., borrowers are all legal and individual persons who borrow from MCOs. Their power stems from their ability to negotiate and price sensitivity, that is, the amount of money they are willing to pay for a particular product that make up interest and fees. Depending on their power, they are willing to negotiate better terms with MCOs or are willing to choose a different product or move on to competitors. The better informed the borrowers are, the better their negotiating position is. The availability of information about products and services gives them additional bargaining power. MCOs are legally required to publish “fact sheets” on their websites for each product they offer. These fact sheets represent the standardization of products offered by MCOs. In this way, borrowers can compare prices and features of individual products, seek more favourable interest rates on loans, etc. Because they are able to get informed about products, borrowers are becoming more demanding and expect MCOs to meet their needs, so the bargaining power of borrowers can be considered as high.

Interest in entering the market is reflected in the above-average financial results achieved by MCOs (ROA and ROE both in the RS and FBiH are higher than the same ratios for MFIs in Eastern Europe and Central Asia region and globally). The growth rate of net financial result in 2019 compared to the previous year, for MCOs seated in the RS was 30 per cent (Banking agency of RS, 2020), while MCOs seated in the FBiH saw a decline for 7 per cent (Banking agency of FBiH, 2020). Therefore, the RS market is seen more attractive and favoured by new entrants. The difference in the attractiveness of the market has resulted in an increase in the number of applications and operating licenses issued to MCOs by the BARS. Since 2015, the number of MCOs registered in the RS increased from 6 to 13, while the number of MCOs registered in the FBiH increased from 13 to 14, which confirms the above. Although the law prescribes a relatively low level of initial capital for MCOs (BAM 50 thousand for MCF and BAM 500 thousand for MCC), entry barriers are still high. The reason for this is that the existing MCOs have already reached economies of scale and lowered unit cost per product or service to a level that new entrants can hardly reach over a short period of time. A longer market presence has also allowed the existing MCOs to have a larger learning curve and experience, developed sales channels, better locations, developed partnerships, etc. For all this, new MCOs that want to enter the market need high investments in product differentiation, development of distribution channels, branches and advertising.

Substitute products are offered by banks. Bank loans are more sizeable compared to MCOs (MCOs may not exceed BAM 50 thousand). In addition, banks may offer products other than loans such as guarantees, deposits, payment transactions, payment/credit cards, etc. which the law does not allow for MCOs. Also, banks have greater financial resources, hence they are able to offer tailored products to their customers because they constantly monitor the situation and invest more in new technologies. Nevertheless, the threat from substitutes

is low because most of the MCOs' clients are individuals who cannot pass strict banking rules and procedures.

Table 19: SWOT analysis of microcrediting market in BiH

Strengths	Weaknesses
<ul style="list-style-type: none"> • a consolidated sector with many years of experience in serving the most vulnerable groups of the population • accessibility to clients and efficient (fast) lending procedures • low levels of non-performing loans 	<ul style="list-style-type: none"> • high transaction costs • excessive interest rates • inability to offer other products in addition to loans such as microinsurance, microdeposits, etc. • not properly regulated (overregulated)
Opportunities	Threats
<ul style="list-style-type: none"> • huge potential and demand & supply gap • development of digital channels • enhance services offered 	<ul style="list-style-type: none"> • new competitors • customers opting for banks

Source: Own work.

3 RESEARCH FRAMEWORK AND METHODOLOGY

3.1 Research objectives

The main objectives of this research are to provide an in-depth analysis of the microfinance environment in BiH, determine whether there are any drawbacks and imperfections of the market that MCOs and regulators as the key stakeholders face, as well as to suggest solutions in order to showcase perspectives for further development of microfinance in BiH. The research seeks to answer three questions:

- What are the main obstacles that MCOs encounter in their lending operations in BiH?
- What are the main challenges faced by the regulators with regard to the supervision of MCOs?
- What are the sustainable solutions both for MCOs and regulators?

3.2 Research design

The research design is compounded both of desktop theoretical research and empirical research. The initial theoretical foundations for thesis are grounded on comprehensive review and analysis of relevant literature on microfinance developments/concept and industry, both on the global and local levels. The collection of academic sources and research papers obtained from reports, prepared by research scholars and universities, published in scientific technical journals and books was used to complete an overview of the theoretical concept of microfinance. The empirical part of thesis, comprehensive market analysis of the

microfinance market in BiH was based on primary data and secondary data. Collected data were used as inputs for quantitative and qualitative (descriptive) analyses.

Secondary data were used for the PEST analysis to examine the macroeconomic environment in BiH. The laws and regulations governing the microfinance market in the RS and FBiH were compared to understand the business environment for MCOs in BiH. This was followed by quantitative financial analysis of aggregate financial statements of MCOs seated in the RS and FBiH to measure their performance. Porter's 5 forces analysis was used as a tool to examine the intensity of competition among MCOs and, accordingly, the attractiveness of the market in terms of its profitability. Based on the findings of other analyses, a SWOT analysis was carried out.

Primary data for this purpose were collected through in-depth interviews. Primary data were processed using the thematic analysis, one of the most common methods of qualitative data analysis, which enables identifying, analysing, and reporting patterns (themes) within data. Thematic analysis involves six phases: reading the collected data, coding, searching for themes among codes, reviewing themes, analysing themes and summarizing findings (Clarke & Braun, 2017). It is a cyclical process which involves going back and forth between phases of data analysis as needed until the researcher is satisfied with the final themes. A theme captures something important about the data in relation to the research question and represents some level of patterned response or meaning within the data set (Clarke & Braun, 2017). The findings provided by a thematic analysis can be potentially useful for decision-makers to make interventions.

3.3 Primary data collection

To understand the microfinance market from inside, primary data focusing on qualitative data were gathered through semi-structured in-depth interviews (Appendix 4). This research method helps in finding answers to questions like how and why, something which is not possible by using other analytical methods (Saunders, Lewis & Thornhill, 2019). Therefore, it was selected as the most suitable research method to examine the attitudes of senior managers of MCO and regulators, as well as with advocates of microfinance in BiH to issues concerning the microfinance market in BiH.

The main questions asked were focused on financial inclusion/exclusion in BiH, supervision of MCOs and consumer protection, as well as processes related to digital transformation of microfinance services. In the end, interviewees were asked on opinion about future (in short, mid and long term) of microfinance in BiH.

The primary data collection took place between January and March 2020. All interviews were conducted in the local language.

3.4 Sample description

For primary data, the non-probability, purposive sampling method was used. The sample was selected based on interviewees' professional expertise and experience in the microfinance market in BiH, as most useful for the purposes of the study. The research included 8 individuals, of whom 2 females. The sample equally represented MCOs (4 senior managers of MCOs, 2 from each MCOs seated in the RS and FBiH) and the representatives of other stakeholders (1 senior manager in BARS, 1 Assist to minister in Government of RS i.e., lawmaker, 1 senior manager in AMFI and 1 Ombudsman for the RS banking system). The selected sample was heterogeneous considering the market field in which interviewees participate. Therefore, the research provides overview of microfinance market in BiH from different perspectives. At the time of the research, the interviewees had 2-21 years of experience in microfinance, which ensured a diverse sample.

Table 20: Participants in research (interviewees)

	Name and Surname	Name of institution/company	Position	Experience in microfinance
Senior managers of MCOs				
1.	Mladen Bosnić	MCC "Микрофин" Banja Luka	CEO	21 years
2.	Dragan Danojević	MCC "Digital Finance International" Banja Luka	CEO	5 years
3.	Džavid Sejfović	MCF "LIDER" Sarajevo	CEO	11 years
4.	Safet Husić	MCF "MI-BOSPO" Tuzla	CEO	18 years
Regulators				
1.	Mile Tamamović	Banking agency of Republika Srpska	Director of Sector for Non-depository Fin Org Supervision,	15 years
2.	Snježana Rudić	Government of Republika Srpska	Assistant to the Minister for financial system	19 years
Advocates of microfinance				
1.	Elma Zukić	Association of Microfinance Institutions in Bosnia and Herzegovina	President	2 years
2.	Vladimir Rudić		Ombudsman for the Banking System of Republika Srpska	9 years

Source: Own work.

3.5 Primary data analysis

Primary data were analysed using qualitative thematic analysis. In the first phase, all the interviews were transcribed and together with the completed questionnaires were reviewed before the analysis itself. In the second phase, the transcript of every interview was reviewed again, and the most frequently repeated phrases were set as codes. As the collected data were manageable without the aid of computer-assisted tool, no encoding software was used. The interpretation in a qualitative study is dependent on the interpretation and skills of the researchers rather than a software tool. The choice of coding the data manually had thus no significant impact on the result in comparison to a quantitative study (King, 2004). In the third phase, the patterns among the created codes were identified and used to determine the themes. In the fourth phase, the themes were reviewed as to assure that the collected data accurately represented the context of each theme. In the fifth phase themes were defined.

