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SPECIAL PAPER WRAP-UP ISSUE

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By Anne-Lucie Lafourcade, published by the Microfinance Information Exchange, November 2007, 12 pages, available at http://www.themix.org/ publication_detail.aspx?publicationID=198

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*We had so many Paper Wrap-Ups for you this month that we couldn't fit them in the regular February MicroCapital Monitor. We hope you enjoy this special Wrap-Up-only issue, our second issue this month. The "Pioneers" and MIX pages are repeated from the original February Monitor.

MicroCapital would like to recognize the individuals at Consultative Group to Assist the Poor, Microfinance Information eXchange (MIX) and Microfinance Gateway for their outstanding work disseminating information on microfinance. Thank you!

PIONEERS IN MICROFINANCE

Ron Grzywinski and Mary Houghton are two of the founders of ShoreBank, which was the first community bank in the United States. Mr. Grzywinski is currently Chair of the Board of ShoreBank Corporation and Ms. Houghton is its President.

Ron Grzywinski and Mary Houghton

MicroCapital: What in your upbringing or background do you think steered you toward a career in social investment?

RG: Four of us came together in the late 1960s for the purpose of doing small business loans in inner-city neighborhoods in Chicago after they had experienced dramatic racial change and the beginnings of deterioration. That's how it all started. The four us included two African-American men, Milton Davis and James Fletcher, plus Mary and myself who got along quite well and who were highly motivated by our work. We had the idea to create what eventually became ShoreBank, a corporation that was totally developed using private sector resources for the purpose of doing development amongst people who have fewer resources. We bought what was then the South Shore Bank in August 1973, and three of the four of us started working here after that time. For the first ten years or so that's all we did. We were invited in 1983 through the Ford Foundation to go to Bangladesh and to work with Yunus when he was getting a bank charter. So that's the background. I think the motivation for me was the opportunity to use the resources that I managed as a banker to achieve social objectives.

MC: It must have been unusual at that time to find bankers who wanted to do social investment.

RG: It was most unusual. We see that banks are beginning to move there now, but they are moving slowly. Compared to what it was then, today it's like a landslide. We were the second bank in the country to start a program to finance minority small businesses, and it wasn't until the mid-1980s when Governor Clinton invited us to come to Arkansas that there was a second effort made to try to use banking resources for development. So it was most unusual.

MH: Ron was the only one of the four of us who had banking credentials, the other three did not. Ron had moved from IBM, where he was selling into the banking system, to being a president of a bank at an early age, and he had sales skills.

RG: None of us had formal business training or banking training. We had all come out of different kinds of liberal arts education and had a variety of relevant experiences.

MC: At the beginning, amid all the things you were trying to achieve, what was the most important innovation? What provided the initial lynchpin for success?

RG: Right from beginning we knew the organization had to be self-sustaining and organized for profit - it's possible this was the first deliberately for-profit social business, as all the previous attempts to raise capital said that the primary focus of the investment is to achieve development outcomes, not maximize the return on capital. There was a very strong orientation that had to be for-profit and self-sustaining.

MC: At this point what was the greatest hurdle that you faced?

MH: The bank that was acquired was very well run, but its market had flipped from 100% white to 70% African-American in the previous eight to ten years. The new customers of the bank were quite a lot lower-income than the departing residents of the neighborhood, so we inherited a bank with a retail deposit business. We opened up access to the bank by changing hours and lowering minimums, which meant we had a high-volume deposit business that was hard to manage because it wasn't very profitable. Figuring out the right model for a retail deposit business was one of our very biggest hurdles. We used an enormous amount of trial and error to find the market niches on the lending side that would help to rebuild the neighborhood; they had to be flexible enough that when it turned out the niches were different than we had imagined, we could just move with the market.

MC: What do you think is your most important achievement?

RG: That we've helped create the idea that the democratization of credit is a legitimate and sustainable objective, and that we've been able to demonstrate to the managers of debt capital that loans made correctly and soundly to low-income people, whether on south side of Chicago or in a village in Bangladesh or anywhere in between, can be solid business with profitable results and can accelerate the rate of development.

