

## FINANCIAL STABILITY AT MICROCREDIT ORGANIZATIONS AND APPLICATION OF “PEARLS” MODEL IN INTERNAL CONTROL

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**Abstract:** This article is devoted to the research of methodological issues of financial stability at microcredit organizations and application of “PEARLS” model in internal control.

**Key words.** Pearls, audit, bank, insurance, leasing, microloan, lombard, loan, WOCCU.

**Introduction.** The Decree of the President of the Republic of Uzbekistan № 4947 as of February 7, 2017 “On the Action strategy of the development of five priority areas of the Republic of Uzbekistan for 2017-2021”, precisely, its prior direction devoted to the economy development and liberalization has highlighted the issue of raising the volume of insurance, leasing and other financial services due to the introduction of their new types and improving the quality, as well as further development of the stock market as an alternative source of attracting capital and placing free funds of enterprises, financial institutions, households and population<sup>1</sup>. Thus by October 1, 2017 total assets of the credit organizations accounted for 200 billion UZS, the balance of credit placements amounted to 178,4 billion UZS and an aggregate capital equaled to 153,4 billion UZS.

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<sup>1</sup> The Decree of the President of the Republic of Uzbekistan № 4947 as of February 7, 2017 “On the Action strategy of the development of five priority areas of the Republic of Uzbekistan for 2017-2021”.

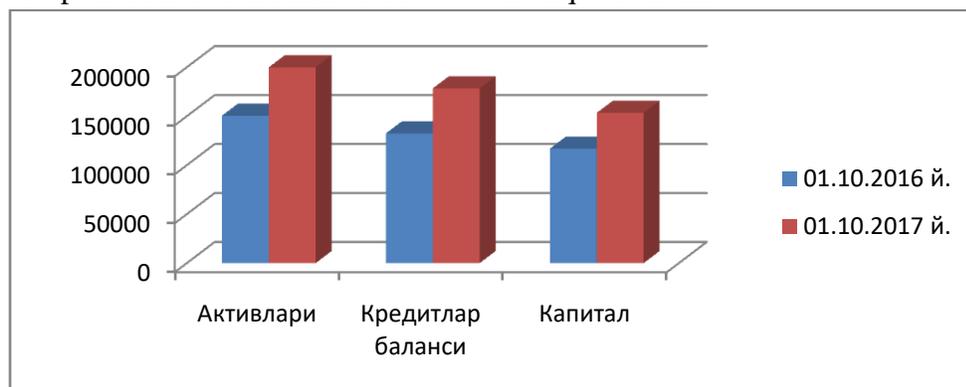
The Decree of the President of the Republic of Uzbekistan № 3270 as of September 12, 2017 “On the measures of further development of the banking system of the Republic of Uzbekistan and enhancing its stability” has laid the grounds for undertaking appropriate measures aimed at strengthening financial stability of the credit organizations, further enhancement of the volume and quality of the services provided, thus, protecting the rights of the consumers of financial services.

In particular, this document determines the minimal level of shareholder equity for newly established microcredit organizations and lombards beginning from October 1, 2017:

- for microcredit organizations - 2 billion UZS;

- for lombards - 500 million UZS.

**Analysis.** Since January 1, 2019 the shareholder equity for microcredit organizations and lombards performing their activities in the territory of the Republic of Uzbekistan must be in compliance with the established minimal requirements.



### Assets Credit balance Capital

**Figure 1. Main indicators of the non-bank credit organizations (in million UZS)<sup>2</sup>.**

If on January 10, 2016 total assets of non-bank credit organizations accounted for 150541 mln. UZS, meanwhile on January 10, 2017 this indicator amounted to 199964 mln. UZS so that we can the increase by 49423 mln. UZS.

On January 10, 2016 the credit balance was 132504 mln. UZS and on January 10, 2017 this indicator reached 178426 mln.UZS that shows the growth of credit balance by 45922 mln.UZS.

