MicroCapital Monitor
THE MICROFINANCE NEWSPAPER

FREE PREVIEW EDITION*

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MICROCAPITAL BRIEFS | TOP STORIES

Andhra Pradesh to File Criminal Cases Against Coercive MFIs

The government of the Indian state of Andhra Pradesh recently announced that it will file criminal cases against any microfinance institution found to have used coercion to recover loans. Officials will also reportedly seek to have the license of such lenders revoked by the Reserve Bank of India. May 17. 2010

Ecuador's Interest Rate Cap Inflates Loan Sizes

Ecuador's central bank, Banco Central del Ecuador, recently further reduced the cap on annual interest rates to 30.5 percent from 33.9 percent for retail microlenders, and to 27.5 percent from 33.3 percent for all other lenders. According to Javier Vaca, executive director of Red Financiera Rural, an Ecuadorian network of organizations that promotes access to financial services, previous tightening of the rate cap has already led various unnamed microbanks to increase their average loan sizes to approximately USD 600 to USD 2,500, an increase of USD 400 to USD 1,000 per loan. May 17. 2010

Central Bank of Kenya Loosens Agency Banking Rules

The Central Bank of Kenya (CBK) passed a law allowing banks, deposit-taking microfinance institutions and mortgage finance companies to open "agency banks" in branch locations of third-party businesses. CBK Governor Njuguna Ndungu praised the opportunity for banks to "leverage additional cost-effective distribution channels." May 14. 2010

BMZ, KfW Launch $150m Fund for African MSMEs

The German Federal Ministry of Economic Cooperation and Development (BMZ) and German development bank KfW recently launched a regional investment fund for micro-, small and medium-sized enterprises in Sub-Saharan Africa. The fund, which has raised USD 150 million in commitments, will provide direct funding for 50 microfinance institutions, which are expected to lend in local currency to a total of 300,000 small businesses. Other investors include Spanish development agency AECID, the World Bank Group's International Finance Corporation and the European Investment Bank. May 11. 2010

responsAbility to Stop Issuing Global Microfinance Fund Shares

Effective May 26, the responsAbility Global Microfinance Fund, which reports total assets of USD 358 million, will temporarily stop accepting new investments. The move is attributed to high net investment inflows at a time of slowing demand from microfinance institutions for credit. The suspension, which has no stated duration, is aimed to reduce the fund's share of liquid assets from 30 percent to less than 10 percent. Secondarily, responsAbility stated that reducing liquidity will strengthen returns. May 10. 2010

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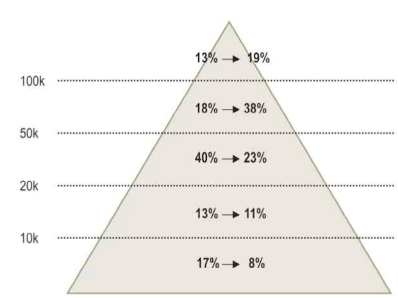
EUROPE AND CENTRAL ASIA
MFI MARKET SHARE TRENDING 2006 TO 2008
BY MFI SIZE (NUMBER OF ACTIVE BORROWERS)



MARKET INDICATORS*

SPECIAL REPORT

Microfinance Cracking the Capital Markets South Asia 2010

BlueOrchard Finance and Grameen Capital India have just been announced as "Supporting Sponsors" of Microfinance Cracking the Capital Markets South Asia 2010 (MCCM), a conference and investment marketplace that will take place in Delhi on June 23 and June 24. Four associated investment-readiness trainings for microfinance institutions (MFIs) have already been held, two in India and one each in Nepal and Sri Lanka. The conference organizers and lead sponsors are US-based nonprofit ACCION International, the Citi Foundation and Indian consultancy EDA Rural Systems.

"With the majority of speakers from the local capital markets, the MCCM program promises to delve into the challenging details of recent and future debt and equity investment in the South Asian microfinance sector," commented Bob Annibale, Citi's Global Head of Microfinance. "Panelists will examine factors that affect capital flows into the sector, particularly in India, such as MFI valuations, a changing risk profile and rapid growth."

The organizers note that USD 200 million in private equity has been invested in microfinance in India in the last 18 months. Equity discussions will not only explore several emerging exit and capital-raising strategies - aside from IPOs - but also methodologies for valuing Indian MFIs which have recently seen their valuations rise significantly.

Another panel will explore the opportunities and risks facing investors in microfinance, including the market's often single-product focus and significant dependence on bank funding.

Conference sessions also will review some of the innovative debt structures that have surfaced including bond issues, securitizations, syndications and non-convertible debentures, all of which are providing diversification of funding and access to new domestic and international funding sources. The need for - and impact of - these debt structures will be evaluated in light of government-mandated priority sector lending to MFIs by Indian banks, on which many MFIs are highly dependent.