> *"We've been able to demonstrate to the managers of debt capital that loans made correctly and soundly to low-income people...can be solid business."*
>
> *RON GRZYWINSKI, SHOREBANK*

MC: If you were starting out now, where would you begin?

MH: We'd be smarter, faster, better, but would try to do the same thing: build an institution that tries to stand in between the for-profit and the social sector. There's still so much misunderstanding of the grey area between profit maximization and philanthropy. We should get better at identifying valid choices for resources - not valuing them as good or bad or right or wrong - but innovating in the use of resources for the benefit of community and environmental investment.

RG: Adding a specific: there is this sense that there are philanthropic dollars and profit-maximizing dollars. There's not a clear, universally accepted norm or standard about what the return on capital ought to be if it's achieving high social outputs. It's our judgment in ShoreBank that there's a consistent predictable low double digits return on equity, with liquidity, within strong mission performance. We need to get clearer on what the financial return expectations ought to be for privately capitalized business with social performance standards.

MC: What is the next challenge, beyond what's being done now?

RG: I think there's a massive opportunity to use modern internet techniques to organize people and their money together, so that people who accumulate savings, whether they are in primarily wealthy nations or not, can feel confident that they're not sacrificing very much in terms of financial returns for themselves and yet know their savings are being used to achieve social objectives - and in the process can have influence on what those social objectives are. If we could do that it, it could be a massive movement. ♦♦♦

2007 Microfinance Information eXchange Global 100: Rankings of Microfinance Institutions

Published by Microfinance Information eXchange, December 2007, 32 pages, available at: http://www.themix.org/publication_detail.aspx?publicationID=203

Microfinance Information eXchange (MIX) recently surveyed a global sample of 820 microfinance institutions (MFIs) that had a combined loan portfolio of USD 24 billion with over 53 million borrowers and 64 million savers. In addition to ranking MFIs along single categories (outreach, scale, profitability, efficiency, productivity and portfolio quality), the 2007 edition of the report also utilizes new composite rankings to highlight the 100 top-performing MFIs that have achieved high outreach and low transaction costs, while maintaining transparency and boosting profitability. The report concludes that leading MFIs broke performance records on all fronts.

The composite rank is an average of percentile ranks for profitable MFIs in each of three areas: transparency, outreach and efficiency. Of 820 MFIs surveyed, 607 met the requisite of profitability, which was considered a necessary and primary condition for a well-rounded MFI. These MFIs had at least 90 percent cost recovery in 2006 and 100 percent during at least one of the three most recent years of operation.

Transparency was the area that most clearly distinguished top-scoring MFIs from the rest. The top 100 were those that maintained at least three years of standard performance results on MIX Market, the most comprehensive public database of MFIs, with at least the last two years verified by audited financial statements. Outreach made the second most important impact on MFI placement in the composite rankings, with the top 100 ranking, on average, in the 72nd percentile. The efficiency ranking measures costs incurred by clients, which are influenced by transaction costs, loan loss and MFI profits. On average, the top 100 MFIs ranked in the 57th percentile, at about five percent of average loan portfolio, half of global margins. Only two MFIs scored above the 80th percentile on this measure.

A geographical analysis of the MIX Global 100: Composite reveals that MFIs from all regions secured spots on the list. Latin America had the most countries (Bolivia, Colombia, Ecuador and Peru) with top-ranked institutions: each with more than five MFIs in the top 100. However 17 Latin American MFIs claimed second-tier spots, ranking between 50 and 100.

Relative to its size in the survey (five percent of surveyed institutions), MFIs from the Middle East/North Africa, took more top spots than any other region. Moroccan MFIs significantly boosted the region's overall performance, claiming five spots in the top 100 and two spots in the top three.

India led the rankings with fourteen MFIs in the top 100, more than double the number held by any other country, with exceptionally high scores in the areas of outreach and efficiency. More specifically, ten of the 14 top-ranked MFIs served more than 100,000 borrowers. Also, relatively low personnel costs and high productivity were achieved through group-based approaches, along with low transaction costs (less than 3 percent of GNI per capita) and small profit margins (averaging 1.9 percent net income relative to loan portfolios).

A second type of ranking methodology, category rankings, provides insights into and reveals commonalities among top-performing MFIs. No MFI achieved top ranks in all areas of performance. Results are summarized below by category.

