MicroCapital Monitor
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MICROCAPITAL BRIEFS | TOP STORIES

Deals Pick Up in India After Publication of Draft Microfinance Bill

The July publication of India's draft "Microfinance Institutions (Development and Regulation) Bill" may have broken the sector's funding logjam. Under the terms of the draft, the entire microfinance sector would fall under the jurisdiction of India's central banking authority, the Reserve Bank of India. State legislation, including the Andhra Pradesh Law that was enacted in late 2010, would be nullified. The draft bill would establish a "Microfinance Development Council" and a "Microfinance Development Fund," which would disburse Finance Ministry funding for on-lending, capacity building programs and other purposes. N Srinivasan, the author of ACCESS Development Services' annual "Microfinance India – State of the Sector Report," praises the bill for its focus on client protection, credit bureau enrolment, homogeneous procedures and framing loan terms with effective annual percentage rates inclusive of interest rates and fees. However, calling the financial penalties for infractions "paltry," Mr Srinivasan calls for fines that are proportional to the size of the lender. As a result of the relative certainty in the sector and as several microfinance institutions (MFIs) reportedly experience an increase in repayment rates, S N Mishra, a general manager at the commercial Indian Overseas Bank, was quoted as saying "risk factors have eased" and that the bank is now ready to consider disbursing new loans to MFIs. Meanwhile, the World Bank Group's International Finance Corporation is purportedly close to approving an investment equivalent to USD 29 million in Bandhan Financial Services, an MFI based in the state of West Bengal. Unitus Capital, a private equity firm based in Bangalore, reportedly is working on deals with five unnamed MFIs worth a total of USD 43 million. Other transactions involving Indian MFIs are covered on Pages 2, 3 and 4 of this newspaper. August 15. 2011

$21m European Solidarity Financing Fund for Africa Launched

The European Solidarity Financing Fund for Africa (FEFISOL, in French) has been launched with the equivalent of USD 21.6 million in funding to be directed in local currency to microfinance institutions, organizations of organic food producers and others involved in fair trade. Commitments to date include a USD 4.32 million loan provided by Agence Française de Développement, USD 7.2 million from the European Investment Bank, USD 7.77 million from the Investment and Support Fund for Africa, USD 2.59 million from the Norwegian Microfinance Initiative and unspecified amounts from Crédit Coopératif, Societa Europea Finanza Etica ed Alternativa, Développement international Desjardins and Fondation Caritas France. August 1. 2011

(For more top stories, please refer to the subscriber edition)

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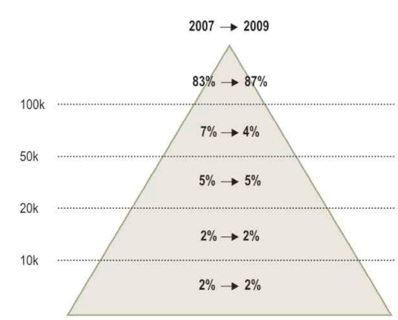
EAST ASIA & PACIFIC
MFI MARKET SHARE TRENDING 2007 TO 2009
BY MFI SIZE (NUMBER OF ACTIVE BORROWERS)



MARKET INDICATORS*

FIELD NOTES

Austerity versus Long-term Growth - Really, I'm Talking About Microfinance...

This month, it was hard for anyone not to notice certain events in developed countries: the political shenanigans in the US Congress, the downgrading of US debt by Standard & Poor's and the stubbornly expanding crises in Europe. I have the pleasure of writing this entry from Italy, and I can assure you people are feeling the strain here. Even in finer circles, I am hearing things like: "No more bottled water; tap water is fine." This in a country where drinking tap water was once equated with drinking from a sewer. So as we enter a new age (or at least a new few months) of austerity here in developed countries, I thought it would be worthwhile to pick up where I left off last month when I noted that many microfinance institutions (MFIs) need to trim their operating expenses to stay healthy and competitive.

There are uncanny parallels between the microfinance markets and the macroeconomic juncture at which we find ourselves. The microfinance markets that are still growing quickly (let's call them, for the sake of analogy, "emerging microfinance markets") are at some risk of overheating, but can handle current levels of leverage and continued inefficiency in the near term. By padding margins, their growth can support reasonable, though high, debt ratios. However, they should be warned to start planning for worse times, lest the fate of mature markets fall upon them.