4 FINDINGS AND RESULTS

This chapter reports the findings and results of the research. As stated in the previous chapter, thematic analysis was used as data analysis method. With the inductive approach to analysis of interviewees' answers, 4 key themes were identified. Each theme was defined to describe a different aspect of the microfinance market in BiH. The findings and results were elaborated as attitudes of senior managers of MCOs and regulators, and microfinance advocates to defined themes.

Table 21: Themes and codes with frequencies in answers of interviewees

Themes	Codes	Frequencies
Goals of MCOs	inclusion/exclusion	49
	access to financial products and services	38
	employment/unemployment	24
	entrepreneur/ entrepreneurship	23
Microfinancing products	micro loan	130
	services	109
	microsavings/microinsurance	24
Market regulation	laws	80
	regulatory framework	79
New technology	digital	34
	new technology	22

Source: Own work.

4.1 Attitudes of senior managers of MCOs

4.1.1 Attitudes on goals of MCOs

According to opinion of senior managers of MCOs, these financial intermediaries in their operations have two goals: financial performance which enables sustainability of MCOs in long run and positive social impact which MCOs accomplish by financial inclusion of their clients.

“Since their introduction in late 1990s, the main goal of MCOs in BiH has been to extend small volume and microcredits to the population and entrepreneurs. This in particular refers to those groups of the population and entrepreneurs that are not guaranteed access to the services of commercial banks for various reasons. In addition to this main goal, another important goal could be the self-sustainability of MCOs so that they are able to provide their services to clients on a long-term basis. This is a very important goal, both for MCOs themselves and the users of their services, because only in this way can clients be provided with continuous access to MCOs services, ensuring the stability and growth of their businesses.” (Bosnić, M.)

Regarding the social goals, the respondents point out that the vast majority of MCOs have been very successful in achieving their goals:

“Many of the currently successful companies have first borrowed from MCOs. Also, many individual clients have had access to the necessary funds by borrowing from MCOs and thus raised their standard of living.” (Danojević, D.)

“Over the past years, hundreds of thousands of clients have used the services of MCOs and are still using them. A good number of them, through the services of MCOs, developed and improved their business, formalized it and created jobs. On the other hand, other clients used the funds to satisfy some of their personal needs, improve the living conditions of their families, etc.” (Bosnić, M.)

But they also believe that MCOs must have made a greater contribution and be a medium for increasing the level of financial inclusion because of the broad base of clients and special relationships with them. From the perspective of senior managers of MCOs, it seems there is still a significant proportion of BiH population who have remained out of financial flows. Therefore, MCOs must make additional efforts to fully deliver on their mission:

“The concept of financial inclusion or exclusion, in my opinion, is equal to any other discrimination in society. All citizens need to be ensured access to financial instruments according to their needs. If this is not the case, the foundations of social inequality will be and not everyone will stand the same chance for success.” (Danojević, D.)

“As far as our country is concerned, unofficial statistics show that 40 per cent of the population in BiH does not have a transaction account with a commercial bank, which is indicative of the need to address this important issue and identify it as priority.” (Sejfović, Dž.)

However, the respondents also argue that it should not be forgotten that MCOs are financial institutions, not social welfare institutions or charities, and as such must meet both financial and institutional standards. However, the respondents believe that some MCOs focused only on financial goals and have disregarded the mission of microfinance.

“Some traditional MCOs have largely shifted from their original mission, as number of them registered as foundations (non-for-profit organizations), generate income that exceeds their expenditures in BAM millions, while on the other hand, they offer services to their clients at rather high costs (EIR), although they could drastically reduce the prices of their financial services and nevertheless achieve, without any difficulty, solid financial results, on the one hand, and thus meet all regulatory or creditor standards, and provide more affordable and inexpensive service to their clients, on the other.” (Sejfović, Dž.)

4.1.2 Attitudes on microfinancing products

Senior managers of MCO share the view that that some MCOs have developed their capacities sufficiently to be able to start providing services other than micro loans.

“Services in the areas of foreign exchange, payment transactions, insurance mediation, money transfers, etc. could be provided by most of the MCOs without any difficulty, perhaps even better than by some other financial institutions, because they have the necessary knowledge, resources, capacities and, more importantly, the market with clients who are in need of these services to be able to further expand their businesses.” (Sejfović, Dž.)

However, the respondents point out that the existing legal framework limits the activity of MCOs to microcrediting only, thus preventing them from providing other services needed by clients who cannot obtain these services from other financial institutions.

“MCOs have highly trained and educated staff, they have very good information systems, and I think that if the legislation were reformed, they would be able to provide other financial services to a greater or lesser extent, depending on their infrastructure and internal capacities.” (Husić, S.)

Some respondents believe that the change in the regulatory framework should allow MCOs to offer all services as offered by commercial banks, including receiving deposits, while others believe that caution is warranted in this regard and that MCOs should be limited to provide a limited range of other services.

“MCOs eager to take on depository operations do not understand that this segment of business, in addition to much stricter regulatory standards (and additional regulators), also requires a major shift in the way of doing business and interactions with clients. As regards lending operations, it is the client who needs to gain the trust of the financial institution, whereas in the case of savings, the financial institution is the one that needs to gain the trust of the client, and these require completely different approaches and concepts.” (Sejfović, Dž.)

According to the respondents, when the legislation is amended and obstacles to the provision of other services are removed, deciding whether and which services MCOs should offer to clients will be a great strategic decision for each MCO individually, given that BiH is a small country with an extremely competitive financial sector given the number of financial institutions already on the market.

4.1.3 Attitudes on market regulation

Senior managers of MCOs believe that the current laws and other regulations that make up the regulatory framework for MCOs in BiH must be revised by professionals, financial market participants and regulators in order to be clearly defined and focused on practical issues. At the same time, the regulatory framework should be harmonized with EU regulations, and follow the best practices in the area of microfinance from countries where microfinance market is well developed.

“The current legal framework dates from 2006 and was somewhat amended in 2011. And the very fact that the fundamental law has not seen any major amendments for almost 15 years now suggests that it would be advisable to do so. The sector has evolved in the meantime, the business environment has changed, the economy has progressed, significant technological innovations have been introduced, etc.” (Bosnić, M.)

Senior managers of MCOs believe that some of the biggest issues of the existing regulatory framework include: the transformation from a non-for-profit to for-profit organization (MCF to MCC) that has not been addressed in the FBiH, inability of MCOs to provide additional services other than loans, size of loans MCFs are allowed to extend, and non-harmonized legal framework for MCOs between the two entities.

“The legal frameworks for the operations of MCOs in the FBiH and RS are not harmonized, and two entity laws provide for a number of important issues different regulations, e. g. the establishment of an MCC, rules for MCO operations, etc. This results in uneven conditions for MCOs in the FBiH and RS and, consequently, permanent business uncertainty. The situation is similar with regard to other regulations that govern MCOs, such as the laws governing labour, taxation, social security contributions, etc.” (Sejfović, Dž.)

Senior managers of MCOs in particular put focus on the fact that MCOs and banks, although financial institutions, cannot be treated in the same way at all. According to the respondents, the legislation fails to consider the specifics of the MCOs in regard to banks, in particular the mission of financial inclusion which MCOs follow.

“Also, in certain aspects, MCOs are treated just as banks. In my opinion, this is redundant, because a failed MCO harms only its owners, whereas a failed bank will harm its depositors, who are all citizens of the country. Finally, MCOs are treated as banks and other financial institutions, and have become subject to a series of requirements that make their operation significantly more difficult because they are in direct conflict not only with the mission of the microcredit industry but also with the principles of financial inclusion.” (Danojević, D.)

In addition to these gaps, the respondents are unanimous in their opinion that the microfinance market in BiH is well regulated, in other words “over-regulated”, even to the extent that some of the regulations, including the number thereof, actually hinder the further development of microfinance:

“To the best of my knowledge, over 50 laws and other regulations apply to the MCOs in the market.” (Danojević, D.)

“The perspective of the sector in any future period will largely depend on the legal framework itself. If it is not reformed, it will be difficult to talk about any perspective but rather the stand-by situation in the sector. More specifically, MCOs will continue to provide microloans and nothing major will happen there compared to the current situation. However, if new legal arrangements allowed MCOs to provide, only to their clients or even the public, other services as well, it would also significantly change the future perspectives of the sector as a whole.” (Bosnić, M.)