Each of the top 100 MFIs by outreach reached more than 67,000 clients, with two-thirds of them reaching more than 100,000. The top 10 MFIs, led by banks in Eastern Europe/Central Asia and Latin America, served over 50 percent of total borrowers and 80 percent of total savers. The leading 25 nearly doubled their client base within a year, averaging growth rates of 75 percent. In addition, MFIs in the top 100, on average, mobilized deposits for clients equivalent to 80 percent of their borrower base.

The top 100 MFIs by scale claimed almost USD 20 billion, or 80 percent of the global portfolio. Banks in Eastern Europe/Central Asia had the largest portfolios. The report notes that the Global 100 are small-balance lenders, addressing the common criticism that large loan sizes tend to skew measures of outreach and scale.

MFIs in Eastern Europe/Central Asia and Latin America/Caribbean took top spots for profitability, boasting high yields in shallow markets with few financial services providers. However, all of the top 100 earned nine percent or more on average assets.

The top 10 MFIs in efficiency were able to significantly reduce the cost of service to their borrowers, paying an average of 3.7 percent of local per capita income, compared to the top 100 and the top 500, which averaged 8.7 percent and 15.1 percent, respectively. These leading MFIs also minimized client cost by maintaining low profit margins, averaging net profits of three percent of average loan portfolio. Group-lending methodologies seemed to be most effective in minimizing personnel costs, the largest component of MFI transaction costs.

In terms of productivity, all top 100 MFIs served more than 230 borrowers per staff, more than doubling the 2006 benchmark of 112. Again, the use of large groups seemed to maximize staff capacity. However, the report acknowledges a trade-off between high staff productivity and default risk.

Portfolio at risk (PAR) over 30 days averaged just over two percent and all MFIs in the top 100 maintained zero or near zero delinquency in portfolios. NGOs dominated the top spots in this category, with 57 MFIs claiming zero arrears over 30 days in their portfolios.

For those interested in replicating these rankings, an Excel-based tool can be downloaded at http://www.themix.org/publications.aspx?level1=001-IND.

The MIX notes that the rankings are not intended to be used as buy list, nor as a rating of the MFIs.

Accelerating Rural Financing Process by Banks in India: Need for Creating Enabling Environment

By Dr. Amrit Patel and Dr. Gopal Kalkoti, November 2007, 9 pages, available at: http://www.microfinancegateway.org/content/article/detail/39605/

The authors identify two major factors affecting the success of Rural Finance Institutions (RFIs) in India: 1) the lack of efficient, low-cost operational solutions and 2) India's overall weak agricultural infrastructure.

Cost-effective banking solutions include increased availability of ATMs as well as mobile phone and internet banking options. Development and experimentation with alternative financial products such as insurance, flexible savings, leasing products and overdraft lines are also potential means of improving RFI efficiency.

Currently, about sixty-five percent of India's population lives in rural areas and depends on agriculture for their livelihoods. The average farmer may earn only up to USD 76 per month after successful yields. Less than a third of farm holds are wholly irrigated, and poor transportation infrastructure and the threat of pests, floods and other natural disasters are a huge obstacle for rural investment.

In order to create an "enabling environment" for the development and success of rural microfinance institutions, the Indian government is urged to invest in infrastructure reforms. These reforms include full development of irrigation systems, soil conservation, improved drainage systems, flood-control measures and improved transportation infrastructure in the form of all-weather roads. Improved productivity can also be achieved through research in biotechnology and the establishment of quality standards for seeds, fertilizers and pesticides. With public investment and thus significant strengthening of agricultural infrastructure, private sector investments will increase, and RFIs can achieve sustainability.

The authors also express that there is currently too much pressure for agricultural development on the land. The current rural infrastructure cannot support the number of farmers; thus there is an urgent need to reduce the number of farmers by thirty percent in the next five years and to create new self-employment opportunities in other economic sectors such as handicraft, silk, tea, coffee and rubber.

The authors cite an immediate need for the Indian government to facilitate the development and expansion of rural microfinance institutions to service the growing demand for rural financial products.

