Western CIS • Russian Federation

Voronezh Oblast – Banking the Unbanked in Remote Areas of the Russian Federation

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Executive Summary

The Voronezh Oblast State Fund for Small Business Support (hereafter referred to as ‘the Fund’) in cooperation with a multitude of partners started to provide microfinance services and mobile banking for micro-and small businesses in 2009 in the remote regions of Voronezh Oblast.

The multi-stakeholder pilot model, which the Fund leads in its field operations, leverages innovative technologies - mobile banking and non-personalized plastic cards. The pilot was conducted in close cooperation with two national umbrella microfinance institutions (MFIs), a commercial bank, Visa International, and regional and local authorities.

The project was introduced in 2009. The two umbrella MFIs, the Russian Microfinance Center (RMC) and the National Partnership of Microfinance Market Stakeholders (NAMMS) are dedicated to the development of microfinance services throughout the Russian Federation via consulting, education, research and lobbying. The Fund, which is the lead MFI on the ground, provides loans to low-income businessmen solely in Voronezh Oblast.

The Fund was established on June 3, 1998 as a legal entity of the regional government in charge of small business development.1 Today, the Fund serves as a coordinating center for the provision of microfinance services in remote areas and has three regional branches and 17 partner affiliated organizations.

The Fund’s vision is to promote access to small business loans for economically active people and thereby help to create employment in Voronezh Oblast. The Fund provides people from remote areas with access to commercial capital and actively promotes additional financial services to a greater number of clients. The mobile banking project is perceived as a major driver of innovative financial service instruments to serve underprivileged businesses, particularly in remote areas, where no physical banking infrastructure is in place.

The Fund has managed to overcome obstacles commercial banks usually face in remote regions. A set of strategic partnerships is orchestrating the service development, delivery and adaptation of standard microfinance products and processes, as well as educating clients in ICT (Information and Communication Technology).

The Fund has 80 employees. In 2008, its revenues reached 13.5 million rubles (USD 451,500), including 9.2 million rubles (USD 307,000) from microfinance operations and 4.334 million rubles (USD 144,466) from guarantees of bank credits for small businesses. It paid 456 thousand rubles (USD 15,200) as federal and local taxes.2 The Fund is commercially viable; its profits for 2008 amounted to 4.2 million rubles (USD 141,033). In 2010, the number of branches and affiliated organizations of the Fund is expected to reach twenty-five.3

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2 According to Russian legislation, revenues from commercial services of non-profit organizations are regarded as profit liable for taxation.

3 Interview with Aleksey Nekhayev, General Director of Voronezh Oblast State Fund for Small Business Support, October 22, 2009.
By providing financial resources to micro- and small businesses and facilitating access to banking services in remote areas through mobile banking, the Fund plays an important role in the economic revitalization of Voronezh Oblast after a long economic stagnation.

Microfinance positively impacts the livelihoods of people, supports the development of private business initiatives and the regional economy. In an area where a quarter of the population lives below the minimum subsistence level, it is vital to help business activities expand and to offer people, in particular the youth, a chance for employment in order to decrease migration to other regions.

Although the Fund’s model has been implemented only recently, the positive experiences with this pilot that combines microfinance services with new technologies could stimulate the development of the microfinance sector in Russia, especially in remote areas.
Introduction

“Microfinance should not be viewed as a lifeline, not as a type of consumer credit, but as bait, as a tool for business development. I firmly believe that the stable development of the country depends on the conditions and processes of development of small businesses,” says Mikhail Kutuzov, independent expert, member of the International League of Strategic Management, Valuation and Accounting.4

Russia is a vast country with a transition economy. In numerous remote regions, banks have a limited presence and people do not have access to the whole range of modern financial services.

According to the Russian Federal Service of State Statistics,5 the minimum subsistence level was 5,093 rubles in the first quarter of 2009 (approx. 170 USD).6 At the same time, the share of the population with incomes below the minimum subsistence level was 17.5% (24.5 million people).

Due to the global financial crisis, many banks that previously had a large network of branches had to reduce costs and thus closed their offices in very remote regions. As a consequence, an increased number of small businessmen and self-employed people have to travel long distances to visit the nearest branch of a commercial bank, increasing overall transaction costs and hindering economic activities in remote areas.

Market and Location Context

MACROECONOMIC BACKGROUND

The Russian economy has been growing steadily since the 1998 financial crisis. However, according to the OECD Economic Survey (2004), the growth is not sustainable in the long term and is largely dependent on export-oriented resource industries. The main engines of the current economic growth have been corporations in oil, gas, timber and metals industries, and to a lesser extent, food and telecommunications. Therefore, the government faces the contradictory challenges of further developing the profitable resource-extracting sectors represented by large enterprises, and simultaneously mitigating the risks of such development. It thus becomes important to create a business-friendly environment in less resource-intensive sectors and boosting entrepreneurial activities among the population through the support of micro, small and medium sized enterprises (MSME).

Micro and small sized businesses contribute a substantial amount to the national economic output. According to the Russian Federal Service of State Statistics, 1.35 million small enterprises were in operation in 2008, of which 1.07 million (79%) belong to the category of micro-enterprises (with a maximum amount of 15 employees). They employ approximately

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4 Interview, October 22, 2009.
6 For calculations we use an exchange rate of 30 rubles per dollar.
10.5 million people, with an average number of eight employees per enterprise. The total annual turnover of small and micro enterprises amounted to 18.7 billion rubles (USD 622 billion), and the average annual turnover per enterprise was 138,714 rubles (USD 4,623).