4.1.4 Attitudes on new technologies

According to senior managers of MCOs, digital transformation is not just a future but necessity. By their opinion, over a period of 2-5 years all sectors of the economy will have to go through this process. This is an extremely important issue for the microfinance market in BiH, which has a huge potential to improve, expand and reduce the cost of its services through digitalization:

“It is impossible not to participate in the process of digital transformation and to lag behind others in this regard. Simply put, technologies are moving forward and MCOs need to catch up and adapt their operations to technological innovation.” (Bosnić, M.)

“All organizations from all sectors of the economy (branches) will have to adapt, therefore, MCOs will have to adapt to new technologies, new customer needs and new customer habits.”

Those who do not adapt are likely to be less successful or disappear from the market.”
(Husić, S.)

A key obstacle to digitization, as seen by senior managers of MCOs, is the absence of a state-level digitalization strategy. BiH lags far behind not only the EU but also almost all countries in the region. The reason is, that development of new technologies has not been followed by changes in legal framework in various areas, for example, the laws governing personal data protection, electronic signatures, etc. Therefore, according to the respondents, the set of laws that would enable accelerated and efficient digitalization not only for the financial sector, but also for many other areas such as pharmaceutical and health sectors, public administration and companies, educational systems, electoral process, etc. must be changed and harmonized as a priority.

“There can be no benefit from the digitalization of processes and business before the current laws and regulations are amended and aligned. Only when this is done digitalization will make sense. For the time being, technology is evolving much faster!” (Bosnić, M.)

On the other hand, senior managers of MCOs maintain there are obstacles to the introduction of digitalization of MCO operations that are created by MCOs themselves. The issue raised by the respondents is whether the business models of individual MCOs, their level and scope of business and institutional organization, require digitalization at all and to what extent.

“New technologies are usually expensive and it is necessary to find the optimum balance between the costs and quality of business operations and the benefits from introducing new technologies.” (Bosnić, M.)

4.2 Attitudes of regulators

4.2.1 Attitudes on goals of MCOs

According to the regulators, the main objectives of MCOs are clearly defined in the entity laws on microcredit organizations. In addition to legal definitions, regulators generally list the following broad MCO primary goals:

“The goal of MCOs is to provide fast and flexible access to funds, loans, especially to clients with impeded access to banks (farmers and small business) and create new jobs.”
(Tamamović, M.)

“MCOs in BiH aim to provide financial services (microcredits) to micro and small businesses and entrepreneurs, which are too risky for the banking sector, which is why banks' financial resources are not available to these entities. Also, in addition to the role in expanding the availability of loans to businesses, MCOs also operate in the retail sector,

where they finance individual persons to whom bank loans are not easily accessible.” (Rudić, S.)

Given that microfinance in BiH was introduced in the post-war period, when most of the banks were illiquid and insolvent, and undergoing preparations for privatization, the regulators note that in such conditions microfinance did meet the defined goals, i.e., MCOs were financial intermediaries that played a significant role in promoting and strengthening financial inclusion. MCOs provided the necessary financial services to persons excluded from the commercial banking sector at a reasonable price, on a long-term sustainable basis. If the goal of MCOs would be to provide access to funds to clients and viewed separately, the regulators conclude that may be said MCOs have fulfilled their purpose.

“MCOs have largely responded to the needs of clients who do not meet banks' requirements in terms of their creditworthiness (in practice, there is a very small number of clients whose loan applications MCOs have rejected).” (Tamamović, M.)

With time, MCOs' operations have evolved and shifted the focus towards consumer lending. Due to this change and the fact that the mechanisms for prevention of excessive borrowing in BiH were not sufficiently developed or controlled until recently, the regulators find the attainment of the goals may become questionable.

“With the strengthening of other segments of the financial market, the initial idea of microcredit mutated into financing without a clearly identified and supervised goal, i.e., the spirit of the law is lost, which has led to number of deviations in practice.” (Rudić, S.)

Given that the goals of MCOs are defined by the entity laws, the regulators have expressed some concern about the extent to which MCOs are currently able to meet these goals, i.e., the extent to which they comply with legal provisions providing for the social mission of MCOs.

“Although the law on microcredit organizations stipulates that the goal of MCOs is poverty reduction, in the broadest sense of the word, there is no exact data as regards whether the goal has been achieved. The economic effects of the activity and given goal is not measured by MCOs, supervisors or any other institution in BiH.” (Rudić, S.)

To illustrate this point, the regulators refer to the level of interest rates that borrowers pay on the loans (as of December 31, 2019 the average weighted EIR on total loans disbursed by MCOs seated in the RS and FBiH was 22.56 per cent and 24.38 per cent respectively), which is quite steep, especially if the economic status of the borrowers, who are generally just above the poverty line is considered.

“If the total amount that a microcredit user has to repay (EIR) is taken into account, then it is clear that there is a lot of room for improvement in that segment in terms of optimizing and administering the level of EIR.” (Tamamović, M.)

4.2.2 Attitudes on microfinancing products

According to the regulators, MCOs are ready for a broader concept of microfinance, which includes the provision of additional services in addition to micro loans. However, they point out the fact that the current legal framework adopted back in 2006 stipulates MCOs' core business is lending, and the position of the regulators on this issue was very clear.

“The new legislation should set a broader framework for operations of MCOs by allowing them the provision of financial services to clients in a broader sense.” (Tamamović, M.)

As regards the types of services MCOs could additionally provide to clients, that regulators are cautious,

“Expanding the portfolio MCO services should be approached with caution and gradually so as not to undermine the stability of the financial system of which MCOs are an integral part.” (Rudić, S.)

however, all respondents on the regulator's side are unanimous in their opinion as regards the services these would include and highlight payment transactions:

“For example: payment operations (primarily domestic), exchange operations, insurance operations, etc.” (Tamamović, M.)

“A significant number of payment services! ... All insurance mediation services, including, in the future, voluntary pension insurance mediation, could be successfully provided.” (Rudić, S.)

The regulators seem not to see microsavings and microinsurance as the next step in the development of microfinance in BiH. The reason for this opinion can be found in the history of the financial sector in BiH, which collapsed during the 1990s due to the war, which stripped a large number of citizens of their savings deposits in banks that mostly went bankrupt. The regulators think that the trust gained in the pillars of the financial system in BiH and the services they provide (above all savings), should not be undermined. In the long run, MCOs could also accept savings deposits, but under strict supervision and rules.

4.2.3 Attitudes on market regulation

Although MCOs are under prudential supervision by the entities' financial sector authorities, the regulators believe that microfinance in BiH is not overregulated, rather is moderately regulated, in line with the licensed scope of work. However, it is clear from the views of the respondents that they are aware that the current regulatory framework is deficient, incomplete, and that certain laws and regulations limit the operations of MCOs.

“The current legal framework is limited to microcredit services only, which is an obstacle to potential introduction of a wider range of services.” (Rudić, S.)

In certain segments regulations are additional burden for MCOs.

“The current regulatory framework is too demanding for MCOs in certain areas, primarily in terms of anti-money laundering and terrorist financing requirements.” (Tamamović, M.)

Also, regulations in force does not favour the development of the microfinance new business models based on digital technologies.

“Laws and regulations do not go hand in hand with the digitalization process. First, the regulatory framework for the identification of clients through modern communication channels should be set in a different way and, consequently, the documentation of credit files in the same domain.” (Tamamović, M.)

However, in addition to the aforementioned, the regulators also emphasized the lack of regulations in the area of social responsibility of MCOs in respect of their clients and ethical approach of MCOs in their operations.

“The current regulatory framework lacks certain reporting requirements for MCOs related to monitoring and measuring the achievement of the economic effects of the activity, i.e., poverty alleviation.” (Rudić, S.)

According to the regulators, the adoption of a new law and regulations should be a priority in the further development of microfinance in BiH.

“Regulations for MCOs were issued back in 2006, so it's time for a new regulatory framework.” (Tamamović, M.)

Also, the regulators opine that in new laws and regulations the approach to regulatory supervision over MCOs should be discussed, with potential shift to non-prudential supervision,

“The supervisory focus should be on the protection of microcredit users, sources of MCO financing, and the methodology for assessing correction of the value for overdue loans, in order to mitigate the risks of MCOs operations.” (Tamamović, M.)

4.2.4 Attitudes on new technologies

Regarding new technologies, regulators did not have a dilemma whether new technologies would be applied to microfinance soon. They see the process of introducing new technologies as a potential not only for the growth of individual MCOs, but also for the growth and development of the sector as a whole.

“Digitalization is a great opportunity for all MCOs to expand business operations.”
(Tamamović, M.)