Microfinance: Cracking the Capital Markets II

By Rekha Reddy, published by ACCION International as InSight #22, May 2007, 16 pages, available at: http://publications.accion.org/insight/InSight_22_224.asp

This paper reviews the 2007 conference hosted by ACCION International and sponsored by Credit Suisse. ACCION is a private, non-profit microfinance organization founded in 1961 that specializes in global micro-enterprise loans, business training and other financial services. Cracking the Capital Markets III is to be held in March 2008.

Attended by fund managers, emerging markets specialists and intermediaries, the conference focused on microfinance investment growth, innovations in structured deals and ways in which microfinance institutions (MFIs) need to develop to better integrate into capital markets.

Reviewing the state of microfinance investment, the paper highlighted increased demand, as the largest 100 MFIs grew their client base by 26 percent per year. However, some investors remarked that the level of investment flooding into microfinance is more than MFIs can absorb. In particular, Jean Philippe de Schrevel of BlueOrchard Microfinance Investment Managers stated he would be unable to place USD 100 million in debt due to the lack of ready MFIs.

Furthermore, some private investors felt that International Financial Institutions (IFIs) were crowding out private investors for deals with top MFIs, rather than making riskier investments to advance the sector. IFIs are typically private sector arms of public finance institutions. However, discussions regarding crowding-out were inconclusive, as the line between IFI and private investments is often blurred.

The paper also noted that savings from local depositors would likely be the largest source of capital. For the 100 largest MFIs according to the Microfinance Information eXchange's MIX Market, savings was the top source of capital at 41 percent of all assets in 2005, whereas foreign capital provided 22 percent of funding. Yet, foreign capital investment did rise to USD 4 billion in 2006 from USD 1.6 billion in 2004, according to the Consultative Group to Assist the Poor (CGAP). Foreign capital is invested primarily from two sources, IFIs and private microfinance funds known as microfinance investment vehicles (MVIs).

Following this overview, the paper detailed recent innovative structured-finance deals, which applied techniques commonly used in emerging markets. In particular, the paper summarized BlueOrchard's 2006 collateralized debt obligation (BOLD-2006-1), which raised USD 99.1 million and brought mainstream investors, such as insurance companies and pension funds, into microfinance. Another deal was the creation of Global Commercial Microfinance Consortium mezzanine fund, which raised USD 80.6 million and allowed IFIs to take riskier positions, thereby encouraging private sector investment. Finally, the portfolio securitization of Bangladesh-based NGO BRAC raised USD 180 million, diversifying its funding sources, reducing the assets held on its balance sheet and saving the MFI 200 basis points over comparable bank funding.

With these new deals, investors must also identify and manage their risks. A panel discussion identified six types of risks particular to microfinance and how to mitigate them. Risks were broken down into two categories, "controllable" and "uncontrollable." Controllable risks included financial, operational and market risks. Uncontrollable risks were regulatory, political and foreign exchange risk. A study by two New York University professors also suggested that microfinance risks are countercyclical and can thus reduce portfolio volatility. As microfinance appears less correlated with macroeconomic indicators and other emerging asset classes, it could be an attractive diversification tool.

While recent structured deals in microfinance have been limited to larger, more-sophisticated MFIs, the paper also stressed the importance of financing smaller, newer MFIs which are often perceived as overly risky for investment. To increase the number of MFIs that can receive commercial investment, conference participants recommended providing management training, using support from IFIs, using local presence, targeting funds for new MFIs, accelerating start-up operations and connecting microfinance initiatives with health or environmental efforts.

Clearly, significant challenges still need to be overcome to build a mature microfinance market. In particular, mainstream investors will require frequent pricing information on investments, liquidity and ease of access to information such as ratings. While microfinance has become a household name, investors will need to find ways to manage risk and address the above challenges to truly crack the capital markets.

Foreign Exchange Rate Risk in Microfinance: What Is It And How Can It Be Managed?