On the other hand, more mature microfinance markets (let's call these the "developed microfinance markets") are stuck. After many good years, a number of both emerging- and developed-market MFIs have relaxed their "fiscal" prudence, focusing instead on growing themselves out of inefficiencies. Now, the loan portfolio growth of MFIs is down from an average 44 percent year-on-year in 2007 (based on my back-of-the-envelope calculations using Microfinance Information Exchange data for those institutions that report portfolio data since 2006 or earlier) to about 21 percent in 2010. Much like with the US economy, slower growth will make it harder to hide inefficiencies. These averages mask the fact that 17 percent of this same sample experienced negative portfolio growth in 2010. Those institutions are the Greece and Spain of microfinance!

Before any suspicions run wild that I am a Tea Party aficionada who believes cost cutting the answer to all ills, I would like to make one last parallel. I agree with Mohamed El-Erian, CEO of Pacific Investment Management Company (PIMCO), who has critiqued the recent budget deal in the US, noting: "When you look at the debt burden, there is a numerator and a denominator. We may end up creating so much damage to the denominator, which is growth of GDP, that what we do in the numerator, reducing the debt, may end up being insufficient." Spending on programs that boost productivity can stimulate and strengthen an economy in the long run. I think there is a controversial, yet interesting, parallel here with microfinance. I have noted more than once that current microfinance practices often don't support microenterprise growth on their own and that, to grow beyond the subsistence level, smaller (usually women-run) businesses need additional help in the form of training, market access and new financial products and services. All these things cost money, yet can help an MFI grow its portfolio by increasing client loyalty, reducing desertion and growing clients' businesses so that they can borrow larger amounts sustainably. The trick, as any developed-country elected official can tell you these days, is finding the money when times are tough!

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PAPER WRAP-UPS

Small vs Young Firms Across the World: Contribution to Employment, Job Creation, and Growth

By Meghana Ayyagari, Asli Demirgüç-Kunt and Vojislav Maksimovic; published by the World

Bank as a working paper; April 2011; 57 pages; available at: http://www-wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/2011/04/11/000158349_20110411130747/Rendered/PDF/WPS5631.pdf

This paper offers data on the contribution of small and medium-sized enterprises (SMEs) and young firms to total employment, job creation and productivity growth across 99 developing economies. The paper includes data collected from 47,745 firms from 2006 to 2010. The sample does not include enterprises with fewer than five employees.

The first finding is that SMEs are the biggest contributors to employment across all countries and they contribute even more to employment in low-income countries than in high-income countries. Specifically, firms that are both old and small (over 10 years old and with 5 to 99 employees) have the largest proportional share of total employment. This is irrespective of the income level of the country. Secondly, SMEs with no more than 250 employees create the most... *(Continued in the subscriber edition)*

Selective Knowledge: Reporting Biases in Microfinance Data

By Jonathan Bauchet and Jonathan Morduch, published by the Financial Access Initiative at New York University's Robert F Wagner Graduate School of Public Service and Hunter College, June 2009, 39 pages, available at: http://www.nyu.edu/projects/morduch/documents/articles/2008-06-Selective-knowledge.pdf

The authors begin with the idea that developing economic theories and the empirical testing of those theories are of utmost importance for "the creation of economics knowledge," but that the collection of useful data largely depends on the willingness of households and institutions to respond to questionnaires. The authors consider the implications of such voluntary reporting on knowledge about microfinance. Generally, useful data from poorer countries are difficult to gather. Thus samples seldom fully represent the underlying populations. The authors argue that this problem is also pertinent to microfinance data because microfinance institutions (MFIs) are systematically biased regarding "which survey to respond to and which specific indicators to report."

The authors consider three sources of microfinance data from the years 2004 to 2006: the MIX Market website of the Microfinance Information Exchange (MIX); the *MicroBanking Bulletin*, which is published by MIX; and data from the Microcredit Summit Campaign (MSC). MIX offers MFI data mostly on financial and institutional indicators, along with a limited amount of data on social performance. *MicroBanking Bulletin* data are from a subset of MFIs from the MIX Market adjusted for improved comparability and implicit subsidies. MSC collects data mostly on social outreach indicators, but from a larger number of MFIs.