Individual entrepreneurship comprises another legal form of ownership, although this is not a legal entity. According to the Federal Service of State Statistics, the number of individual entrepreneurs was 2.6 million people in 2007. However, many of the small and micro businesses in Russia operate on an informal basis.

THE ROLE OF MICROFINANCE IN RUSSIA

In Russia, the number of microfinance organizations is growing steadily. As of early 2008, the country had more than 2,300 microfinance providers of various types (credit cooperatives, state foundations and non-profit organizations) with an aggregate loan portfolio of around 25 billion rubles (USD 1 billion). Because of the credit crunch that occurred during the global financial crisis in 2008, demand for microfinance assistance increased. Nowadays the Russian government considers the provision of microfinance loans for entrepreneurs, the self-employed and small businesses as an anti-crisis instrument. If used as working capital credits, rather than consumer credits or the pay back of defaulted loans, micro credit and credit in general can overcome liquidity problems of small businesses.

Nevertheless, around half of Russia’s economically active population lacks adequate access to financial services. Prime-minister Vladimir Putin also highlighted in a message to the State Council that approximately 60 million Russians do not have access to banking services and only one quarter of Russians have a bank account. Tackling these issues will become a priority for the country’s social and economic development. However, building an inclusive financial system requires consistent and appropriate legislation and government policies (see Annex 8, “Legislative Conditions”).

BUSINESS ENVIRONMENT IN VORONEZH OBLAST

The region of Voronezh (“Voronezh Oblast”) is situated in the southern part of Central European Russia (see Annex 1 “Geographical Position”). The city of Voronezh, the capital of the region, is located approximately 500 km southeast from Moscow. The region is known for its mild climate, fertile land and agricultural traditions. Agriculture, food processing and construction are the main economic activities (see Annex 2 “Key Indicators of Voronezh Oblast”).

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8 Interview with Mikhail Mamuta, on October 12, 2009
10 Russian Microfinance Center. 2008. “Notes on Regulation of Branchless Banking in Russia.”
11 See map in Annex 1.
During the 1990s, the region belonged to the so-called “Red Belt”, i.e. communist and socialist ideas gained wide support among the population that experienced serious socio-economic hardships. Nowadays the majority of the members of the regional parliament and the governor A. Gordeev belong to the pro-government party “United Russia”, which is headed by the Prime Minister Vladimir Putin.\(^{12}\)

According to the administration of Voronezh Oblast, the share of the population with income below the subsistence level reached 26.5% in 2005 (500,000 people) and remained stable in the following years.\(^{13}\) Despite the rich agricultural resources of the region, people in rural areas are poor and have limited access to means of transportation, good-quality health care, education and employment. Villages do not have decent housing and community infrastructure. Private or state owned farms are the major employers in most villages.

According to official information of the government of Voronezh Oblast, approximately 62,000 SMEs were active in the region by mid-2009. Of them, 2,000 were small businesses and the other 60,000 were individual entrepreneurs. The share of small businesses in the gross regional product in 2009 amounted to 18.2%.\(^{14}\)

**TELECOMMUNICATION SERVICES IN VORONEZH OBLAST**

In spite of its disadvantaged socio-economic situation, Voronezh Oblast has a relatively developed telecommunications infrastructure. However, at the beginning of 2007, 139 rural settlements still remained without stationary telephone services. To solve this problem and eliminate disparities in coverage of urban and rural areas, the administration of Voronezh Oblast decided to increase the penetration of mobile telephony in rural areas. In 2007, six mobile communication providers were already operating in the Voronezh Oblast and they served 2.1 million people, but the majority of their clients were situated in the city of Voronezh.\(^{15}\) Thus, the administration issued a proposal to all cellular operators working in the region to participate in the implementation of this socially oriented project, aimed at providing communication services to poor and remote areas. The telecommunication company Tele 2 offered the best price and quality and was chosen to implement the project.\(^{16}\)

In 2007, mobile telecommunication services reached areas in the center of the district as well as rural settlements with a population of up to ten thousand people (20 settlements in total). Tele 2 deploys a mobile phone coverage program for villages with a population of up to two


\(^{15}\)First Voronezh Investment Forum, www.voronezh-forum.ru

\(^{16}\)Tele2 is a leading European alternative telecommunication company. Its most important services are mobile telephony and broadband Internet access. The first TELE2 network In Russia was launched in 2003. Today TELE2 Russia has over 15 million subscribers in 37 regions of Russia.
thousand inhabitants. The priority to participate in this program is given to those rural areas where telecommunication services are still absent.17

The amount of mobile phone users (number of SIM cards) in Voronezh Oblast is about 2.5 million, which equals the amount of the Oblast population.18 Since many people have more than one phone number, it can be assumed that not everybody is a mobile phone user. Nonetheless, almost 100% of the people involved in business use mobile phones and thus could have access to mobile banking services.

Thus, the actions taken by the regional administration for the increased availability of telecommunication services in remote regions formed a good base for the future development of inclusive business models in Voronezh Oblast.