By Scott Featherston, Elizabeth Littlefield and Patricia Mwangi, published by Consultative Group to Assist the Poor as Focus Note 31, January 2006, 16 pages, available at http://www.cgap.org/docs/FocusNote_31.pdf

Because most microfinance institutions operate in developing countries where the risk of currency depreciation is high and debt restructuring occurs periodically, they are particularly vulnerable to foreign exchange rate risk. A recent Consultative Group to Assist the Poor (CGAP) survey not only revealed that 50 percent of MFIs have no protection mechanisms in place, but also indicated a general lack of understanding of both foreign exchange risk and the extent to which MFIs are exposed. This paper seeks to raise awareness of the issue of foreign exchange rate risk within the microfinance sector in three ways: by providing a brief overview of the different components of risk, by looking at current techniques employed by microfinance institutions (MFIs) and investors to manage these risks and, finally, by making recommendations on mitigating or avoiding exposure to exchange risk.

The three components of foreign exchange rate risk are: devaluation or depreciation risk, convertibility risk and transfer risk. The first arises in microfinance when an MFI acquires debt in a foreign currency (usually USD or EUR) and then on-lends in a domestic currency (DC). Because the MFI then has a liability in a hard currency and assets in DC, resulting in a "currency mismatch," fluctuations in the relative values of the two currencies may threaten the financial viability of the institution. The second component of foreign exchange rate risk is convertibility risk, which refers to the risk that the national government will not sell foreign currency to those with hard currency debt. Finally, transfer risk is the risk that the national government will not allow foreign currency to leave the country, regardless of its source. In both of the latter cases, while the MFI has the capacity to make hard-currency payments, it is unable to do so due to restrictions imposed by its government.

There are several options for organizations exposed to foreign exchange rate risk. One option is to "hedge" against their exposure by using a number of conventional hedging instruments. One of these is a "forward contract," an agreement to exchange or sell foreign currency at a certain price in the future. Another is a "swap," an agreement to simultaneously exchange or sell an amount of foreign currency now and resell or repurchase that currency in the future. Lastly, "options" are hedging instruments that provide the option to buy or sell a foreign currency in the future once the value of that currency reaches a previously agreed price. While all of these conventional hedging methods usually protect MFIs against all three components of foreign exchange rate risk, they are often not easy to obtain in the shallow financial markets in which many MFIs operate.

Because hedging is not without challenges, both in terms of cost and availability of instruments, organizations may choose to only partially hedge against their exposure to foreign exchange rate risk. Back-to-back lending is the method most commonly used to hedge against devaluation or depreciation risk, but it often fails to protect the MFI from convertibility and transfer risks. Under this hedging option, the MFI takes out a foreign currency loan and deposits it in a domestic bank. This foreign currency deposit provides the collateral for the MFI to take out a DC loan from the local bank to fund its loan portfolio, and is released upon repayment of the DC loan. A similar option is the letters-of-credit method, in which the domestic bank uses a letter of credit from an international commercial bank, instead of a foreign currency deposit, to extend a DC loan to the MFI.

In yet another hedging method, the MFI converts a hard currency loan into local currency to build its loan portfolio. Throughout the lifetime of the loan, in addition to regular interest payments, the MFI also deposits pre-determined amounts of hard currency into a "currency devaluation account." At loan maturity, this account compensates for any shortfall after the principal has been repaid according to the original exchange rate. However, if there is not enough in this account, the lender suffers that loss. Under this arrangement, risk is shared between the MFI and the lender. On the other hand, regular interest payments and deposits may become a financial burden if the DC depreciates, and the MFI may still be exposed to convertibility and transfer risks if the currency devaluation account is held domestically.

One strategy, of course, is to do nothing and accept the consequences, although this is not recommended for substantial exposures. Another is to limit exposure to foreign currency liabilities. However, limiting exposure to risk also obscures the advantages of hard currency loans. Finally, MFIs can pass on foreign currency risk to their clients in the form of higher interest rates, such that the MFI bears no devaluation or depreciation risk. However, this method has been shown to increase client default rates in the case of DC depreciation and still does not protect the MFI from the other two components of foreign exchange rate risk.

