MicroCapital Monitor
THE MICROFINANCE NEWSPAPER

FREE PREVIEW EDITION*

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MICROCAPITAL BRIEFS | TOP STORIES

South Africa's Blue Reports Big Loss, Loses License in Rwanda

Blue Financial Services, a South African microfinance institution with operations in 14 African countries and total assets equivalent to USD 343 million, has reportedly lost its operating license in Rwanda after announcing it expects a company-wide loss of up to USD 194 million for the year that ended in February. According to a media report, the license suspension was due to allegations of fraud, but Blue counters that it came to an agreement with the central bank to suspend operations due to a capitalization shortfall. June 16. 2010

Gates, USAID Offer $15m for Mobile Money Services in Haiti

The US-based Bill and Melinda Gates Foundation and the US Agency for International Development (AID) have announced a USD 15 million fund to encourage companies to initiate mobile financial services in Haiti. Two companies will be eligible to receive a total of USD 4 million for launching services within the next six to 12 months. USD 6 million will be awarded as incentives for the completion of the first 5 million transactions. The remainder will be disbursed for technical assistance and direct employment programs. June 11. 2010

India's Kerala State Defends NBFC Rate Cap in Court

Instigating multiple court challenges, Kerala and Andhra Pradesh, two states in southern India, have mandated that non-banking financial companies (NBFCs) and microfinance institutions (MFIs) register under local moneylending laws, which limit the interest rates they may charge. The High Court in Andhra Pradesh has exempted MFIs from the requirement, and NBFC Shriram Transport Finance Company is now challenging the mandate in the Kerala court system. The maximum rate in Andhra Pradesh has not been specified, but Kerala's regulation states that a moneylender is not permitted to charge more than 2 percent per year over the applicable Reserve Bank of India interest rate. June 7. 2010

EFSE Pledges $1b to Small Businesses in Southeast Europe

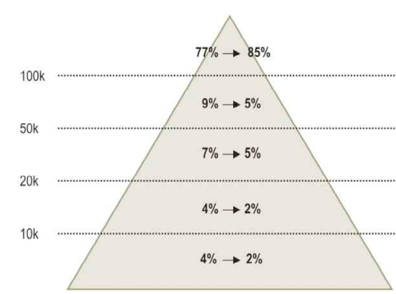
In advance of its annual meeting this month, the European Fund for Southeast Europe, a microfinance investment fund, pledged the euro-equivalent of USD 1 billion to finance housing improvement loans to low-income households and long-term loans to micro- and small enterprises. The fund reports an outstanding investment portfolio of USD 775 million. May 31. 2010

China Development Bank Loans $51m to Kenya's Equity Bank

The state-owned China Development Bank (CDB) has agreed to loan the local-currency equivalent of USD 50.9 million to Equity Bank, a commercial microfinance institution in Kenya with assets of USD 987 million, from a USD 5 billion fund... *(Continued in the subscriber edition)*

MicroCapital

EAST ASIA AND PACIFIC
MFI MARKET SHARE TRENDING 2006 TO 2008
BY MFI SIZE (NUMBER OF ACTIVE BORROWERS)



MARKET INDICATORS*

EDITORIAL

Field Notes: Toaster Loans in Chile

Microfinance has existed in Chile since before I got involved there in 1990, yet Chile is not well known for its microfinance sector. Developed primarily by public and private banks since that time, the microfinance sector has delivered a broad range of products and services to 300,000 microentrepreneurs out of the 1.4 million informal sector workers in the country. Most of those served work with banks, which generally cover the middle and upper range of the market with average loan sizes over the equivalent of USD 1500. Microlenders that reach the lower end of the market, such as co-ops, NGOs and foundations, cover only about 50,000 clients, or 17 percent of the microfinance market, according to the local microfinance network.