Voronezh State Fund for Small Business Support – Business Model

FUND’S HISTORY

Voronezh Oblast State Fund for Small Business Support (hereafter referred to as “the Fund”) is a non-profit microfinance institution (MFI) and the lead firm of this case study.

The Fund was established on June 3, 1998 as a legal entity of the regional government and put in charge of small business development.19 It is a public fund and its headquarters are located in the city of Voronezh. As start-up capital, 400 thousand rubles (approx. USD 67,000 at the pre-default exchange rate)20 were allocated from the Voronezh Oblast administration budget. In the period 1999-2005, the Fund received various foreign grants – the Swiss Foundation for Technical Cooperation (Swisscontact), DAI and the Eurasia Foundation (USAID funding) supported the initial portfolio enlargement and the Fund’s methodology development. During 2007-2009, the Fund received subsidies from the Voronezh Oblast government within the framework of the Voronezh regional target program for the development of regional business and for providing financial and consulting services to small businesses in remote areas.21

To increase the number of issued loans, the Fund also received 24 credit lines from commercial banks in 2002-2007, which were used to provide loans to local businessmen who had not been able to receive loans directly due to poor financial conditions and/or because of the lack of access to financial services.

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17 Commune newspaper, 6 June 2008.
18 First Voronezh Investment Forum. “Voronezh Oblast.”
20 In August 1998, the Russian currency was strongly devalued due to a financial crisis. The pre-default exchange rate was approx. 5 RUB/USD. In just few months the exchange rate reached 25 RUB/USD and kept falling.
Since its foundation, the Fund serves on average approximately 1000 customers per year, with 50% of its clients living in remote areas. Small and micro-entrepreneurs, as well as self-employed people are the main clients, accounting for 75% of the total amount of customers of the Fund. The clients are mainly from trade and service provision (about 70%), as well as from agriculture and manufacturing (30%). About 40% of the clients are women.

Interest rates vary from 24% to 36% per year, depending on agreements between clients and the Fund. The average loan size is 70,000 rubles (USD 2,300). Before the global financial crisis in 2008, the average loan size was 30,000-50,000 rubles (USD 1,000-1,700). Businesses that previously were served by commercial banks applied for bigger loans after the crisis. They started taking loans from MFIs due to the tightening credit conditions in commercial banks. The smallest loan issued by the Fund was 3,000 rubles (USD 100).

The average annual default rate of the Fund’s issued loans is roughly 1%, or about 1 million rubles (USD 33,333). The Fund’s profits are reinvested in the credit portfolio, which in 2008 equaled 500 million rubles (USD 16.6 million). The Fund’s revenues in 2008 were 13.5 million rubles (USD 450,000).

The Fund serves as a coordinating center for the provision of microfinance services in remote areas. It has three regional branches and 17 partner affiliated organizations. 16 people work in the Fund’s headquarters in Voronezh, and another 9 in its regional branches. Part-time employees are employed by 17 partner organizations situated in 32 districts of the region. In total, the Fund employs about 80 people, including local salesmen.

**FUND’S SERVICES IN RURAL AREAS**

The time it takes for a loan applicant to go through the application process and receive a loan is significantly lower in the Fund as compared to commercial banks. The consideration of a loan application at the Fund takes 4-5 working days for a first-time borrower, and with a solvent borrower's credit history, a loan may be issued within one day. In commercial banks, it can take up to a month.

The requested package of documents is about the same as in commercial banks, but the Fund has a larger variety of interest rates and conditions (period and schedule of installments, size and type of guarantees), since conditions can be directly agreed between Fund and borrower and are not restricted to banking laws and Central Bank instructions. In addition, the Fund does not require notarized copies of documents that save time and money for borrowers, as notary offices are not present in remote areas.

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23 Small business enterprises are those that have an annual turnover of up to 60 million rubles (USD 2 million).
24 Average annual turnover between 1 million rubles (USD 30,000) to 3 million rubles (USD 90,000).
25 Figures provided by Aleksey Nekhayev, General Director of the Fund, in interview on October 22, 2009. Official financial data is not publicly available.
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The business niche of the Fund is the cost efficient delivery of financial services in rural areas, whereas commercial banks are not attracted by the margins that accrue from dealing with low-income, distant and unbanked borrowers.

THE ROLE OF TECHNOLOGY

For people living in remote areas, where banks do not have many branches or offices, the use of a mobile phone allows them not only to have access to communication services, but also to use mobile banking services. Mobile banking enables people to become more economically active without having to rely on conventional banking infrastructure.

Mobile banking involves financial transactions conducted by logging on to a bank’s website using a cell phone. Transactions include viewing account balances, making transfers between accounts, or paying bills. Mobile banking is most often performed via SMS or mobile Internet, and uses specially designed applications. Clients can deposit money via a branch of a commercial bank or of a microfinance institution (MFI) and conduct transactions through mobile banking. However, to withdraw cash, clients still need an Automated Teller Machine (ATM) or to travel to a bank.

Mobile banking is not limited to the mere extension of online banking to handheld devices. The newest area of development lies in mobile payments. It allows a customer to make a payment to a retailer through a near-field communication (NFC) chip that accesses the bank’s web server or through SMS. The user swipes his or her phone on a terminal and funds are transferred directly from the bank account to the retailer’s account. NFC technology is becoming increasingly important for retail in under-banked countries and is already being applied on a large scale in inclusive business models in Africa.