Future investment strategies will be explored, taking into account that structured finance has begun to allow foreign debt capital into the Indian market. MFIs are strongly positioned to issue new debt instruments, more domestic investors are coming into the picture and there are signs of possible mergers within the sector. The conference's closing session will look specifically at which investors and promoters are building the pipeline for the future.

An investment marketplace will be held as part of the conference on June 24, allowing investors and MFIs to put words into action. For more details on both the conference and marketplace, please visit http://southasia.crackingthecapitalmarkets.com/.

This report is sponsored by the conference organizers.

EDITORIAL

Banking on Remittances

I have been attending the Inter-American Development Bank/Multi-lateral Investment Fund's Remittance Forum for the last three years, but this year's REMESAMERICAS 2010 was by far the most impressive, with over 300 participants. The recent passage of a controversial immigration law by the US state of Arizona made the selection of Mexico City as a host for the event especially relevant.

The remittance market is significantly different from the microfinance market. A representative of one Mexican microfinance institution (MFI) told me that only 30 percent of its clients receive remittances. In El Salvador, only 20 percent of FEDECACERES' clients receive remittances. However, the microfinance and remittance industries do have important characteristics in common: (1) they both serve low-income or vulnerable populations, generally outside of the formal labor force and formal banking system; (2) they provide access to liquidity for families that are often strapped for cash; and (3) there is significant discourse in both markets about how to turn liquidity into investment or savings.

Ambassador Carlos García de Alba of the Institute for Mexicans Abroad (IME) noted that 86 percent of remittances are used to cover household expenses. While such use of funds serves a clear need, the money could be leveraged further. The Mexican government's 3x1 program seeks to do just that, offering migrant communities a matched investment from federal, state and local authorities when migrants invest in infrastructure back home. Fonkoze's new website, Zafen.org, is beginning to channel diaspora investment to finance entrepreneurial and infrastructure loans that Fonkoze pre-approves. While these projects are admirable, they fail to scratch the surface of the potential volume for remittance-linked retail savings. In Latin America alone, remittances reached USD 58.8 billion in 2009.

Remittance operators have been innovating to compete in a fast-changing market, primarily by introducing new technologies to cut costs and by linking up with retail channels. Yet getting remittance senders and recipients "banked" remains a challenge. In EA Consultants' 2007 paper "Hand Up or Hand Out: Microfinance, Remittances and Entrepreneurship in Nicaragua," we found that microentrepreneurs receiving remittances were less likely to have a savings account or a loan than were those not receiving remittances. Mexico's BANSEFI, has developed a bank-to-bank transfer product, Directo a Mexico, that allows banked migrants to send money home for USD 0.60. Yet money transfers through BANSEFI's other channels are more frequently used despite their higher cost. In Bolivia, BancoSol's remittances are sold as part of a package of various services, including savings accounts. Payments for BancoSol's microinsurance products sent from abroad must be withdrawn from savings accounts.

Linking savings and remittances is difficult, and legal restrictions against marketing financial products from abroad makes this challenge even harder in many countries. However, if we want to see remittances leveraged in significant amounts, we need to encourage more appropriate and accessible financial products and services, coupled with financial education on both sides of the border.

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.

SPECIAL REPORT

Mitigating Risk in Volatile Times: microRISK Alliance Develops Tools to Help Microfinance Industry Understand and Manage Exposure

The economic shocks and currency swings of the past two years have changed the way the microfinance industry thinks about risk. Long-held concerns about the risks of cross-border debt financing in dollars and euros were realized as many microfinance institution (MFI) balance sheets were hit by currency fluctuations. Others had shifted this exposure on to their vulnerable end borrowers by lending in dollars or euros. At the same time, lack of portfolio awareness meant that some institutions and their investors were caught off guard when spikes in portfolio at risk (PAR) and defaults illustrated problems in their lending practice or stronger correlation with the broader economy than they had anticipated.

Cygma, MFX Solutions and TriLinc Global (formerly PAES) are all new ventures launched to address market gaps in risk management for MFIs. The Microenterprise Development office at the US Agency for International Development (USAID) identified them as important innovations and good candidates for support to broaden their impact and speed their time to market. The approach was to combine USAID's extensive experience building public-private alliances and promoting knowledge management with the innovation of new private enterprises to foster organic and systemic solutions addressing these industry challenges.

The result was the microRISK Alliance, a grant-supported effort that created analytical tools and a learning network that developed a resource for the industry. Together, the microRISK Alliance sought to identify and promote effective and replicable risk management practices for microfinance by articulating challenges faced by the industry; identifying best practices and guidelines; raising awareness of risk management issues; partnering with other industry actors; informing policy decisions; and promoting adoption of innovative tools and approaches.