Although the legal framework currently does not provide for the use of new technologies in MCO business operations, a few of them have already started with development of some kind of digital solutions for the microcredit approval process. Considering this fact and given the number of MCOs and the capital they have access to, according to the regulator, the race between MCOs in service digitalization will be fierce. Consequently, digitalization will evolve rapidly, and the respondents are cautious about what the market will look like when some MCOs introduce digital services and some others are left out in the process.

“The digitalization process will depend on the type of services that MCOs offer on the market. Those MCOs that recognize digitalization as an opportunity will survive in the new business environment.” (Tamamović, M.)

Although digitalization is inevitable, regulators believe that numerous obstacles remain and could slow down the process itself.

“Given the general digital (illiteracy) of citizens and business, perhaps the low level of use of digital services by MCOs clients will be the main obstacle to the digitalization of MCOs. The lack of readiness/expertise of individual MCOs to digitalize their business processes should not be overlooked.” (Rudić, S.)

The regulator believes that the emerging services that rely on modern methods of communication and digitalization, will not be the end of the traditional forms of microcrediting:

“In the short term, MCOs can, by inertia, continue to provide services in the way they have done so far.” (Rudić, S.)

“MCOs will certainly have a market niche in the future, but their modus operandi will have to be better adapted to the specific needs of clients.” (Tamamović, M.)

4.3 Attitudes of microfinance advocates

4.3.1 Attitudes on goals of MCOs

Advocates of microfinance in BiH believe that the main goal of MCOs is, to put it simply, financial inclusion, other words to provide individuals and legal entities with access to useful and affordable financial products and services that meet their needs, where those services must be delivered responsibly and sustainably. The respondents argue that MCOs initially met the declared goal. MCOs offered their products to individuals who did not meet the

criteria of banks, with the aim of ensuring access to financing for the purpose of their business ventures or everyday needs.

“In principle, most entities on the demand side have access to most of the well-known groups of financial products and services, which are somewhat simpler and as such best meet user needs.” (Rudić, V.)

This view is further supported by fact that since the onset of their operations, MCOs in BiH have extended almost BAM 9 billion in loans, of which 70% has been invested in activities that generate income to clients who do not have access to traditional methods of financing. During this period, MCOs extended loans at reasonable price, which were similar or slightly less favourable than the price of banks. However, the respondents note that nowadays is evident that a significant part of micro loans, no longer have investment or development characteristics, be it in terms of the form or volume. In most cases, MCOs disburse non-purpose consumer microcredits, usually with a very high EIR, which are unfavourable for investment purposes, as well as various other loans which are not best suited for starting or improving a business or employment.

“The main role of MCOs should be to provide a simple and affordable portfolio of financial services to individuals, i.e., households who find it more difficult (formally or for other reasons) to meet the borrowing requirements set by banks or banks do not find their business ideas viable, where high yield should not be the key driver.” (Rudić, V.)

Advocates of microfinance in BiH note that MCOs which consider the database of clients who find it difficult to meet the requirements of a more regulated banking sector as an asset and have proactive attitude towards them, especially in sense of trust in business ideas of those individuals, are in minority.

“MCOs that have an active relationship with their clients, with asset risk management as the key business policy (growth of trust through longer-term mutual business interactions, providing advisory assistance and monitoring the use of microcredits approved for investment, debt restructuring, etc.) are more successful and have better results when it comes to achieving the goals of clients, as well as broader and their own goals.” (Rudić, V.)

4.3.2 Attitudes on microfinancing products

According to advocates of microfinance in BiH, the fact that the aggregate credit portfolio of MCOs in BiH is constantly growing year on year shows that there is a continuous need of microcredit users for financial services and that the time has come to enable MCOs to provide new financial services other than microcredit.

“In addition to the products and services already provided by law, it is necessary to provide as wide a range of additional products and services as possible in order to complete the portfolio that MCOs can offer to their customers.” (Zukić, E.)

This would primarily enable current and potential microcredit users as well as all those with impeded access to banking services to meet their needs through MCOs, which would ultimately contribute to improving the financial position of microcredit users, increasing employment, providing support for the development of small businesses and financial inclusion. In addition to these expected positive effects, advocates of microfinance in BiH believe that the same would result in a reduction of interest rates on microcredits.

“Allowing MCOs to perform other business activities, other than microcredit, would diversify the risks of their business operations. On the other hand, income generated from the services other than microcredit would contribute to reducing the cost of microcredit, which would have a positive impact on service users.” (Zukić, E.)

“The provision of additional services by MCOs in line with best practices and trends in Europe and the world would bring about further development and stability of the sector and provide additional and cheaper services to MCOs clients.” (Rudić, V.)

Also, according to the respondents, in respect of the so-called banking operations, MCOs could be more flexible in providing certain services than banks and probably could more efficiently perform the basic neutral banking operations, which are markedly service-oriented.

“The possibility should be considered and steps should be taken for MCOs to perform internal payment operations, where competition is essential, because banks have a monopoly on the payment operations, which, as expected, has caused higher transaction fees for the service users.” (Rudić, V.)

Advocates of microfinance in BiH argue that there are no obstacles for MCOs to introduce a wider range of financial services. MCOs are already supervised by the entity financial sector authorities, which monitor and control their operations. In addition, laws governing anti-money laundering and terrorist financing apply to MCOs, including laws providing for the protection of financial service users. Therefore, introduction of a broader concept of microfinance, other words introduction of new financial services for MCOs would not pose a risk to the financial sector in this sense.

“In terms of organization and infrastructure, and provided all statutory requirements are in place, there are objectively no obstacles for MCOs to, first of all, buy and sell foreign currency (exchange operations), buy and sell monetary market instruments for their own or others' accounts (where other entities are not particularly limited), as well as perform insurance mediation activities, of course in accordance with all regulations governing insurance mediation” (Rudić, V.)

4.3.3 Attitudes on market regulation

According to advocates of microfinance in BiH, although it could be claimed that the regulation of microfinance in BiH is broader in its scope in comparison to certain other markets, it can also be claimed that it is balanced and that largely corresponds to the realities of the situation subject to regulation. According to the respondents, the existing regulations have been in force for a long time, still 27 MCOs operates in BiH, while vast majority of which have had growth trends. However, advocates of microfinance in BiH pointed out that the existence of two legal frameworks in the RS and FBiH, and their non-concordance significantly complicates the operations of MCOs.

“In order to fully exploit the potential of this sector it is necessary to establish a harmonized and adequate legal framework that will enable its further growth and development, increase financial involvement of the population and its most vulnerable groups and improve regulatory standards, as well as standards for the protection of financial service users.” (Zukić, E.)

By advocates of microfinance in BiH the main shortcomings of the existing regulations refer to the restriction that MCOs may not perform activities and services other than microcredit, and to overregulation of some segments of business operations.

“There is a question of further legal amendments with goal to MCOs primarily meet the needs of end users of microfinance services, including the needs of MCOs, as well as EU standards such as the PSD2 Directive, etc.” (Zukić, E.)

“Regulations, which are extremely scarce, it should be developed to introduce more flexible capital and provisioning requirements, as these are non-depository organizations.” (Rudić, V.)

Into account should be taken also the fact that the market itself is changing, where reform of the legal framework in this regard is inevitable and will require MCOs to adjust as well.

“The regulator has covered all segments of microfinance, but the fact is that the market is facing new practices and technologies (cloud, fintech, etc.), that market participants do not have enough information or practice, and that in the future we will all learn more about them. In the same context, regulators should focus on cyber security in particular.” (Zukić, E.)

With the above attitudes as a starting point, to further improve the overall regulatory framework, advocates of microfinance in BiH believe that only the collaboration of MCOs and regulators, where the views of clients would be considered, can contribute to improvement.

“I believe that positive dialogue is a must before the adoption of any laws or regulation. In particular, sensitivity and responsibility of regulators and MCOs are required in respect of the needs of end users.” (Zukić, E.)

4.3.4 Attitudes on new technologies

Advocates of microfinance in BiH believe that individuals who nowadays turn to MCOs for financial management use a limited number of digital electronic tools and channels, and rather rely more on the traditional method of placing microcredits through a branch network. The reason for this, respondents see in the limited level of technological literacy of microcredit users. However, according to the respondents, the generational shift is expected to bring about higher technological literacy of the population in BiH. The digital transformation of MCOs, according to advocates of microfinance in BiH, would ensure easier access to financial products and contribute to the financial inclusion of individuals. The benefits of digitalization for microcredit users will undoubtedly put pressure on MCOs to expedite their digital transformation and adjust their operations and service delivery conditions accordingly.