In the current case, the simple extension of online banking to mobile phones is used to provide access to financial services to people in Voronezh Oblast. Mobile banking services have been mostly developed by commercial banks. For example, the Russian mobile banking provider, Moscow Industrial Bank (MIB), does not charge a fee for mobile banking services, but fees are charged for bank transactions (USD 1-20 per transaction, depending on the transaction amount) and for mobile banking information services via SMS (50 rubles/month, approx. USD 1.7).

Mobile banking is especially useful for clients in remote areas in receiving information about the status of their account, in saving time by not having to travel to banks and in speeding up financial transactions.

29 In Kenya the mobile service provider Safaricom developed a technological solution in partnership with Vodafone. The result was M-PESA, an electronic money transfer product that makes transactions faster, cheaper and more secure. M-PESA allows money transfer through SMS service. Cash withdrawal and deposit are available at retail outlets to pay for goods and services. Source: “Creating Value For All: Strategies For Doing Business With The Poor.”
REACHING RURAL BUSINESSMEN WITH THE HELP OF MOBILE MICROFINANCE SERVICES

The Fund’s business model aims to serve the market segment that has no or limited access to banking services. In 2007, the Fund started to develop a project that promoted the use of mobile banking and non-personalized plastic cards, helping low-income businesses from remote areas get access to financial services. The project started in 2009. Through the provision of mobile banking and non-personalized banking cards directly at the Fund’s offices, people get access to financial services in remote areas without physically having to travel to a branch of the bank.

Figure 1. Microfinance process and mobile banking

THE FUND AND ITS PARTNERS

The provision of microfinance services in Voronezh Oblast by the Fund was achieved through two tier partnerships: firstly, a collaboration between the Russian Microfinance Center (RMC), the National Partnership of Microfinance Market Stakeholders (NAMMS) and Moscow Industrial Bank (MIB); and secondly, a collaboration between Visa International and the regional government. The partnership between the three lead organizations was initiated by Mr. Mikhail Mamuta, the current president of RMC, NAMMS chairman, and a former director of the Fund (see Annex 4).

RUSSIAN MICROFINANCE CENTRE (RMC)

The Russian Microfinance Center, RMC was established in 2002 in response to the need for an organization which represents and advocates the interests of the entire microfinance
community. The RMC supervisory board currently includes representatives of 22 major Russian MFIs and their networks (associations), with a combined total loan portfolio of USD 170 million and about 120,000 active customers. Thus, RMC represents a significant share (25%) of the loan portfolio of all Russian MFIs, worth about USD 700 million.

The RMC’s mission is to promote a strong and sustainable microfinance sector in the Russian Federation, to facilitate access to financial resources for SMEs and low-income people in order to create jobs and improve the living conditions of the poor. Its longstanding efforts have received the support of internationally recognized charity and development agencies such as the World Bank, the United Nations Development Programme (UNDP), Citigroup Foundation, United Way International, Consultative Group to Assist the Poor, CAF-Russia, and others.

In the partnership with the Fund, RMC provides project coordination, education, consulting and shares international best practices. RMC also works with providers of telecommunication services, commercial banks and the Fund to implement information technologies and settlement transactions with the help of mobile banking. As an umbrella NGO, RMC serves microfinance institutions (MFI) all over Russia, whose clients are mainly rural micro- and small businesses with low income.

NATIONAL PARTNERSHIP OF MICROFINANCE MARKET STAKEHOLDERS (NAMMS)

The National Partnership of Microfinance Market Stakeholder (NAMMS) acts as an intermediary between local and national regulatory and legislative bodies. It was established in 2006 as a private non-profit organization. NAMMS mission is to promote the development of microfinance in Russia through improvements in legislation on microfinance and its institutions, developing standards, supporting implementation of microfinance programs, taking into account the changing needs of small businesses, bringing together professional organizations and representing the interests of the microfinance market.

In its partnership with the Fund, NAMMS performs technology transfer and training. For example, in 2009 Mikhail Mamuta, president of MNC and chairman of NAMMS, signed the memorandum of partnership with Professor Muhammad Yunus, Nobel Prize Laureate and founder of the Grameen Bank and the Russian National Bank TRUST. This agreement started a major social project aimed at the support and development of Russian micro entrepreneurship. The partnership’s objectives are better availability of financial services for microbusinesses, exchange of business models, organization of discussions, trainings, and conferences, as well as cooperation with other international structures and funds.

In 2007, RMC and NAMMS carried out the project “VISA cards for Microfinance Organizations”, which was aimed at promoting non-personalized banking cards and mobile banking in microfinance. The project gained support from the Moscow office of VISA International.32

32 See Annex 6

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MOSCOW INDUSTRIAL BANK (MIB)

In 2008, Moscow Industrial Bank (MIB), one of the largest commercial banks in Russia, joined the RMC/NAMMS team. Voronezh was chosen as one of the pilot regions to implement the microfinance project, with the Fund to be a key player. The MIB headquarters in Voronezh acts as the focal point for the Fund’s operating branches.

The Voronezh Branch of MIB has been expanding its customer base – every year, about 150 new microfinance borrowers receive loans, and more than 100 of them sign up for mobile banking. The bank also intends to develop its presence in the region by opening new branches and ATMs. In addition, MIB promotes mobile banking: every month the bank personnel conduct presentations of its services to its clients in Voronezh Oblast and publish information in the local mass media.\(^33\)

VISA INTERNATIONAL

It was agreed with MIB that RMC would be an agent in the dissemination of its accounts and cards to the Fund and its clients. VISA International provides the modern payment system, while the bank issues a plastic card and account in cooperation with the microfinance organization.