The microRISK Alliance collaboratively developed learning products to share with the microfinance industry to improve practice and most importantly mitigate risk. Looking at the continuum of actors in the system, identifying best practices quickly became a focus for the group, with the result being a set of guiding principles for good risk management, case studies and analytical tools for MFIs and investors to better understand their risk exposure. These resources can be accessed at www.microlinks.org/mra:

- Principles of Risk Management in Microfinance: A comprehensive guide for actors in the microfinance industry

- Case Studies: Illustrative risk management examples

- Tools: Innovative tools that have been developed by the participating organizations to manage risk

The microRISK Alliance was a natural extension of USAID's support for MFI transition to private capital. Over the past 30 years, USAID has been the largest bilateral donor in microfinance, providing funding and leadership for some of the important innovations that have helped propel the sector. It also maintained a commitment to moving beyond the limits of donor funding to scale the microfinance industry through savings mobilization and access to private capital.

The transition to private capital remains an essential component for scaling up microfinance, but it presents new challenges and risks for the entire industry. USAID's support of the microRISK Alliance delivered expert solutions to manage these challenges and mitigate the risks.

About the alliance members:

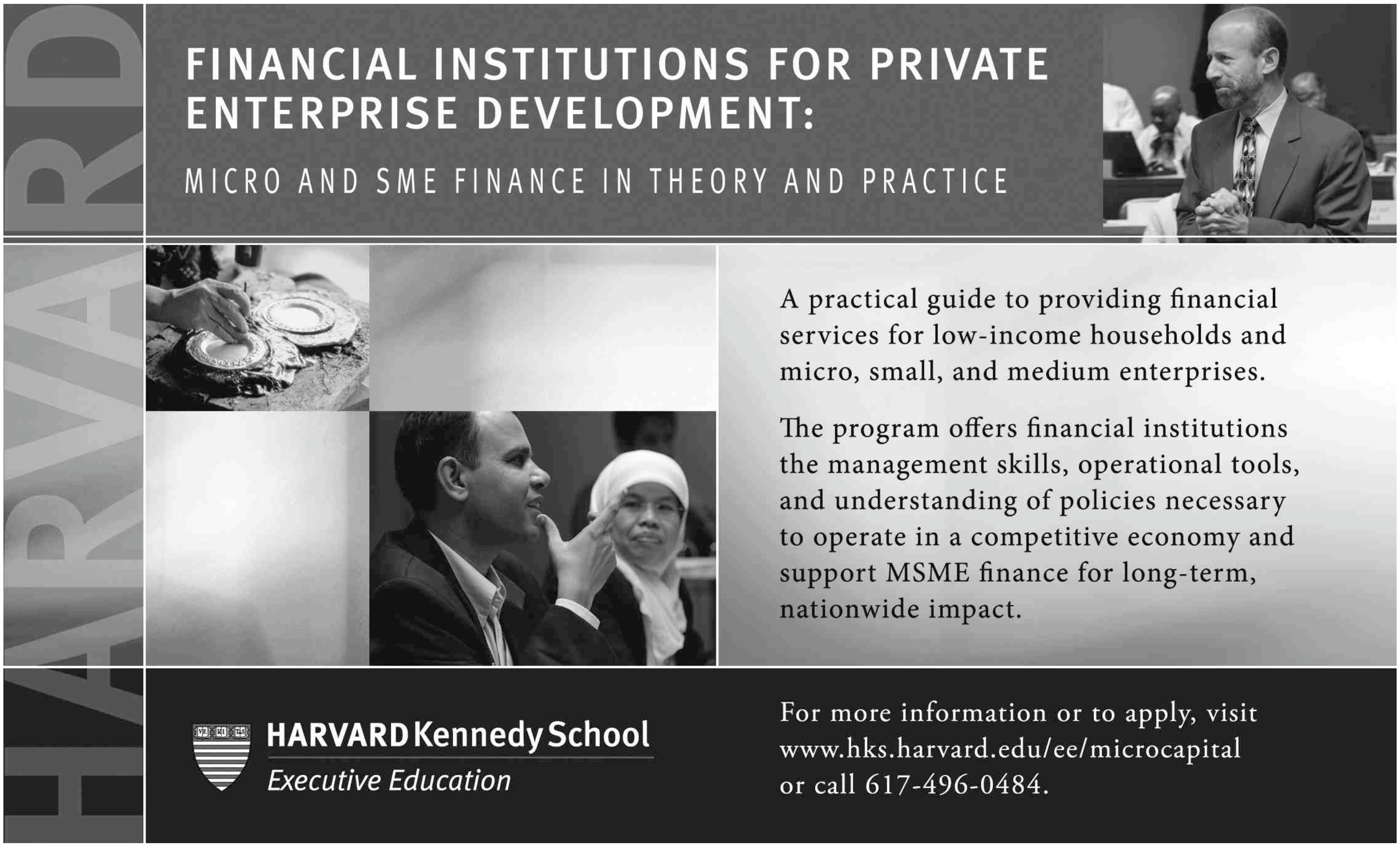
Founded in 2008, Cygma developed out of the collaborative efforts of Chatham Financial Corp, a leading capital markets consulting firm specializing in interest rate and foreign exchange risk management and other leading microfinance players.