The paper concludes with general recommendations for different players in the microfinance sector. First and foremost, MFIs should give priority to domestic sources of funding or foreign funding in local currency. If a foreign currency debt is obtained, MFIs should analyze and adopt suitable hedging instruments or methods to mitigate risk. CGAP also advises that MFIs seek training or legal counsel to enable them to negotiate favorable terms with foreign and domestic lenders. Managing bodies of MFIs also need to establish and evaluate appropriate risk parameters and policies. The paper suggests that, because investors are typically more financially sophisticated than their borrowing MFIs, they should shoulder the responsibility of ensuring that their borrowers understand and have recourses for managing the risks that they are taking on. Finally, it is suggested that the microfinance sector as a whole should work to promote the development of local capital markets in order to increase MFIs' access to local currency funding. In addition, by including foreign exchange risk in ratings of MFIs, rating agencies can encourage both MFIs and investors to educate themselves on the issue.

Microinsurance in Focus - Note Number 1: "Marketing: Promoting Insurance to the Poor"

Published by Consultative Group to Assist the Poor (based on portions of Protecting the Poor: A Microinsurance Compendium), October 2007, 2 pages, available at http://www.microfinancegateway.org/content/article/detail/46501

In this first of twelve microinsurance focus notes, Consultative Group to Assist the Poor (CGAP) provides tips on how to market insurance to low-income populations. Because this market segment is particularly disinclined to purchase insurance for several reasons, including lack of insurance education, limited resources, intangible benefits, short-term perspectives and trust issues, social marketing techniques coupled with financial education are often necessary to successfully sell microinsurance.

Four main messages are used by microinsurance providers to promote their products. The first is protection, the core benefit of insurance; this message is often communicated through personal testimony. The second is solidarity, which builds on informal self-help mechanisms that are familiar to many in the market segment. This message is important in explaining the risk-pooling aspect of insurance. Another is the "positive spin" message, which highlights the security provided by insurance, rather than the risks that clients would otherwise face. Finally, a fourth message is trust, which insurance providers achieve through branding or partnering with trusted organizations. Above all, the paper recommends that the best way to establish rapport is to pay claims.

In converting sales, raising awareness is the first step: both awareness about insurance in general and about specific insurance providers. However, the question of who is better-suited to take on the role of providing quality financial education to the public - individual insurers or government/insurance associations - still remains unanswered. The second step in converting promotions into sales is education on specific products, which must be tailored to different target audiences by taking into consideration cultural nuances. The last step, activating clients, may involve techniques such as limited enrollment campaigns or prize drawings.

The paper concludes that marketing can make or break an insurance scheme, so it must be approached holistically and strategically. After-sales service is crucial in microinsurance marketing activities, and this is best achieved by facilitating claims submissions and paying claims in a timely manner.

Microinsurance in Focus - Note Number 2: "Product Design and Insurance Risk Management"

Published by Consultative Group to Assist the Poor (based on portions of Protecting the Poor: A Microinsurance Compendium), October 2007, 2 pages, available at: http://www.microfinancegateway.org/content/article/detail/46504

This microfinance focus note focuses on ensuring the viability and sustainability of the insurance product. In order to design a product that strikes a balance between broad inclusion, value, affordability and sustainability, microinsurance providers must start with four basic steps: define the target group, assess insurable risks, determine key product features and establish payment capabilities among the target population.

The paper compares various types of insurance products: group and individual, mandatory and voluntary. Group insurance targets those who are members of existing groups and tends to be cheaper to administer. On the other hand, individual insurance may be better-suited for a scattered market or products that cannot be offered through a group approach. Mandatory insurance with voluntary options for individual coverage upgrades is highlighted as a successful combination that can provide the affordability and sustainability of mandatory insurance while presenting the flexibility in choice of voluntary insurance.

In terms of payment options, the paper highlights short-term insurance policies with renewable terms as the best compromise for policyholders to have continued coverage and for insurers to be able to adjust pricing as needed. Because the low-income market tends to have unpredictable cash flows, payment deadlines should be timed to correspond with periods, such as harvest seasons, when households are more likely to have surplus income.

Product benefits should be kept as simple as possible, such that they can be easily explained in a few minutes. Clients should also have ready access to these benefits through an easy claims submission process. Distribution of benefits, whether in cash or in kind, should depend on the type of insurance. On the other hand, long-term clients who have not claimed any benefits should also be offered extra benefits, such as savings features and premium refunds.