PRIVATE COMPANIES (MOBILE COMMUNICATIONS, INSURANCE)

Mobile phone companies have relations with MIB as providers of mobile banking services. MIB co-operates with the three largest telecommunication companies in Russia - Beeline, MegaFon and MTS. The fact that they cover the whole territory of Russia is crucial for their participation in Mobile Banking project. TELE 2, which, as mentioned earlier, heads a project on providing telecommunication services in remote areas of Voronezh Oblast, is a relatively small company with limited territorial coverage and thus does not take part in Mobile Banking project. Furthermore, insurance companies participate in microfinance services to ensure that loans will be paid back.

The project implementation started in 2009. In addition, the Voronezh Oblast Administration carried out a target program for small business support and provided subsidies to the Fund to develop its branches in remote areas to provide consultation and training services for low-income entrepreneurs, self-starters and the unemployed.

The figure below depicts the principal relationships of the Fund. Dotted arrows mean indirect relations, which link for example the client and mobile phone operator, or mobile phone operator and the bank. Clients can choose the phone company and the bank according to their own criteria. Insurance companies are legally obliged to insure the life of a client (in case when he is a private entrepreneur) and the risk in case it is a legal entity.

\(^{33}\) Interview with representatives of the Voronezh branch of Moscow Industrial Bank on October 22, 2009.
Constraints and Solution Strategies

UNDEVELOPED LEGAL ENVIRONMENT

The law “On Microfinance Activity and Microfinance Organizations” has not been adopted, although it has been presented as a draft to the Parliament of Russia. Although the adoption of this law is now a matter of time, the development of broader financial legislation remains crucial. Thus, legal uncertainty is the main hindrance to the further development of microfinance in Russia.

The regulatory framework for mobile banking has been slow to catch up with practice and needs further improvements. Besides, there is also an absence of a clear legal framework for national payments systems. Nevertheless, authorities are not inclined to promote mobile banking or e-money, because the Russian financial system is fragile and immature and financial pyramids may appear as a result of introducing of e-money. Besides, much more major laws for financial market need to be developed beforehand.

According to the research conducted by CGAP (Consultative Group to Assist the Poor), “The further development of branchless banking in Russia is being threatened both by the risks posed by unregulated entities and their significant growth and size, as well as by the legal ambiguity regarding whether nonbanks may provide payment services. The future course will also depend significantly on (1) adopting a legal definition of e-money (and resolving the legal issues regarding whether nonbanks may issue e-money), (2) permitting a broader use of retail
banking agents, and (3) revising the anti-money laundering/combating the financing of terrorism requirements to provide a truly risk-based approach.”  

The Fund’s strategy was to adapt to the risky environment and to mitigate risks by forming partnerships. NAMMS, one of the partners of the Fund, is directly engaged in legal work and is involved with improvements in legislation on microfinance and its institutions, developing standards and representing the interests of microfinance organizations.

FINANCIAL AND ICT ILLITERACY IN RURAL AREAS

Another obstacle the Fund faced when implementing mobile banking services was a lack of appropriate knowledge and skills, ranging from general financial illiteracy to particularly ICT illiteracy among its clients that mostly reside in low-income communities in rural areas. People in many cases were not able to understand completely how the microfinance system works, and how to use bank cards and mobile phones to operate a bank account (especially elderly people). Additionally, people did not trust loan providers in general. However, the locality of the Funds’ branches helped to build trust and educate people.

Financial literacy of the customers is one of the key success factors of any MFI. But demanding rural businessmen to use new technological devices is very challenging. However, the Fund could rely on the training provided by Visa and others that consulted potential clients in business planning and examined their projects (see Annex 4 “The Fund”).

Aleksey Nekhayev, General Director of the Fund, reports “Consultations provided to clients by MFI employees are very important, because many rural entrepreneurs lack deep economic knowledge and necessary contacts in a business environment. They also need help in defending their legal interests”.  

Besides, the Fund and RMC also organize trainings for the local administration and employees of microfinance institutions (Fund’s branches and partners). Participants are trained in customer relations, using innovations in the field of microfinance (including modern technologies) and new legislation. Annually about 50 people are trained on specialized seminars and conferences. Trainings are conducted on the regional and municipal levels and therefore raise the awareness of the local authorities about the specific features of the microfinance sector and its role for SME development.

RMC and NAMMS also organize educational events together, conferences and seminars on the national level for other MFIs.

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34 CGAP is an independent policy and research center. It defines branchless banking as the delivery of financial services outside conventional bank branches using information and communications technologies and retail agents.
35 See Annex 4 - Structure of Voronezh Oblast State Fund for Small Business Support
36 (Interview, October 2009)
37 For example, in October 2009, a training program called “Microfinance Programs at Regional and Municipal Levels: Development and Implementation” was held in Moscow. It was organized by the Ministry for Economic Development, the Russian Microfinance and the State University Higher School of Economics. 39 representatives of regional administrations and funds for SME support from 31 region
Last but not the least, RMC manages a scholarship fund for Russian MFIs and low-income households and runs training programs on financial literacy for this target group. In the framework of its charitable activities the RMC is closely cooperating with the UN specialists on microfinance development.