“The use of new technologies opens up new perspectives and opportunities for the financial sector in terms of new services, easier access to finance and less expensive services for MCOs clients.” (Zukić, E.)

Advocates of microfinance in BiH note that, in terms of technology, MCOs could relatively quickly and easily, with the help of professional providers, apply new technologies and digitalize the processes necessary to provide services. As the technological aspect is only one segment of the digital transformation, the respondents believe that the transformation will require acceptance of substantial changes in MCOs in terms of gradual abandonment of the traditional approach and setting new strategic goals regarding the end point of digitalization of the lending process. In addition, MCOs will necessarily need to introduce certain organizational adjustments, with a special focus on employees and their training to adopt new practices as soon as possible.

“Digital transformation is not only about technology, but it also begins with our readiness to accept change and adapt to new circumstances. MCOs have invested heavily in digital transformation projects - nevertheless, a large proportion of organizations fail to achieve digital transformation. The reason for this is that organizations focus on technology instead of first understanding where they want to be upon digital transformation. The key is in preparing a digital strategy. Not only should technological investments be aligned with business goals, but it is also desirable that organizations rely more on the knowledge of their employees than suggestions and good business practices of external consultants. It is highly important that management understand employees' fears of being made redundant in a way that encourages and raised the awareness of employees about how digital transformation is an opportunity for their professional advancement so that they can be responsive to the new

business environment. It is necessary to put the client in the foreground and think about how the new change will affect their experience.” (Zukić, E.)

Advocates of microfinance in BiH believe that MCOs are already moving in the direction of digitalization, but both MCOs and regulators must set activities related to digital transformation as priority in the laws and legal framework.

“If MCOs were allowed to offer other services, on an individual basis, the most efficient and innovative ones could grow into a certain type of fintech companies with a broader and more competitive business portfolio.” (Rudić, V.)

4.4 Accomplishments of microfinance in BiH

MCOs in BiH are committed to the microfinance mission, i.e., to help the most vulnerable. With that goal MCOs have formed databases of clients who need services like savings, insurance, or payment services, but do not have access to traditional ways of financing. Such databases helped MCOs to approach those categories of the population and meet their needs. In this way MCOs enabled its clients to become part of financial system and achieve financial inclusion, which is one of presumptions for their employment, poverty alleviation and social protection. Many individual persons used the potential of MCOs and with their help and loans, they came up with the necessary funds to improve their standard of living. In the last 20 years, MCOs in BiH have placed more than 3 million loans worth about BAM 9 billion. Currently, number of microcredit users in BiH equals to some 210 thousand (both legal entities and individual persons) and shows that more than 600 thousand BiH citizens directly or indirectly benefit from microfinance services, which is about 17.6 per cent of the population. Out of the total number of active users of the microloans, 42 per cent are women (AMFI, 2020).

In addition to financing the needs of individual persons, MCOs in BiH also recognized the need of small entrepreneurs for working capital and additional funds. To support small entrepreneurs MCOs offer help and participation in projects of significance for entrepreneurs. Many successful companies in BiH have secured their first commercial loans from MCOs rather than from banks. Of particular importance is that 18 per cent of BiH’s population under the age of 30 used microloans as initial capital to start business activities, i.e., start-ups, or used these funds to improve an existing business activity (AMFI, 2020). In this way MCOs in made a significant contribution to the entrepreneurship and overall development of economy in BiH.

As a prerequisite for financial support to clients in the long run, MCOs make efforts to improve transparency, visibility, and financial sustainability. For a high level of transparency in business and financial reporting, MCOs in BiH won recognitions and awards from the World Bank and the Poverty Assistance Consulting Group. Out of 20 MFIs from all over the world, awarded in 2007, there were 5 MCOs from BiH. In the same year, 4 MCOs from BiH

were ranked among the 50 most successful MFIs in the world according to the world's most influential financial magazine Forbes. In 2013, 3 MCOs from BiH were among the first 5 MFIs in the world to receive the prestigious Certificate of Client Protection, within the global Smart Campaign project, which aims to implement the principles of client protection in the global microfinance industry. Help and support to existing and future clients has resulted in the fact that the microfinance in BiH is rated as one of the most dynamic and developed in Europe and the world (AMFI, 2020).

4.5 Drawbacks of microfinance market in BiH

The goals of MCOs stipulated in entity laws on microcredit organizations indicate the lawmakers were determined to define microfinance as a tool by which the financial inclusion of end users would be achieved. Although MCOs have extended over BAM 9 billion since the beginning of microfinance in BiH (AMFI, 2020), the question that arises is whether MCOs have aligned their operations with the goals stipulated by laws. Majority of MCOs set financial inclusion as number one strategic goal. The problem is that it is difficult to measure or determine whether MCOs services and work methods are consistent with the social mission as required by laws. In addition, the issue of social effects resulting from their lending operations, such as the impact on employment, generation of household income, taxes, etc., has not been addressed by any government, ministry or institution.

The regulatory frameworks in force have limited MCOs from offering individuals or vulnerable groups products or services other than loans. Also, the existing regulatory frameworks have been in force for almost 15 years, a period marked by significant innovations in the ICT sector, which have been applied in microfinance globally. Following these trends, MCOs in BiH have, to some extent, started using technology in their business processes, however, for a complete digital transformation of MCOs, the existing regulatory frameworks need to be complemented by new laws and regulations. New regulations in this area would be a tail wind to the use of new technologies in the microfinance market in BiH, and thus place BiH in the rank of other countries where use of new technologies in microfinance have already resulted in significant gains with regard to financial inclusion (cell-phone based payment systems in African countries and India, granting loans through automated teller machines in Kazakhstan etc.).

Microfinance in BiH is regulated by laws and regulations adopted at the entity level. Since the adoption of these legal frameworks in 2006, with minor amendments in 2011, they have not changed significantly. Over time, certain shortcomings of regulatory frameworks have become apparent. One of the major gaps is that the laws and regulations that make up the regulatory framework in each entity are not aligned, which ultimately results in an unequal position of MCOs registered in different entities in BiH. One of the significant differences between the two regulatory frameworks relates to the possibility of transforming MCOs from non-for-profit organizations to for-profit companies. The FBiH regulatory framework does

not allow such a transformation, whereas the RS regulatory framework allows it, where non-for-profit MCFs may establish and become owner/co-owner of for-profit MCCs. Although it may sound irrational that a non-for-profit organization could help more people if transforms into a for-profit company, the history and evolution of financial inclusion proves that the largest and most successful MFIs, with the greatest fundraising ability, best corporate governance and long-term financial sustainability are actually for-profit companies or specialized microloan banks.

Digital technologies need to be applied in microfinance in BiH more comprehensively and in the process of digital transformation MCOs should not lag behind other participants in the financial market and the economy in general. One of the significant transformations of the banking industry in the past twenty years has certainly been the emergence of internet banking. Due to its speed, availability and low price, it has spread relatively quickly among the users of banking services, and today there is almost no bank that does not offer internet and mobile banking. On the other hand, MCOs in BiH have not yet fully embarked on the introduction of new technologies into their operations although almost all have set digital transformation as a strategic goal in their plans. An obstacle to this is the legal framework governing the use of digital technologies for effecting transactions in the financial market. The BiH Parliament passed the Law on Electronic Signature of BiH in 2006, but it is not in force because it is not in line with the EU directive. In RS, the Law on Electronic Signature was adopted in 2008, and in 2015 the Law on Electronic Document was passed as well, but implementation is still pending. In early 2020, only the draft Law on Electronic Signature was adopted in the FBiH. It is evident that key laws governing financial transactions using digital technologies are deficient or not fully enforceable. On the other hand, in addition to legal obstacles, another objective barrier to a broader use of digital technologies is IT illiteracy of microcredit service users.

5 DISCUSSION OF THE FINDINGS AND RECOMMENDATIONS

5.1 Achieving the goal of microfinance

The main goal of microfinance has always been a poverty reduction. According to the UN Millennium Declaration, social goals of microfinancing for new millennium are to support the poorest population, reach as many people as possible (known as the depth and breadth of outreach in the literature), empower women, and provide responsible support to borrowers (UN, 2000). In accordance with this resolution, the entity laws on microcredit organizations specify the goals of MCOs in BiH, namely: to improve the financial standing of MCO service users, increase employment, support the development of entrepreneurship and generate profit. However, interviewees in their answers pointed out that so far, no institution in BiH has addressed the social effects of microfinance to date. The question of whether and to what extent MCOs achieve the statutory goals defined has remained unanswered.