The paper recommends that insurers avoid elective participation, diverse target populations and numerous product choices, all of which increase adverse selection and necessitate more controls. However, some claims controls are crucial in maintaining the viability of microinsurance schemes. Effective ones, especially when used in combination, include: deductibles, which reduce administrative cost; coinsurance, in which the insured assumes partial liability; benefit ceilings, which curb insurer cost; and waiting periods, which help insurers better assess high-risk clients while providing immediate benefits.

Benchmarking African Microfinance 2006

By Anne-Lucie Lafourcade, published by the Microfinance Information Exchange, November 2007, 12 pages, available at http://www.themix.org/publication_detail.aspx?publicationID=198

This study, covering 119 microfinance institutions from 24 African countries, indicates that growth was inconsistent in 2006, with some regions experiencing dramatic growth while others experienced decline. Kenya experienced the highest growth in average loan portfolio with an increase of 50 percent. MFIs in Southern Africa experienced a 59 percent growth in average loan portfolio due to an increase in loan sizes and expansion of services in urban areas. Benin experienced the steepest decline, with a loss of 30,000 loan clients in twelve months.

The data for 2006 show a high demand for deposit and savings services, with savings services doubling in the period, as opposed to credit services which increased by one third. For MFIs offering both credit and savings deposit services, client savings covered 90 percent of loans. On average these MFIs were able to leverage their capital four times over. NGOs, which do not accept client deposits, were the most dependent on donor funds.

Currently, the African microfinance sector is mostly controlled by a handful of large institutions, with sixteen MFIs having a total of over 50,000 loan clients each. The larger institutions were more profitable and displayed the lowest financial and operating expenses. Institutions with loan portfolios of USD 8 million and higher were able to serve clients for as little as USD 0.23 for each USD lent.

Due to weak infrastructure and high labor costs, only one third of the surveyed MFIs were self sufficient, with an average loss of 2.4 percent of assets. The wages to employ and retain skilled personnel were an average of twelve times the GNI per capita, which was more than twice as high as any other region in the world. In Southern Africa, personnel and administration expenditures accounted for 35 percent of assets, with the average MFI spending over USD 0.72 for every USD outstanding.

MFIs targeting the poorest clientele were the least profitable due to a very high cost structure and failure to adjust interest rates to a cost-recovery level. Cooperatives remained plagued by low yields due to regulated interest ceilings. Larger loans improved efficiency and increased profitability of African MFIs in 2006, while MFIs that lowered their loan sizes experienced a decline in efficiency and profitability. MFIs that targeted small businesses and higher-end clients were more than able to recover their costs with an average financial self-sufficiency (FSS) rate of 104 percent. Loans of less than USD 200 had operational expenses of over 50 percent, while larger loans of at least USD 3000 had operational expenses of less than 20 percent. Offering sustainable financial services to the poorest clientele remains a big obstacle in the region.

Another challenge faced by the African microfinance sector is improving portfolio quality. African MFIs struggled to recover past-due loans, with 22 percent of the sampled MFIs having 10 percent or greater portfolio at risk (PAR) over 30 days. Weak credit culture, inadequate product design, ineffective recovery methods and tough economic conditions are important factors contributing to declining portfolio quality. The African microfinance sector is divided between large, sustainable, efficient institutions and inefficient MFIs that have yet to achieve scale. As the MFI sector continues to grow in Africa, one of the major obstacles to overcome in achieving profitability is cost efficiency, especially in reaching poorer and more-remote clients. Overall, the African region is showing increased availability of sustainable financial services, with a growing number of institutions achieving scale and profitability.

MICROCAPITAL MARKET INDICATORS I EASTERN EUROPE AND CENTRAL ASIA

21 COUNTRIES I 178 MFIs REPORTING[1]

Albania	Bosnia and Herzegovina (BH)	Georgia	Kyrgyzstan	Mongolia	Russia	Turkey
Armenia	Bulgaria	Kazakhstan	Macedonia	Poland	Serbia and Montenegro (SM)	Ukraine
Azerbaijan	Croatia	Kosovo	Moldova	Romania	Tajikistan	Uzbekistan