INADEQUATE PHYSICAL INFRASTRUCTURE

Another constraint for banks in reaching customers in the rural areas of Russia, and in particular in Voronezh Oblast, is the lack of physical infrastructure, with few banking branches in place. This obstacle was overcome by leveraging mobile banking technology to reach clients even in remote areas.

To summarize, the Fund has faced three major constraints: lack of adequate legal regulation of microfinance activities, poor banking infrastructure in remote regions and financial and technological illiteracy. The solution was to adapt its operations by using mobile banking and sharing risks with its partners. Only by combining resources and skills with partners was the Fund able to execute mobile banking operations and run appropriate ICT systems.

Results Created

As the mobile banking project was launched only in 2009, it is difficult to measure its success based solely on the preliminary results, but its initial performance can be extrapolated to indicate its future potential.

PRELIMINARY ECONOMIC RESULTS

Economic results of the mobile banking project are hard to measure as the project is still in its pilot phase. The Fund has 80 full-time and part-time employees. In 2008, its revenues accounted for 13.5 million rubles (USD 451,500), including 9.2 million rubles (USD 307,000) from microfinance operations and 4.3 million rubles (USD 144,466) from guarantees of bank credits for small businesses. It paid 456,000 rubles (USD 15,200) as federal and local taxes.\(^3^8\)

The Fund is commercially viable - its profits for 2008 were 4.2 million rubles (USD 141,033). In 2010, the number of branches and affiliated organizations of the Fund is expected to reach twenty-five.\(^3^9\)

It is estimated that the number of people in the region using mobile banking will double in 2010 to reach up to 1,000 persons, and this growth is expected to continue. According to the Fund, the new mobile banking services are especially attractive for young people, the self-employed and businessmen. Young people are better educated in new technologies and find it

\(^3^8\) According to Russian legislation, revenues from commercial services of non-profit organizations are regarded as profit liable for taxation.
\(^3^9\) Interview with Aleksey Nekhayev, General Director of Voronezh Oblast State Fund for Small Business Support, October 22, 2009
easier to use them in their everyday life. Businessmen are also familiar with the advantages ICT technologies offer to their business. On the whole, ICT illiteracy among the poor is still the most difficult constraint to overcome.

SOCIO-ECONOMIC RESULTS

"With a microfinance loan I was able to turn “Dance Academy” into a home to people with modest income – students, small business employees, even pensioners, who are dancing and spending a lot of time here. They come to dance, but also become members of a social club".  

Galina Butorina, owner/manager of a dance studio, MFI client

The main social contribution of the Fund is enabling entrepreneurs from remote areas gain equal access to financial services by helping the poor to gain access to financial services through modern technologies. The success story of one of its first customers illustrates the positive socio-economic results of microfinance.

Galina Butorina, the owner cum manager of the dance studio “Dance Academy” in Voronezh has developed a business after receiving loan from the Fund. The Academy, which was opened in 2007, attracts people from ages 4 to 60. Target customers are low-income people, students and workers as well as pensioners. With the help of the Fund, MIB issued a non-personalized plastic card for the entrepreneur that had already been credited with the loan money. Galina also signed up for mobile banking, as she is very busy during the day and does not have time to go to the bank. According to her, mobile banking services help her save time and help her to concentrate on her business.

The business is profitable - the annual turnover is approximately 3 million rubles (USD 100,000), with an annual net profit of 400,000 rubles (USD 13,000). Today Galina Butorina considers herself a happy woman. She is thankful to the Fund, whose support allowed her not only to survive, but also start a successful business.  

To sum up, social results lie in the provision of credit and technology to people who previously did not have access to them. Supporting self-employment and entrepreneurship increases job opportunities as well as access to goods and services formerly unavailable in these regions. In addition, the Fund and its partners enhance financial and ICT literacy.

In Voronezh Oblast, where one quarter of the population lives below the subsistence level, it is extremely important to help private business activities expand. Modern technologies such as mobile banking in microfinance have a larger effect on the whole community. Increased local economic activity improves the quality of life and enhances the vibrancy of community life. Thus, emigration to urban areas and other regions can be decreased.

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40 Interview with Galina Butorina on October 21, 2009
41 Ibid.
ENVIRONMENTAL RESULTS

Although the environmental impact is not substantial, providing credit to the poor in remote areas via banking cards and mobile technology reduces the need for travel from rural areas to large cities, which positively impacts the environment due to a reduction of travel related carbon emissions.

Growth Strategy and Future Outlook

As a result of a unique concerted action between microfinance institutions, commercial banks, local authorities and telecommunication service providers, low-income people and small businesses in Voronezh can benefit from the advantages of modern technologies in microfinance. There are plans to introduce this pilot program in other remote regions of Russia.

However, in order to roll out and scale up this innovative model in other regions of Russia, major challenges have to be overcome, which are related to the adoption of the law on microfinance, clarifying the status of microfinance institutions, establishing relationships of trust with potential customers and borrowers, implementing modern information and communication technologies, educating ICT illiterate entrepreneurs, and reducing the costs of financial services for micro- and small businesses in remote areas.