MFX Solutions was created after a group of forward thinking microfinance organizations (lenders, investors, raters, networks, and foundations) came together in 2005 to seek an answer to the problem of currency risk in microfinance. MFX is an industry vehicle for increasing foreign exchange risk management know-how and sharing affordable and accessible currency risk management tools and services with the industry.

PAES Incorporated was acquired by TriLinc Global LLC, a global social impact investment firm focused on high-impact entrepreneurs generating a triple-bottom-line return. PAES became TriLinc Analytics Systems, which was developed to offer a suite of analytics that gives institutions in emerging markets insight into portfolio behavior and decision-making ability that their peers in advanced markets enjoy.

For more information, visit http://www.microlinks.org/mra or email Catherine Horn at chorn@qedgroupllc.com.

About the Author: Conan French served as the Advisor to the microRisk Alliance and is a former Director of the USAID Microenterprise Development office.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PAPER WRAP-UPS

All Eyes on Asset Quality: Microfinance Global Valuation Survey 2010

By Xavier Reille, Christoph Kneiding, Daniel Rozas, Nick O'Donohoe and Frederic Rozeira de Mariz; published by CGAP (Consultative Group to Assist the Poor); March 2010; 40 pages; available at: http://www.cgap.org/gm/document-1.9.42531/OP16R.pdf

The authors of this paper offer benchmarks for the valuation of microfinance assets using two datasets, one being a sample of 200 private equity transactions between 2005 and 2009 and the other being data on eight publicly listed low-income financial institutions (LIFIs). Four development finance institutions, 13 microfinance investment vehicles and 14 microfinance institutions (MFIs) contributed information on transactions that occurred from 2005 to September 2009 to create the private equity transaction dataset. The eight publicly listed LIFIs were chosen as proxies for MFIs because their client base closely overlaps with that of MFIs. However according to the authors, "LIFIs do not necessarily have an explicit social agenda, and their loan portfolios tend to feature more... *(Continued in the subscriber edition)*

Microfinance and Financial Sector Development

By Annabel Vanroose and Bert D'Espallier, published by the Emile Bernheim Center Research Institute in Management Sciences at the Solvay Brussels School of Economics and Management, September 2009, 41 pages, available at: http://www.solvay.edu/EN/Research/Bernheim/documents/wp09040.pdf

This paper assesses the impact of the development of the formal banking sector on several microfinance institution (MFI) performance measures. The study is based on data from 1,073 MFIs reporting to the Microfinance Information Exchange from 1997 through 2006. The dataset includes cooperatives, non-bank financial institutions, banks and nonprofit organizations.

The main findings are that lower formal financial sector development is generally associated with better performance for MFIs in terms of profitability and outreach. For MFIs, the number of active borrowers, total loan portfolio, operational self-sufficiency (OSS), return on assets (ROA) and return on equity (ROE) are all negatively correlated with the number of automated teller machines (ATMs), a measure of financial access. These same measures of MFI profitability and outreach are also negatively correlated with... *(Continued in the subscriber edition)*

Outlook for Remittance Flows 2010-2011

By Dilip Ratha, Sanket Mohapatra and Ani Silwal; published by the Migration and Remittances Team of the World Bank's Development Prospects Group; April 2010; 18 pages; available at: http://siteresources.worldbank.org/INTPROSPECTS/Resources/334934-1110315015165/MigrationAndDevelopmentBrief12.pdf

The Migration and Remittances Team of the World Bank's Development Prospects Group, an organization providing information and analysis on global economic trends, recently published this paper covering trends in remittances with statistics from 2008 and 2009 and estimates related to remittances over the next few years.

Remittances decreased from USD 336 billion in 2008 to USD 316 billion in 2009. This was the first decrease since the 1980s. However, remittances were more resilient during the financial downturn relative to other flows such as private debt, equity and foreign direct investment.

Eastern Europe and Central Asia saw the largest decrease in remittances, 21 percent from 2008 to 2009. South Asia saw the highest increase in remittances (5 percent), though this is modest compared with... *(Continued in the subscriber edition)*