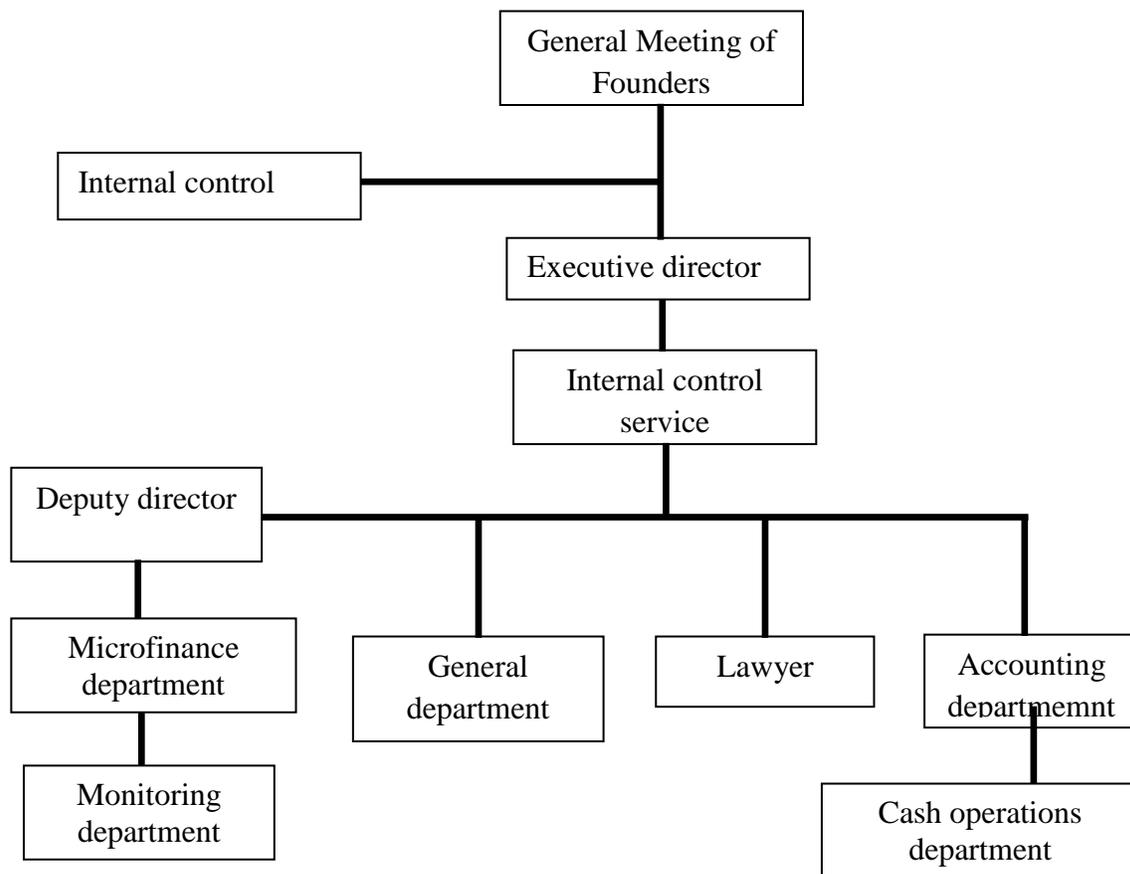
If on January 10, 2016 the capital of non-bank credit organizations accounted for 116878 mln. UZS, meanwhile on January 10, 2017 this indicator amounted to 153446. UZS so that we witness the increase by 36568 mln. UZS.

<sup>2</sup><http://cbu.uz/ru/press-tsentr/press-relizy/2017/10/95620/>, access time: January 29, 2018, time 10.00.

In addition, microcredit organizations also perform an important social function as individual entrepreneurs who have just launched their own business, learn the fundamentals of financial management, business plans and development forecasts, thereby in this way these organizations encourage the development of private entrepreneurship in the country.

Currently 76 non-bank microcredit organizations are operating in the territory of the Republic of Uzbekistan. Among them 30 are microcredit organizations and 46 – lombards<sup>3</sup>.

The management structure of the microcredit organizations consists of General Meeting of Founders, internal auditor, executive director, internal control service, deputy director, microfinance department, monitoring department, accounting department, cash operations department, a lawyer and a general department and the following management structure has been proposed.



Source: Developed by the author

**Figure 2. Management structure of the microcredit organizations**

<sup>3</sup><http://cbu.uz/ru/press-tsentr/press-relizy/2017/10/95620/>, access time: January 29, 2018, time 10.00.

Above-stated management structure in the form of the chart (figure 2) has been developed by the author and implemented in practice.

When performing financial analysis we consider microcredit organizations as the charts which represent a set of interconnected units, such as the principles, description, definition and interpretation of some of the main aspects.

However, it is not a schematism. On the contrary, it is the process of thinking which requires generalization and comparison of the ideas gained from the experience.

Table 1 illustrates the differences between microcredit organizations and banks.