The Fund and its partners have proven through the pilot project in Voronezh Oblast that they are able to successfully bring financial services via ICT to previously excluded SMEs. This has been achieved by setting up local branches with trained local staff who educate clients. The Fund’s partners trained the Fund’s local staff in modern mobile banking, and they in turn provided training to their clients, in particular on how mobile banking could be applied to their rural businesses.

The next success indicator will be the improvement of the Funds’ quality of services in rural areas. The Fund should also focus on the possibility of standardization in order to lower its operating costs and make its model sustainable. This will most certainly result in lowering interest rates and enhancing advisory services to support start-ups.

However, due to the current economic crisis and inflation, the ability of borrowers to pay their debts has decreased. The risks connected with economic problems can be overcome by expanding the Fund’s services to guarantee bank loans for its clients. On November 2, 2009, the Bid Evaluation Commission of the Ministry of Economic Development explored the possibility of additional funding for regional guarantee funds from the federal budget. For low-income businesses the problem of guarantee provision for the loan is the most serious, because in most cases they do not own valuable assets. During the Commission meeting it was decided to allocate 59.7 million rubles (USD 2 million) from the federal budget to replenish the guarantee fund of Voronezh Oblast State Fund for Small Business Support.42

Another important challenge will be to develop new technologies, such as the improvement of security for mobile banking transactions. Non-personalized banking cards are only the first step and new devices are already on their way to provide more sophisticated services for people living in remote areas (see Annex 7).

Last but not the least, microfinance is a very promising tool in promoting a market economy and private entrepreneurship in Russia, taking into consideration the untapped potential of the regions and the millions of people living there.
References

- Russian Microfinance Center. 2008. “Notes on Regulation of Branchless Banking in Russia.”
- Deutsche Bank Research. 2007. “Russia’s Financial Sector.”

INTERNET SOURCES:


LEGAL DOCUMENTS:

Codes
- Constitution of Russian Federation
- Civil Code of Russian Federation

Federal laws

Laws

Interviews

<table>
<thead>
<tr>
<th>№</th>
<th>Name</th>
<th>Position</th>
<th>Date of interview</th>
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<tbody>
<tr>
<td>1</td>
<td>Mamuta, Mikhail</td>
<td>RMC President/Manager</td>
<td>October 12, 2009</td>
</tr>
<tr>
<td>2</td>
<td>Krivosheev, Vladislav</td>
<td>RMC Vice-President</td>
<td>October 12, 2009</td>
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<td>3</td>
<td>Nekhaev, Aleksey</td>
<td>General Director, Voronezh Oblast State Fund for Small Business Support</td>
<td>October 21-22, 2009</td>
</tr>
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<td>4</td>
<td>Kutuzov, Mikhail</td>
<td>Independent expert, member of the International League of Strategic Management, Valuation and Accounting</td>
<td>October 22, 2009</td>
</tr>
<tr>
<td>5</td>
<td>Butorina, Galina</td>
<td>Owner/manager of Voronezh Dance Studio</td>
<td>October 21, 2009</td>
</tr>
<tr>
<td>6</td>
<td>Representatives of the Voronezh branch of Moscow Industrial bank</td>
<td></td>
<td>October 22, 2009.</td>
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</tbody>
</table>
Annexes

ANNEX 1. VORONEZH OBLAST KEY INDICATORS

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Notes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Territory</td>
<td>52,200 sq. km</td>
</tr>
<tr>
<td>Population</td>
<td>2,270,000</td>
</tr>
<tr>
<td>Capital city of the region</td>
<td>Voronezh</td>
</tr>
<tr>
<td>Population of the capital city</td>
<td>839,900</td>
</tr>
<tr>
<td>Population density</td>
<td>43 people per sq. km</td>
</tr>
<tr>
<td>Urban population</td>
<td>1,436,700 (63.3% of total population)</td>
</tr>
<tr>
<td>Economically active population</td>
<td>1,140,900 (50% of total population)</td>
</tr>
<tr>
<td>Regional GDP</td>
<td>USD 254.85 billion</td>
</tr>
<tr>
<td>Inflation rate</td>
<td>9.8 %</td>
</tr>
<tr>
<td>Registered unemployment</td>
<td>58,300 people</td>
</tr>
<tr>
<td>Retirement age</td>
<td>55 years for women</td>
</tr>
<tr>
<td></td>
<td>60 years for men</td>
</tr>
<tr>
<td>Average nominal monthly salary</td>
<td>13,173.4 Rub (USD 440)</td>
</tr>
</tbody>
</table>

Source: Voronezh Oblast State Statistics Committee. www.voronezhstat.gks.ru

ANNEX 2. GROWTH IN THE RUSSIAN FINANCIAL SECTOR

Source: Deutsche Bank Research. 2007. “Russia’s Financial Sector.”
ANNEX 3. MIKHAIL MAMUTA

Mikhail Mamuta was born on September 29, 1974. He graduated from Voronezh State University with a degree in Nanoelectronics and Nanotechnology and a Master of Science in Physics. Later he received a degree in Banking Finance and Credit, and completed further studies in the field of crisis management and adult education.

Since 1997, he has been working in the field of finance and credit for small business and microfinance. During 1997-2000, he was employed with the Administration of Voronezh Oblast and was responsible for financial and credit support and taxation of small businesses as well as the development of regional programs for small business development. He also has experience as a crisis manager in the banking sector.