Although it is difficult to measure the social performance of MCOs, i.e., based on numerical data, determine whether MCOs actually achieve statutory goals, certain actions to emphasize the mission and fulfilment of goals may be introduced on the part on MCOs and on the part of the regulators. First, goals of MCOs are clearly stipulated by law and the attainment thereof is a legal requirement. Consequently, MCOs should clearly define their mission and objectives in accordance with the law and should be accountable for carrying them out. One tool that would ensure monitoring of the social performance of MCOs and encourage MCOs to follow the microfinance mission is social audit. Social audit is a formal review of a company's endeavours, procedures and code of conduct regarding social responsibility and the company's impact on society. MCOs could introduce social audit as an internal system. Internally developed social auditing systems would assess how good MCOs are in achieving its own goals or benchmarks for social responsibility. These internal organizational systems would be managed by the MCOs themselves but would be moderated/supervised by an external independent evaluator, in this case regulators. As part of the overseeing they already perform, regulators would also perform an evaluation of internal social auditing systems to assess the extent to which verification of compliance with MCO's statutory objectives is covered by the system, and to assess the extent to which MCOs are mindful of the microfinance mission. If MCOs care about maintaining a focus on social goals, such as reaching very poor or remote rural households or increasing the incomes of their clients, the promise of social performance will most likely be realized and goals would be achieved.

On the other hand, from tables 10 and 17 (the average weighted EIR on loans placed both in RS and FBiH), as well as from tables 11 and 18 (aggregated income statements for MCOs seated both in RS and FBiH), indicate that MCOs have discovered that very poor clients represent a good business opportunity rather than approach these people from a social perspective, and concern about ethics in MCOs doing business is ubiquitous. Therefore, regulators in addition to the role of evaluators of MCOs' social auditing systems should complement its supervision function with activities that would give further encourage for MCOs to meet their goals. In addition to the existing regulatory requirements for MCOs, regulators could introduce a requirement for MCOs to periodically conduct in-depth analyses which should justify the level of interest and fees charged to clients. Such analysis would be complementary to the existing set of reports that MCOs are required to submit to regulators. Regulators would evaluate all submitted data as part of the supervision of the financial performance of MCOs, including the submitted analyses and issue an opinion on whether there is an adequate ratio between the actual costs of MCOs, on the one hand, and interest rates and fees charged to clients, on the other, including whether MCOs determine the price of their services based on objective criteria and actual costs incurred. The findings of the evaluation of the analyses would be an indicator of the extent to which MCOs are focused on achieving a positive financial result, and how committed they are to the microfinance mission.

Although debt to equity ratio for MCOs seated in RS amounted to 1.7 and for MCOs seated in FBiH amounted to 1, the potential of microfinance in BiH in achieving financial inclusion could be further exploited through the access to new funding sources. These additional funds could be provided by EU funds that offer institutional support and concessional lending for the development of self-employment, as well as micro and small entrepreneurship. One such program is the EU Program for Employment and Social Innovation (hereinafter: EaSI). This program is a financing instrument at EU level, managed directly by the EC, with goals to promote a high level of quality and sustainable employment, guaranteeing adequate and decent social protection, combating social exclusion and poverty, and improving working conditions. In addition to EU member states and candidate countries, the program is also intended for potential candidates, such as BiH. Through these programs, MCOs would be able to provide and ensure adequate and decent social protection, contribute to the fight against social exclusion and poverty and improvement of working conditions. To achieve these goals, the program for the period 2014 - 2021 has a total budget of EUR 919 million. In the period 2021 – 2027 the EaSI program will become a strand under the European Social Fund Plus, Europe’s main tool for promoting employment and social inclusion which should help people in getting a job (or a better job), integrating disadvantaged people into society, and ensuring fairer life opportunities for all (European commission, 2020).

5.2 Microsavings and microinsurance

In circumstances where excessive debt control mechanisms in BiH were insufficiently developed or controlled until recently, and where comprehensive and structured plans for ensuring the financial literacy of certain population groups have not been implemented, the exposure of financially illiterate persons to financial services is often a reason for their excessive debt. The inappropriate level of understanding of the purpose of certain financial products and behaviour in relation to their use, including the lack of awareness of the need to make responsible financial decisions are just some of the causes that significantly increase the risk of excessive borrowing and consequently exposing the entire financial system in BiH to higher risks. All interviewees in their answers agreed that it is in their interest that such persons, in addition to credit products also receive adequate support so as not to find themselves in a vicious circle of debt (borrowing from one MCO to repay loans to other MCO). Senior managers of MCOs in their answers suggested that these persons need a protective approach and MCOs make efforts to, at least at a basic level, protect them from potential excessive debt. To this end, MCOs should be institutionally involved in the financial literacy education process and create new products that would include an advisory component. Through a financial literacy and consulting service that would be offered along with lending options, MCOs would show a commitment to the aspect of continuity and sustainability of the investment of borrowers. This service could be offered by MCOs within the existing regulatory framework without amending laws or by-laws.

On the other hand, any change in the regulatory framework in the part related to the activities that MCOs can perform, would enable MCOs to offer other products and services to loan users. With new laws and regulations, lawmakers would give MCOs an opportunity to create various products and services on the supply side, such as savings, insurance, payment services, etc. Given the specific features of the business models they apply, each MCO would, according to its policies, develop a range of services and methods for the provision thereof, thus compiling a catalogue of its products and services with a detailed description. This would increase the opportunities for individuals below the poverty line to access services that are not currently available to them and meet their needs for certain financial services, thus reducing their financial exclusion.

In addition to products and services that MCOs themselves could offer to clients, institutions from different levels of government in BiH could, through joint projects with MCOs, create products and services aimed at expanding and strengthening financial inclusion, in particular the development of entrepreneurship. Support for entrepreneurship development would result in job creation and self-employment. Borrowers who are on the existential minimum, without or with insignificant and volatile incomes, or who live in poorly developed rural areas, or borrowers who belong to the so-called vulnerable groups are primarily in need of employment. Only with a constant source of income that would enable them a sustainable cash flow, these groups of loan users would be able to eliminate the causes that put them in a difficult financial situation. All of this would have multiple positive effects, it would reduce the number of individuals below the poverty line and contribute to the economic growth of BiH. More importantly, as by World Economic Forum's Global competitiveness report for 2019, BiH by "brain drain" was ranked in 140th position of 144 countries, it could directly help to solve the challenge of young and qualified people leaving BiH.

An example from Belgium, where the National Employment Office (hereinafter: NEO) has an active role in microfinance, can be taken as a model of cooperation between MCOs and state institutions that could be applied in BiH. Belgian MCOs with NEO have pushed authorities to adopt regulations, which since 2016, allowed all jobseekers to start or pursue independent economic activities, while maintaining their right to unemployment benefits (NEO, 2020). The role of MCOs, in addition to providing financial support through lending, is to advice to borrowers regarding the establishment and management of an independent economic activity, whereas the role of NEO is to be a guarantor for borrowers who decide to start an independent economic activity. If revenue of the independent economic activity is insufficient and other criteria are fulfilled, the unemployment benefit will be granted by the NEO during a period of twelve months, while independent economic activity continues. If revenue of the independent activity exceeds defined amount, unemployment benefits will be reduced. In this way, MCOs and the state institution work together to help vulnerable groups start a business of their own. The goal is to encourage individuals to become fully independent after a period of twelve months.

5.3 Prudential or non-prudential regulation

Inconsistencies between the entity regulatory frameworks, which limit the development of MCOs, should be eliminated through legislative harmonization, especially in light of the fact that BiH remains a single economic space albeit with its territorial, administrative and functional division into entities and cantons. Senior managers of MCOs in their answers recommended that reform and harmonization of regulatory frameworks to address the imperfections could also include the approach to supervision of MCO itself.

Consistent adherence to regulatory frameworks and supervision of licensed MCOs is the responsibility of the regulators. The regulatory frameworks in force and the supervision administered by regulators represent prudential regulation of MCOs. Given the turbulent developments in BiH during the 1990s, which had significant adverse impact on the country's financial system, lawmakers through a prudential regulation approach intended to ring-fence the financial system, to the extent possible. Although prudential regulation of microfinance required higher financial resources compared to a non-prudential regulation, it was justified at the time. Currently, as is obvious from tables 11 and 18, the microfinance in BiH generates positive net financial result, in other words majority of MCOs are self-sustainable. Additionally, number of microloan users increases from year to year while regulators duly supervise MCOs. In these circumstances, the prudential regulation of microfinance in BiH may be to some extent overbearing, and therefore could be re-examined and modified. However, in order to allow MCOs to receive deposits and offer other services, prudential regulation is needed to stay in power, but it should balance the need for stringent regulation with the flexibility needed to make MCOs functional. Also, it should balance the risks facing individual depositors and the financial system as a whole, with the goal of providing greater access to financial services to those individuals who are unbanked. In their answers, interviewees suggested that with loosening current regulation, the focus of regulation should be primarily put on protecting financial service users who are largely financially illiterate and require additional protection by MCOs when providing services. As part of regulatory requirements for consumer protection, regulators should also define requirements and reports for MCOs that would enable them to monitor the extent to which MCOs achieve economic and social objectives, i.e., the social performance.