This is a mere drop in the bucket compared to the penetration of retail credit cards into the low-income market. In 2008, Chile's population of 17 million held about 20 million credit cards, 15 million of which were active. Lower-end retailers understand the limited stability of their target segment and often don't require information about a client's job or salary, making these especially accessible to low-end customers that may have a hard time accessing a bank loan, even with a niche "microfinance" bank. Last week I sat down with 12 clients of a small microfinance institution (MFI), who earn between USD 300 and USD 600 per month, and most held one or more of these cards.

According to the central bank, consumer debt in Chilean households grew from 14 percent of income in 2001 to 37 percent in mid-2009. Retail stores such as supermarkets and department stores hold 47 percent of the consumer debt market in the country. One might argue that the retailers have played an important role in providing access to credit where banks and NGOs have not been able to - but at what price? Interest rates on retail credit cards are at least double MFI or bank rates, totaling over 50 percent per year. Buying a USD 20 toaster on a credit card could cost you USD 60 with a retail credit card (including monthly fees, interest and principal). For a larger loan, say USD 5,000, retailers may offer you 36 monthly installments to allay the pain of paying almost USD 7,000 in interest instead of USD 2,500 at a bank.

Many, including myself, would argue that there is a positive social value in facilitating access for someone of limited resources to buy a toaster. Who doesn't love toast? However, now that Chilean families are spending 57 percent of their income paying off loans, we should stop and consider that an oversupply of lending, increased risk tolerance to gain market share and high retail interest rates may have favored the retail market at the expense of investment in the productive activities of microentrepreneurs.

About the Author: Ms Barbara Magnoni is President of EA Consultants, a development consulting firm based in New York. She has 15 years of international finance and development experience and has worked with organizations including Goldman Sachs, Chase and BBVA and has advised institutions such as the International Finance Corporation, the US Agency for International Development and the International Labour Organization. She may be reached at +1 212 734 6461 or bmagnoni@eac-global.com.

PAPER WRAP-UPS

Microfinance Foreign Exchange Facilities: Performance and Prospects

By David Apgar and Xavier Reille, published by CGAP (Consultative Group to Assist the Poor), April 2010, 12 pages, available at: http://www.cgap.org/p/site/c/template.rc/1.9.43712/

This paper reviews methods microfinance institutions (MFIs) and microfinance investment vehicles (MIVs) use to manage foreign exchange risk. It considers the nascent microfinance hedging market by detailing the operations of The Currency Exchange Fund (TCX), Cygma Corp and MFX Solutions LLC. It concludes by examining the importance of local-currency markets and further development of the microfinance hedging market.

Foreign exchange risk, a key issue to the development of microfinance, is most significant when an MFI operating in an illiquid domestic currency accepts a hard-currency loan. Fluctuating exchange rates through the term of the debt may adversely affect the MFI, though some MFIs pass this risk on to borrowers, meaning that even successful borrowers may be unable to pay back a loan. While large organizations operating in relatively liquid currencies can execute swaps and forwards, many MFIs are either too small or operating in markets where those instruments are not readily available. In a currency forward, two parties agree to exchange future payments in different currencies at an exchange rate that reflects expected future interest rates associated with the two currencies. A swap occurs when two parties exchange equal-value loans in two different currencies with interest rates reflecting anticipated currency movement and institutional credit quality. These tools allow an institution to replace uncertain currency movement with a locked-in exchange rate.

TCX, a microfinance-only currency hedging fund created in 2007, addresses this problem by offering swaps and forwards to institutional investors in emerging market currencies. TCX has raised USD 590 million, including roughly USD 89 million from the Dutch government, as of April 2010. TCX plans to hedge three to six times the total amount invested and requires a minimum investment of USD 5 million. TCX was designed to manage only emerging market foreign exchange and interest rate risk, accepting no default risk. As a result, use of TCX is limited to institutional investors, a requirement effectively disqualifying MFIs from direct contact.