**Table 1**

**Differences between microcredit organizations and banks**

<b>№</b>	<b>Microcredit organizations</b>	<b>Banks</b>
1.	Main income is interest yield	Main income is money transfer
2.	Authorized capital (shareholder equity) – 2 billion UZS	Authorized capital (shareholder equity) – 100 billion UZS
3.	Annual interest rate of microloans accounts for 35 %	Annual interest rate of banks accounts for 20-24 %
4.	% is calculated on the monthly residual amount	% is calculated on the total amount

Nowadays 28 banks are operating in the republic among which 3 are the state-owned, 12 joint-stock commercial banks, 8 private banks and 5 banks with participation of foreign capital.

All banks and non-bank organizations perform their activities under the license issued by the Central Bank of the Republic of Uzbekistan.

Currently microcredit organizations of the republic offer the following services:

Microloan is the sum of money amounting to up to 100 minimal wages and lent to individuals without asking about the purpose.

Microcredit is the sum of money amounting to up to 1000 minimal wages and lent to small business entities through 5% monthly money transfer. A tax isn't imposed on the interest yield. Factoring implies purchase of debt obligations. Factoring isn't widely used in the microcredit organizations but is extended for targeted purposes.

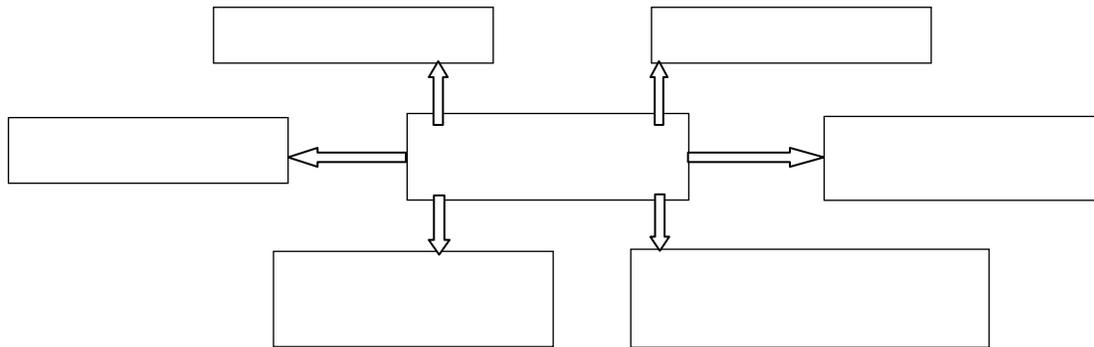
Microleasing is the sum of money amounting to up to 2000 minimal wages and is extended for the purchase of the machinery, equipment and technologies.

Consumer loan – is the sum of money amounting to up to 1000 minimal wages on the basis of trilateral agreement and is extended on the basis of microleasing.

Consulting services – advisory services rendered at getting a microloan, microcredit, microleasing, factoring, or a consumer loan.

Typical loan period for microloans, microcredits, microleasing, factoring and consumer loans:

1. Short term – from 1 month to 6 months.
2. Medium term – 12 months.
3. Long term – from 24 months to 36 months.



Микрокредитлаш ташкилоти – microcredit organization

Микроқарз- microloan

Микрокредит - microcredit

Факторинг - factoring

Микролизинг - microleasing

Истеъмол кредити – consumer loan

Микрокредит олишда консалтинг хизмати – consulting services on microloans

Source: Developed by the author

### Figure 3

#### Main services provided by microcredit organizations

The main tool to ensure strategic development of the modeled credit organization is PEARLS, the system for financial monitoring developed by the World Council of Credit Unions (WOCCU). This system enables to conduct an objective assessment of the microcredit organizations' reliability and represents the set comprising of 45 financial indicators and ratios.

Table 2

#### Main indicators of PEARLS

Sphere	PEARLS	Description	Norm
P= protection	P1	Reserves to cover the expenses on loan /Outstanding balance of these loans for 6 months	100 %
	P2	Reserves to cover the expenses on loan /	100 %

		Outstanding balance of these loans for 6 months	
E=effective financial structure	E1	Assets: Net loans/Total assets	70–85 %
	E5	Savings & deposits (excluding shares)/Total assets	70–80 %
	E9	Capital: Reserves & retained earnings/Total assets	70–80 %
A=asset quality	A1	Outstanding balance of delinquent loans > 30 days/Total loans	<=5%
	A2	Non-earning assets/Total assets	<=5%
R=rates of return and cost	R7	Total yield interest (by dividend payments) / dividends by average share	Market rates >=R5
	R9	Total expenses on transaction/ cost of average assets	<10 %
	R12	Net income / cost of average assets	<10 %
L=liquidity	L1	Short-term investments / Liquidity Reserve/Withdrawable savings & deposits	Minimum 15 %
S=signs of growth	S10	Membership growth	>=5 %
	S11	Growth of total assets	> Inflation

**Discussion and conclusion.** The PEARLS system enables to evaluate microcredit organizations by the following parameters: asset quality, revenues, growth rates, value, financial system effectiveness, protection. The use of this system gives an opportunity not just to determine problematic aspects, but also to develop the most efficient ways to solve the problems of the institutional development.