In addition to consumer protection and social performance, the new regulation should define minimum standards for risk management. These standards should, for each risk category (credit, operational, market and other risks), set the regulatory requirements for MCOs to ensure that they minimize the overall risk of their operations, while maximizing access to financial services.

5.4 New technology and microfinance

In recent years microfinance globally has been the subject of various innovations and experiments, from leveraging the hugely popular mobile banking industry, where mobile

phones are used to send and receive money to various other products which include usage of some kind of new technology as its integral part. Digitalization is inevitable and significantly affects changes in the way MCOs operate. Digital technologies would introduce new sales channels, faster access to services and provide a different user experience as customers would be able to access the services without physical contact with the branch. Data show that the penetration rates in BiH in 2019 for the Internet and mobile Internet were 70 per cent and 100 per cent respectively, and that 48 per cent of the population used social networks every day (Agency for Statistics of BiH, 2020f). Therefore, it can be concluded that the society in BiH is ready for digitalization, which represents a huge potential for growth and development of microfinance.

Considering these trends, all governments at all levels, as well as most of MCOs set digitalization as one of their strategic goals, however, it is evident that they still lag behind in terms of technological development. Senior managers of MCOs and advocates of microfinance in BiH in their answers appealed that the legal framework in force is largely conservative and fails to adequately reflect technological development. Such a legal framework slows down the progress and development of microfinance and is an obstacle that MCOs cannot overcome in their efforts to meet market demand for the implementation of new technologies in products and services.

To enable the digital transformation of the BiH society in general, lawmakers need to tackle several open issues, and, more importantly, all authorities should take a more proactive approach in introducing new and improving existing laws and regulations, which will create a more favourable legal framework. The legal framework should clearly define the qualified electronic signature (hereinafter: QES) an advanced electronic signature (hereinafter: AdES) based on a qualified certificate, which is created by a qualified electronic signature creation device (hereinafter: QSCD). QES includes all the secure features that an AdES provides with addition of a qualified certificate. This certificate is issued by a qualified trust service provider, and it attests to the authenticity of the electronic signature to serve as proof of the identity of the signatory. The signature itself must be created using a QSCD. This device is responsible for qualifying a digital signature with specific software and hardware. Under the EU regulations, a QES has the same legal effect as a handwritten signature, and it is recognized in all member states. In addition to QES, a new legal framework should determine acceptable methods of identification and verification (hereinafter: ID&V) of end service users through new technologies. As with transactions using QES, it is essential that the ID&V process is executed in a secure and efficient manner. Secure video calls, online security checks of passports or national IDs, facial biometrics and access to national documents and personal registers are just some of the technological innovations that could be applied in the end user ID&V process. A prerequisite for aforementioned is the infrastructure including broadband networks that would enable real-time data exchange.

On the other hand, by opinion of senior managers of regulators, in addition to strategic commitment of MCOs to digitalization and new technologies, for a successful process of

complete digital transformation MCOs should, based on available data, conduct detailed analyses and identify the most cost-efficient way and scope of digitalization which will be implemented in their organizations. Only after such studies, each individual MCO would be able to adopt adequate strategic documents that would specifically meet its needs. Based on this, MCOs could develop and adopt detailed plans for the introduction of new technologies in their business, both concerning the market (new products, new sales channels and advertising) and the MCO organization itself (cloud solutions, document management system solutions, and employee training).

By introducing a new legal framework and its full and adequate implementation, microfinance in BiH would have an opportunity for further growth and development. By shifting from a traditional to a digital business model, MCOs could reduce their business costs allowing them to offer less expensive products and services, and consequently provide access to affordable financial products and services that MCOs would deliver to customers in a responsible and sustainable manner.

CONCLUSION

Through thesis the concept of microfinance and its presence in BiH is examined and analyzed with purpose to emphasize its accomplishments in BiH as well as current drawbacks of the market that deter MCOs to fulfil the microfinance mission and further development of microfinance in BiH.

In initial theoretical part of thesis, the beginnings and development of microfinance are explained, continuing to services that are encompassed with that term and current debate on microfinance topics such as regulation and transformation of MFIs, consumer protection etc. Later, thesis focuses on microfinance in BiH. It gives insight in development of microfinance in BiH from its appearance shortly after the Dayton Peace Agreement ended the war, in late 1995, until current situation in the microfinance market.

In analysis of microfinance in BiH, at first country's macroeconomic analysis is presented, followed by market analyses from outside which include overview of regulatory framework and supervision of MCOs, analysis of key financial performance indicators on aggregate level of entities in BiH and industry analysis. The microfinance market is analysed also from the inside. To get view from inside the microfinance market, expert in-depth interviews are conducted with main stakeholders in the market: senior managers of MCOs and regulators, and microfinance advocates in BiH. Their answers are analysed with qualitative thematic analysis. With the inductive approach to the analysis, 4 key themes are identified: (1) Goals of MCOs, (2) Microfinancing products, (3) Market regulation and (4) New technology. Each theme is defined to describe a different aspect of the market. Senior managers of MCOs and regulators, and microfinance advocates attitudes to defined themes are elaborated as findings

of analysis. The results are interpreted to summarize accomplishments of microfinance in BiH as well as to detect the drawbacks in the market.

Based on gathered results of analyses, both from inside and outside, the recommendations and solutions are given as perspectives for further development of microfinance in BiH such: recommendations for achieving the microfinance mission, introduction of new products and services, approach to microfinance regulation and finally, how to adapt to new technologies. In the short, medium and long term, despite the obstacles they currently face, MCOs in BiH have a perspective. In the coming period, MCOs will have to adapt to changes pertinent to the market, to the needs of clients and their habits, but also to certain global trends that have an impact on BiH such as emigration of working age population, technology development, etc. Considering the indicators related to the economic status of individuals, their financial and technological literacy, microfinance in BiH will require more time to achieve the microfinance mission. On the other hand, for achievement of the microfinance mission and further development of microfinance in BiH an adequate regulatory framework is a precondition. Reform of the regulatory framework should include a broader set of legislation and regulations to fully address the problems MCOs are currently facing, thus giving an additional incentive to MCOs to work on microfinance missions. It is expected that an adequate regulatory framework will enable MCOs to offer new products and services, which would narrow the gap between supply and demand for microfinance products and services, resulting in improved access to finance for micro and small enterprises, reduced unemployment and poverty, as well as the growth and development of the domestic economy in general.

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APPENDICES

Appendix 1: Povzetek (Summary in Slovene)

ANALIZA MIKROFINANČNEGA TRGA V BOSNI IN HERCEGOVINI: POMANJKLJIVOSTI IN PERSPEKTIVE

Mikrofinančne institucije (v nadaljnjem besedilu: MFI) so začele svoje dejavnosti v Bosni in Hercegovini (v nadaljnjem besedilu: BiH) kmalu po tem ko je Daytonski mirovni sporazum končal vojno v tej državi (1992-1995). Prvi cilj teh MFI v BiH je bil pomagati povojnemu okrevanju družbe z odgovarjanjem na nujne potrebe demobiliziranih borcev, razseljenih ljudi, beguncev in povratnikov na svoje domove, ter družinam padlih borcev. Od takrat je mikrofinanciranje v BiH igralo pomembno vlogo v boju proti revščini, pa tudi v podporo razvoju mikro, malih in srednje velikih podjetij. Danes je večina MFI v BiH dosegla stopnjo finančne vzdržnosti in trg na katerem poslujejo je zelo konkurenčen.