MFX offers non-deliverable swaps and forwards to MIVs and MFIs that cannot deal directly with hedging organizations such as...
(Continued in the subscriber edition)

The Potential for Scale and Sustainability in Weather Index Insurance for Agriculture and Rural Livelihoods

By P Hazell, J Anderson, N Balzer, A Hastrup Clemmensen, U Hess and F Rispoli, published by the International Fund for Agricultural Development and the World Food Program, May 2010, 153 pages, available at: http://www.ifad.org/ruralfinance/pub/weather.pdf

This paper provides an introduction to agricultural risk and the use of weather index funds to mitigate that risk. Participants in a weather index fund receive financial compensation if an index highly correlated with local crop yields follows an undisclosed pattern. This pattern is kept secret to reduce the risk of moral hazard.

Weather index insurance is designed to handle highly covariate but infrequent risks. Covariate risks affect an entire community at the same time, such as a flood or drought. An example of a non-covariate risk is the accidental death of a head of household. Many communities have developed informal methods to handle non-covariate risks, though catastrophic covariate events generally outstrip their abilities.

While individual farmers can purchase weather index insurance, the cost is often prohibitive. As a result, weather index funds...
(Continued in the subscriber edition)

PAPER WRAP-UPS

Savings Constraints and Microenterprise Development: Evidence from a Field Experiment in Kenya

By Pascaline Dupas and Jonathan Robinson, published by the National Bureau of Economic Research, March 2009, 48 pages, available at: http://ideas.repec.org/p/nbr/nberwo/14693.html

Ms Dupas and Mr Robinson conducted a field experiment to examine whether savings constraints prevent the self-employed from increasing the size of their businesses. The authors opened interest-free savings accounts for a random selection of low-income earners in rural Kenya. Although the bank charged substantial withdrawal fees, take-up and usage was high among women. Furthermore, the savings accounts had substantial, positive impacts on their productive investment levels and expenditures. The results suggest that a significant proportion of daily income earners face important savings constraints and have a demand for formal saving devices.

The authors propose that there are strong theoretical and empirical foundations for the importance of savings. First, standard economic theory suggests that individuals should be able to save their way out of credit constraints, even though building up such savings takes longer than getting credit up-front. Furthermore, many individuals face significant savings constraints: theft, approbation by the spouse or other relatives and present-biased preferences (i.e. they are tempted to spend any cash they hold). These constraints are often so great that many individuals are willing to pay a premium to be able to save securely. Consistent with these observations, recent research suggests the existence of a significant demand for formal savings mechanisms and a substantial positive impact from the provision of these services. For example, a 2007 paper by Don Johnston and Jonathan Morduch indicates that approximately 90 percent of Bank Rakyat Indonesia clients save but do not borrow. A 2005 paper by Joseph Kaboski and Robert Townsend finds a significant impact of savings accounts on long-term asset growth in Thailand.

This paper examines the importance of savings constraints using a random selection of market vendors, bicycle taxi drivers, hawkers, barbers and artisans in Kenya. The savings accounts were interest-free and included substantial withdrawal fees, so the de facto interest rate on deposits was negative (even before accounting for inflation). The demand for such an account should be zero in the absence of savings constraints, and getting access to such an account should have no effect on users' investment and expenditure levels. To test this hypothesis, the authors examined a dataset collected from 185 self-reported, daily logbooks kept by individuals in both the treatment and the control group (i.e. those with and without access to a savings account).

The analysis produced three main findings:

1. Access to formal savings accounts had substantial positive impacts on business investment for women, but no effect for men. This suggests that women face significant, negative returns on the money they save informally.

2. Access to a savings account had a positive impact on the daily expenditure levels of women, which suggests that the higher investment levels led to higher income levels.

3. Accounts had some effect in making women less vulnerable to illness shocks. While women in the control group were forced to draw down working capital in response to health shocks, women with a savings account were less likely to reduce business investment levels and were better able to smooth labor supply during times of illness. They were also more likely to be able to afford medical expenses for more serious illnesses.

The authors present two possible explana-tions... *(Continued in the subscriber edition)*


MOBILE MONEY
SERVICES AFRICA
20th – 22th July 2010
Southern Sun Grayston Hotel, Johannesburg
www.iir-telecoms.com/mmsa