During 2000-2002, Mr. Mamuta worked as the General Director of the Voronezh Oblast Fund for small businesses support. He was engaged in the creation and development of the microfinance program and the establishment of a microfinance network in remote areas. During 2002-2006, Mikhail Mamuta worked as the Director of the Microfinance Center, and in 2007 he became its President. He is also the President of the National Partnership of Microfinance Market Stakeholders (NAMMS). Mr. Mamuta plays an active role in the activities of the Council for Small Business Development (Upper Chamber of Parliament) by drafting legislation on microfinance and credit cooperatives, and supporting the creation of an all-inclusive financial system in Russia.

Source: www.opora-credit.ru
ANNEX 4. FUND STRUCTURE AND MICROFINANCE SERVICES

STRUCTURE OF THE FUND

Regional Branches:
1. Liskinskiy Municipal Fund for Small Business
2. Ramonskiy Municipal Fund for Small Business
3. Rossoshanskiy Municipal Fund for Small Business

Local partners:
1. Autonomous nonprofit organization "Bobrovskiy regional business support center"
2. Autonomous nonprofit organization "Borisoglebskiy business support center"
3. Autonomous nonprofit organization "Buturlinovskiy business support center"
4. Autonomous nonprofit organization "Pavlovskiy business support center"
5. Autonomous nonprofit organization "Rossoshanskiy center for entrepreneurship support and investment."

MICROFINANCE SERVICES OF THE FUND:

- Granting micro-loans to small businesses
- Granting compensatory loans to small businesses to repay interest-bearing liabilities to credit institutions
- Issuance of guarantees for the obligations of small businesses to credit institutions and leasing companies
- Promoting mobile banking and other innovations

The Fund does not charge fees for consulting services. Costs are covered from the Fund’s profits from microfinance activities. The non-profit character of the organization allows directing all created income to the Fund’s activities.

ANNEX 5. PROJECT STAKEHOLDERS

Visa Inc. is the world’s largest retail electronic payments network, with nearly USD 4.3 trillion worth of transactions conducted on its payment products over the four quarters ended June 30, 2009. Visa is a global payments technology company that connects consumers, businesses, banks and governments in more than 200 countries and territories, enabling them to use digital currency instead of cash and checks. It is capable of handling more than 10,000 transactions per second. It provides transaction-based services to financial institutions and merchant customers through VisaNet - secure, centralized and global processing platform. Visa also provides value-added services including risk management, fraud protection, loyalty, dispute management and debit issuer processing. In September 2000, the first Visa office was

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43The activities of the Fund are mainly the provision of financial and informational support to persons who run small and medium-sized businesses.
opened in Moscow that is responsible for business development and support of more than 600 member banks of Visa in Russia and the CIS.44

Moscow Industrial Bank (MIB) was established in November, 1990. Its 199 offices employ 3,000 people. MIB has more than 500,000 clients, and its profits for 2008 amounted to 1,445 million rubles (USD 50 million).45 In Voronezh Oblast, MIB has 17 branches.

The other stakeholders are the Government of the Voronezh Oblast46, which provides annual budget subsidies to the Fund, mobile telecommunication companies (MTS47, MegaFon48 and Beeline49, Tele2), that provide mobile phone and Internet services, and insurance companies50 involved in the microfinance process, as they guarantee the credit will be paid back.

ANNEX 6. MOBILE BANKING SERVICES.

1. Information services provided by Moscow Industrial Bank through mobile banking:

1) Changes of cash balance - notifying clients of their expenditure and receipt transactions on their accounts for an amount not less than 50 rubles ($2) (for foreign currency cards - $ 1 or 1 Euro, respectively);

2) Expiration of a card - notification is sent to the cardholder three times;

3) Inability to perform operations on the card - the customer is notified of an unsuccessful attempt to perform an operation on his/her card account;

4) Implementation of non-financial transactions using the card - the customer is notified of all attempts to check his/her account balance in the ATM and PIN code changes of his card.

Informational services are available on inexpensive mobile phones too, as they do not need any special programs.

2. Full Mobile Banking Service varies from bank to bank and may include the following:

1) Money transfer between card accounts of the client;

2) Money transfer from the deposit on the card account. This operation is operated with password or via special device, crypto-calculator. The payment for this device is about 600 rubles (USD 20) and is paid once, when the device is provided to client.

3) Transfer money from card account to the bank accounts of individuals and legal bodies (this type of operation is carried out with indication of bank details of the recipient);

50 Mutual insurance and life insurance are required when microfinance borrowers are engaged in a dangerous business (construction, welding, etc.)
4) Repayment of debt on credit cards by transferring funds from client’s current account to the credit account;
5) Balance replenishment of client’s cell phone and cell phones of client’s relatives;
6) Payment for Internet services;
7) Payment for the housing, land-line and long-distance communications;
8) Checking the balance on all banking products (accounts, deposits, and loan products);
9) Blocking / activation of a bank card.

A client can choose any of three Russian mobile phone operators (Beeline, Megaphone or MTS) to be connected to this service. To start using the Full Mobile Banking Service a client needs a mobile phone (Smartphone, communicator) that supports JAVA MIDP 2.0 technology and has activated GPRS service.

Annex 7. MAP OF THE RUSSIAN FEDERATION.

Source: CIA World Factbook

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November 2010

The information presented in this case study has been made available to the company in
subject to ensure its accuracy and is accurate to the best of the author’s knowledge. The views
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