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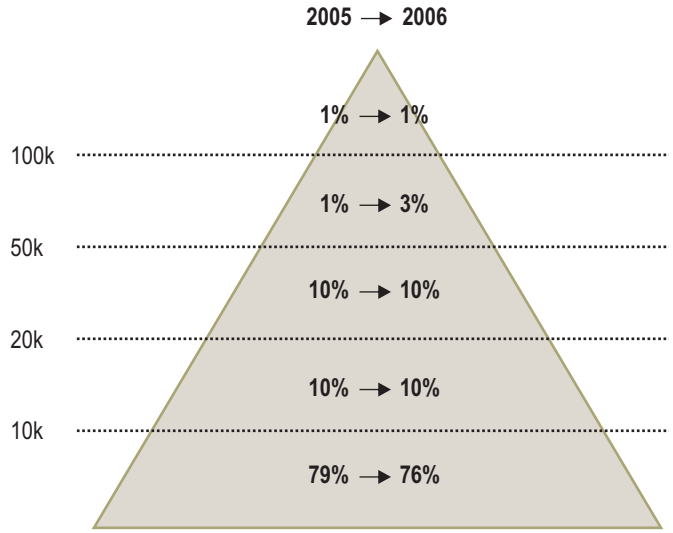
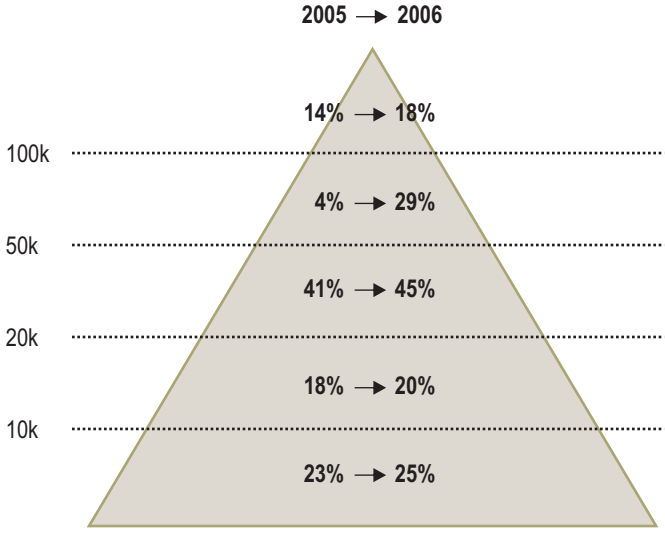
TOP 10 MICROFINANCE INSTITUTIONS (MFIS) BY GROWTH IN GROSS LOAN PORTFOLIO: CHANGE IN USD

MFI NAME	COUNTRY	ABSOLUTE	% CHANGE	2005	2006
KMB Bank	Russia	304,204,368	67.8	448,728,704	752,933,072
ProCredit Bank Serbia - formerly MFB	SM	181,806,922	83.3	218,222,640	400,029,562
ProCredit Bank Ukraine - formerly Microfinance Bank	Ukraine	126,359,992	73.3	172,447,008	298,807,000
ProCredit Bank Romania - formerly Miro Bank	Romania	102,128,799	97.3	105,006,720	207,135,519
Khan Bank (Agricultural Bank of Mongolia LLP)	Mongolia	93,361,884	87.4	106,843,856	200,205,740
ProCredit Bank Kosovo - formerly MEB	Kosovo	88,566,952	44.3	199,866,752	288,433,704
ProCredit Bank Bosnia and Herzegovina	BH	60,138,936	63.6	94,489,160	154,628,096
ProCredit Bank Bulgaria	Bulgaria	57,328,227	21.8	262,848,192	320,176,419
ProCredit Bank Georgia - formerly MBG	Georgia	49,607,352	36.9	134,368,720	183,976,072
Opportunity Bank A.D. Podgorica	SM	47,015,582	121.9	38,568,396	85,583,978

PERCENT OF MFIs IN MARKET BY SIZE (NUMBER OF ACTIVE BORROWERS)



MARKET SHARE BY MFI SIZE



(1) Denotes only MFIs that report data for 2005 and 2006 to MicroBanking Bulletin (MBB) or MIX Market.
Source: Microfinance Information eXchange, Inc., December 2007, based on MFIs reporting to MBB or MIX Market

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