As reporting to these databases is voluntary, results based on these data are vulnerable to self-selection bias, which can be manifested in several ways. First, the reporting institutions, which actively choose to share their data, are likely to be different from the non-reporting ones. Second, MFIs self-select into reporting to either one of the databases or both. Finally, MFIs may report some indicators for some time periods but not for others. This paper examines the latter two sources of bias.

The analysis employs data on 2,072 MFIs from the MIX and MSC databases. The authors find that the two databases attract considerably different MFIs. MFIs reporting to MSC are typically larger, more focused on reaching poor clients and more likely to operate in South Asia. On the contrary, MFIs reporting to MIX Market are more profit-focused and more likely to operate in Latin America, Eastern Europe and Central Asia.

Financial indicators are more often reported than social indicators. Also, reporting patterns... *(Continued in the subscriber edition)*

Discovering Limits: Global Microfinance Valuation Survey 2011

By Frederic de Mariz, Xavier Reille and Daniel Rozas; published by JP Morgan and CGAP (Consultative Group to Assist the Poor); July 2011; 29 pages; available at: http://www.microfinancegateway.org/p/site/m//template.rc/1.9.52137

In their third annual Global Microfinance Valuation Survey, US-based investment bank JP Morgan and nonprofit research center CGAP (Consultative Group to Assist the Poor) provide an overview of the financial standing of microfinance institutions (MFIs) around the world. Invoking the subtext of "Discovering Limits," the authors argue that "no longer can microfinance investment be viewed as an exclusively do-good, low-risk, relative safe haven."

In the first section of the paper, the authors focus on the global microfinance sector and private equity participation therein, using a dataset of 238 equity transactions involving 110 MFIs in 53 countries between 2005 and 2010. Private equity investment in 2010 was dominated by Latin America and the Caribbean (56 percent), with South and East Asia trailing (33 percent) and Europe and Central Asia further behind (7 percent). The only year-on-year increase occurred in the South and East Asia region.

As microfinance markets have begun to mature, many investors are looking to exit the market by selling their stakes, while fewer MFIs are interested in raising growth capital. As primary issuances such as initial public offerings have slowed, they have been replaced with secondary market activity, which now accounts for 70 percent of the value of transactions, up from 12 percent in 2007.

The authors find that earnings multiples, which have historically been a key valuation metric for investors, have lost their reliability over the last year, as a combination of write-offs and increased loan-loss reserves has resulted in ratios that do not reflect underlying institutional quality. In Europe and Central Asia, five out of seven transactions involved an MFI with negative earnings.

The report suggests that the forward book value multiple (price-to-book value) has become a more consistent and accurate indicator of performance. After peaking at an average value of 1.7 in 2009, the forward book value multiple fell to 1.6 in 2010, which is commensurate with the authors' view of microfinance markets. MFIs in Mongolia, Cambodia, Peru and Tanzania, for example, have seen their price-to-book ratios exceed their historical median, justifying strong investor interest and a willingness to pay a premium for quality. Other countries, such as Nicaragua, Nigeria and Bolivia, have stagnated in value, as political and regulatory uncertainties contribute to fading investor interest.

South and East Asian institutions have witnessed the greatest volatility in book value multiples, while those of Latin American and Caribbean MFIs have barely fluctuated from a multiple of 1.0. Whereas India was until recently considered a high-potential growth market, valuations have decreased to the world median book value, and the authors expect a further correction in line with regulatory uncertainty, pervasive over-indebtedness and over-reliance on microcredit. On the other hand, Peru's microfinance sector has passed through its growth phase and holds strong levels of deposits, accompanied by uniform regulation and a functional credit bureau - all signs that point to a stable valuation, even if debt loads are reportedly rising.

The second half of the report focuses on an index of 11 "lower income finance institutions" (LIFIs), which serve as a sample of publicly listed MFIs: Bank Rakyat, Bank Danamon and Bank Tabungan Pensiunan Nasional of Indonesia; SKS Microfinance of India; African Bank and Capitec, both of South Africa; Kenya's Equity Bank; Compartamos Banco and Financiera Independencia of Mexico; First Cash... *(Continued in the subscriber edition)*

MOBILE MONEY
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31 OCTOBER – 3 NOVEMBER 2011, DUBAI, UAE