In addition, the implementation of the economic normative system facilitates the efficient reduction of risks occurred in the activity of microcredit organizations, thus, contributes to ensuring of the legal equality of the microcredit organizations. Thus the PEARLS system serves as a supplementary and supporting tool for the company management in developing their strategic plans.

We can study the performance of the “BV Finans invest” microcredit organization on the case-study of the main indicators of the PEARLS (Table 3).

**Table 3**

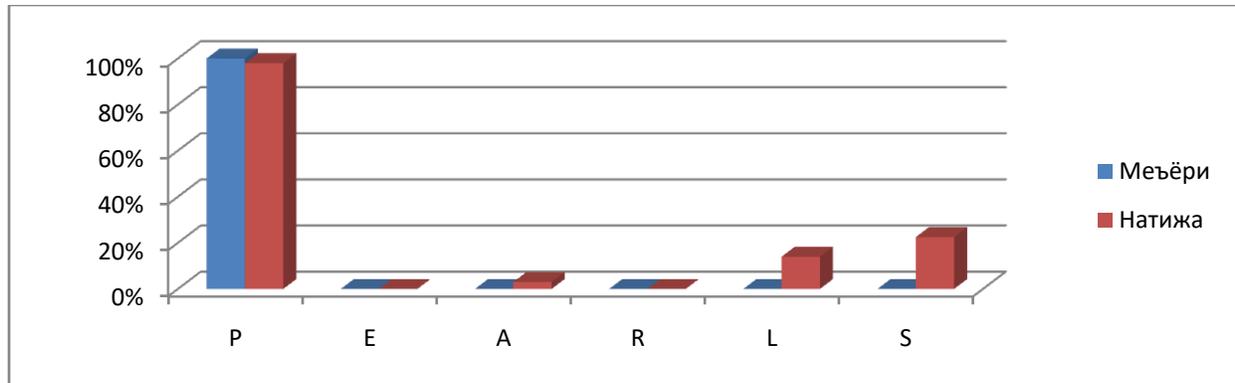
**Data analysis of the financial reporting of microcredit organization “BV Finans invest” on the basis of the PEARLS main indicators for 2016**

Соха	PEARLS	Тавсифи	Меъёри
P= protection	P1	$49665 / 50227 = 98 \%$	100 %
E=effective financial structure	E1	$1032116 / 1193273 = 86 \%$	70–85 %
	E9	$1043622 / 1193273 = 87 \%$	70–85 %
A=asset quality	A1	$33272 / 1032116 = 3 \%$	$\leq 5\%$
R=rates of return and cost	R9	$260825 / 1193273 = 21 \%$	$< 10 \%$
	R12	$324377 / 1193273 = 27 \%$	$< 10 \%$
L=liquidity	L1	$1193273 / 1043622 * 100 = 14\%$	Minimum 15 %
S=signs of growth	S11	$1538662 / 1193273 * 100 = 22,5 \%$	$> \text{Inflation}$

**Source:** calculated by the author on the basis of the financial reporting of microcredit organization “BV Finans invest” for 2016.

The modern model of microcredit organizations is aimed at supporting the economically active population, which rationally uses credit resources.

We have calculated the data from financial reporting of “BV Finans invest” microcredit organization for 2016 on the basis of the main indicators of PEARLS and analyzed in the form of the bar-chart (Figure 4).



**Meъери - Norm**

**Натижа - Result**

**Figure 4. The data from financial reporting of “BV Finans invest” microcredit organization for 2016 on the basis of the main indicators of PEARLS**

Finally, reserves of “BV Finance Invest” microcredit organization accounting for 98% are considered to be sufficient, effective financial structure with 86-87% shows a positive result, asset quality 3%  $\leq$  5% which is an excellent indicator, rates of return and cost indicator accounts for 21-27%  $<$ 10% which is a negative factor, balance sheet liquidity shows a positive indicator of 14%, and signs of growth are 22,5% higher than the inflation rate.

### Reference

1. The Decree of the President of the Republic of Uzbekistan № 4947 as of February 7, 2017 “On the Action strategy of the development of five priority areas of the Republic of Uzbekistan for 2017-2021”.
2. The Decree of the President of the Republic of Uzbekistan № 3270 “On the measures of further development of the banking system of the Republic of Uzbekistan and enhancing its stability” as of September 12, 2017.
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