Do zdaj je bilo izvedenih več neodvisnih študij o vplivu mikrofinanciranja v BiH. Rezultati teh študij so segali od pozitivnih, preko nevtralnih do negativnih vplivov. Izvedenih pa je bilo le nekaj študij z namenom analize samega trga. Večina dosedanjih raziskav je ukvarjala samo en vidik istega. Iz tega razloga je predmet te raziskave izčrpna analiza mikrofinančnega trga v BiH z njegovimi ovirami in perspektivami. Namen raziskave je poglobiti duibnsko razumevanje okolja v katerem mikrofinanciranje obstaja v BiH. Raziskava preučuje tržne ovire, s katerimi se soočajo MFI in regulatorji, ki so tudi najpomembnejše zainteresirane strani na trgu. Odkrivanje teh ovir daje priložnost zainteresiranim stranem, da združijo moči in najdejo načine, kako jih premagati. Namen raziskave je zato pokazati perspektive nadaljnega razvoja mikrofinanciranja v BiH in predlagati, kako naj sodelujejo vse zainteresirane strani na trgu, da bi mikrofinanciranju v BiH dali nov zagon. Končno bi lahko rezultati te raziskave služili udeležencem na mikrofinančnem trgu nekatere druge države. Cilji, ki izhajajo iz namena raziskave, so: (1) raziskati okolje, v katerem mikrofinanciranje deluje v BiH (2) preučiti ovire s katerimi se MFI srečujejo na trgu, (3) odkriti težave s katerimi se srečujejo regulatorji za mikrofinanciranje (4) pregledati stališča višjih menadžerjev MFI, regulatorjev in zastopnikov mikrofinanciranja v BiH o teh vprašanjih (5), predlagati rešitve tako z vidika MFI kot z vidika regulatorjev in (6) zagotoviti nadaljnji razvoj mikrofinanciranja v BiH.

Metodologija te raziskave je sestavljena iz teoretičnih in empiričnih vidikov. Začetne teoretične osnove raziskave se temeljijo na ustrezni znanstveni literaturi, ki je vključevala zbirko akademskih virov in člankov, zbrane iz poročila, publikacija, strokovnih revija, zbirki člankov in knjiga. Empirični del raziskave se temeljijo na analizi primarnih podatkov (uporabljenih za analizo trga od znotraj) in sekundarnih podatkov (uporabljenih za analizo trga zunaj). Primarni podatki so bili zbrani s strokovnimi polstrukturiranimi intervjuji, opravljenimi s 4 višjimi menadžerji v MFI, 2 višjima menadžerjema v regulatorjih in 2 zastopnikom mikrofinanciranja v BiH. Sekundarni podatki so bili zbrani iz zbirk podatkov

regionalnih in svetovnih organizacij, kot so Svetovna banka, Evropska banka za obnovo in razvoj, CIA in druge, pa tudi iz letnih publikacij regulatorjev mikrofinanciranja v BiH.

Primarni podatki so bili analizirani s kakovostno tematsko analizo, ki omogoča identificiranje, analizo in predstavitev oblika (tem), ki se v podatkih najpogosteje ponavljajo. V prvi fazi analize so bili vsi intervjuji prepisani in pregledani skupaj z izpolnjenimi vprašalniki. V drugi fazi so bili znova pregledani prepisi vsakega intervjuja, te su fraze, besede in pripovedi, ki so se v intervjujih najpogosteje ponavljale določene kot kode. V tretji fazi je bil uporabljen induktivni pristop k tematski analizi. Identificirani so oblici pri ponavljanju ustvarjenih kod in na podlagi njih so bile definirane teme. V četrti pa so bile teme pregledane, da se zagotovi natančen prikaz konteksta, za katerega so bile opredeljene. V peti fazi je bila vsaka tema poimenovana na način, ki opisuje določen vidik mikrofinanciranja v BiH. Pri iskanju tem, ki so se ponovile v odgovorih preiskovancev, so bile opredeljene 4 teme, ki odražajo ovire mikrofinanciranja v BiH, in sicer: problem doseganja mikrofinančnih ciljev v BiH, ponudba mikrofinančnih izdelkov in storitev, regulativni okvir MFI, in vpliv novih tehnologij o mikrofinanciranju v BiH. Sekundarni podatki so bili analizirani za proučitev poslovnega okolja, v katerem delujejo MFI, ter za sestavo kvantitativne finančne analize na ravni skupine za vse MFI, ki delujejo v BiH.

Na temelji zgornjih analiz je raziskava zagotovila perspektive za nadaljnji razvoj mikrofinanciranja v BiH in vključuje: priporočila za doseganje misije mikrofinanciranja, uvajanje novih izdelkov in storitev, pristop k regulaciji MFI in nenazadnje, kako prilagoditi MFI novim tehnologijam. Kratkoročno in srednjeročno ter dolgoročno, MFI v BiH imajo perspektivo, kljub oviram s katerimi se trenutno srečujejo. V prihodnjem obdobju se bodo morale MFI prilagoditi spremembam na trgu, tj. potrebam strank in njihovim navadam, pa tudi nekaterim svetovnim trendom ki vplivajo na BiH, kot so izseljevanje delovno aktivnega prebivalstva, razvoj tehnologije in vseč. Glede na kazalnike, povezane z ekonomskim statusom posameznikov, njihovo finančno in tehnološko pismenostjo, bo BiH še dolgo potrebovala za uresničitev mikrofinančne naloge. Zaradi tega bodo morale MFI v prihodnje bolj delati in prispevati k izpolnjevanju misije mikrofinanciranja. Po drugi strani, za resnično promocijo mikrofinančne misije pa je potrebno reformirati regulativni okvir za MFI. Ustrezen regulativni okvir je predpogoj za nadaljnji razvoj mikrofinanciranja v BiH. Sprememba regulativnega okvira bi morala vključevati širši obseg zakonov in podzakonskih aktov, da bi v celoti odpravili težave, s katerimi se trenutno soočajo MFI, kar bi MFI dalo dodaten zagon za delo na mikrofinančnih misijah. Za učinkovito spremembo regulativnega okvira za MFI bodo morali vsi udeleženci na trgu mikrofinanciranja, vključno z MFI, regulatorji, zastopnikov mikrofinanciranja v BiH, lokalnimi ministrstvi, donatorji in drugimi zainteresiranimi stranmi v prihodnjem obdobju sodelovati in si dodatno prizadevati za doseg kompromisa.

Appendix 2: BiH country map

Figure 1: Map of BiH



Source: CIA (2021).

Appendix 3: List of MCOs in BiH

Table 22: List of MCOs in BiH

	MCOs seated in RS	MCOs seated in FBiH
1.	MCC “Микрофин” Banja Luka	MCC “CREDO CENTAR” Mostar
2.	MCC “Здрaво” Banja Luka	MCC “IuteCreditBH” Sarajevo
3.	MCC “Прво Пензионерско микрокредитно друштво” Banja Luka	MCC “EKI” Sarajevo
4.	MCC “FinCredit” Banja Luka	MCF “EKI” Sarajevo
5.	MCC “CREDIS” Banja Luka	MCF “LIDER” Sarajevo
6.	MCC “Digital Finance International” Banja Luka	MCF “LOK MKF” Sarajevo
7.	MCC “Брчко гас пензионерско микрокредитно друштво” Banja Luka	MCF “Melaha” Sarajevo
8.	MCC “Привредник” Bijeljina	MCF “MI-BOSPO” Tuzla
9.	MCC “Taurus” Banja Luka	MCF “Mikra” Sarajevo
10.	MCC “Auris” Banja Luka	MCF “MIKRO ALDI” Goražde - Ferida
11.	MCC “Про фин” Istočno Sarajevo	MCF “PARTNER MKF” Tuzla
12.	MCF “Про фин” Istočno Sarajevo	MCF “PRVA ISLAMSKA MKF” Sarajevo
13.	MCF “Prodest” Banja Luka	MCF “Sani” Zenica
14.		MCF “SUNRISE” Sarajevo

Source: Own work.

Appendix 4: Semi-structured interview questionnaire

Gender:

Name of institution/company You work for:

The position You hold:

How long You are employed/involved in microcredit sector in BiH:

1. In your opinion, what are the main goals of Microcredit organizations (MCOs) in BiH?
2. In your opinion, have MCOs reached set goals in BiH so far? Why do you think some of them are successful in reaching their goals, and others aren't?
3. How do you perceive financial inclusion/exclusion in BiH?
4. What do you think should be the role of MCOs in financial inclusion in BiH? Should they be involved? If so, in what way? If not, why not?
5. Do you think MCOs in BiH are ready to adopt concept of microfinancing instead of just microcrediting?
6. Which other financial services do you think MCOs could offer aside of microcredits?
7. How do you see MCOs in BiH in the process of digital transformation (new industrial revolution)?
8. What do you think are the main obstacles for digitalization of the microcredit sector, and how would you suggest overcoming them?
9. Do you think the microcredit sector in BiH is "overregulated" by regulatory bodies? In what way?
10. What do you think should be the focus of regulatory bodies in microcredit sector in BiH and why?
11. To what extent do you think is the microcredit sector in BiH limited by current legislation?
12. What do you think are the main drawbacks in legal framework of microcredit sector in BiH which limit the MCOs to grow and expand?
13. How do you see microcredit sector in BiH in short, mid and long term?

Thank you for your participation!

