



VIème Midi de la Microfinance

La microfinance
est-elle victime de son propre succès ?

29 janvier 2008

Programme

- 12.00 Mot d'accueil
Philippe Depoorter, Banque de Luxembourg
- 12.10 Introduction
Axel De Ville, ADA Luxembourg
- 12.15 **Mission sociale et rentabilité financière :
la microfinance est-elle victime de son propre succès ?**
Damian von Stauffenberg, MicroRate
Quelle est l'évolution du secteur de la microfinance au cours des trois dernières années ? Quelles sont les conséquences et les tendances liées à la croissance et l'intérêt grandissant pour ce secteur particulier situé à mi-chemin entre la finance et la lutte contre la pauvreté ?
(Intervention en anglais avec traduction simultanée en français)
- 12.40 Questions/Réponses
- 13.00 Mot de clôture
Léon Kirch, Luxembourg CFA Society
- 13.10 Déjeuner (buffet)
- 14.00 Fin

Sommaire

- 1) Introduction
- 2) **«La microfinance est-elle victime de son propre succès ?»**
Damian von Stauffenberg, MicroRate
- 3) Articles et références
- 4) Biographie de Damian von Stauffenberg, MicroRate
- 5) Présentation de Luxembourg CFA Society

Microfinance

Victim of its own Success?

Microfinance institutions in developing countries (“MFIs”) are growing exceedingly fast. The average MFI tracked by MicroRate in Latin America doubles in size every two years. Similar growth rates are observed in other continents. Funds and other vehicles, that mobilize money from investors in developed countries and channel it to MFIs in poor countries (“MIVs”) are growing even faster. In recent years, they have nearly doubled in size every year. Investor enthusiasm for microfinance is a good thing – as long as investors know where their money is going.

The danger facing microfinance is that at the moment too many microfinance funds are trying to place too much money in a still relatively small microfinance sector. As these funds compete with each other spreads begin to narrow. In many instances rates at which Funds lend to MFIs are too low to cover both, credit risk and political risk. While it lasts, this is good for MFIs, but it is not sustainable in the long run. Of more immediate concern, however, is a tendency among some funds to loosen the definition of what microcredit actually is.

Microcredits are not just small (“micro”) loans to poor people. Moneylenders have made such loans for thousands of years. The exciting new feature of microcredit is that these loans act as a catalyst for the productive capacity of borrowers. Microcredit enables the borrower to create the wealth that will not only repay the loan, but that will also increase the borrower’s standard of living. It is therefore essential that the MFI has the capability to determine, which prospective borrowers will be able to use a loan productively. If it cannot do that, then additional credit will simply place borrowers in a debt spiral.

In their eagerness to rapidly increase lending volumes, some funds are beginning to ignore this vital distinction between (productive) microcredit and indiscriminate lending to the poor – never mind for what the loans are used. Consumer credit agencies in particular are capturing increasing amounts of funding that the original investors had intended to go to microfinance. Consumer credit may or may not end up financing a productive activity - the lender simply doesn’t know.

Microfinance is not a victim of its own success – yet! To the contrary it is a very powerful tool for development and a textbook example for how market forces can take over from development agencies. But it is easy to see how microfinance could become a victim if investors continue to indiscriminately entrust their money to anything that calls itself microfinance, no matter what those loans are really used for.

Damian von Stauffenberg
MicroRate

NB: MicroRate is the first rating agency specializing in microfinance institutions. MicroRate and its sister company, Micro Credit Ratings International have rated 128 microfinance institutions in 2007. Through its constant contact with microlenders, MicroRate is in an ideal position to observe trends in the industry.

La microfinance

Victime de son propre succès ?

Le nombre d'institutions de microfinance (IMFs) dans les pays en développement connaît une croissance exponentielle. La taille des IMFs suivies par MicroRate en Amérique Latine double tous les deux ans, et on constate des taux de croissance similaires sur les autres continents. Les fonds et autres véhicules d'investissements, mobilisant de l'argent provenant d'investisseurs des pays développés et l'acheminant aux IMFs des pays pauvres (VIMs), évoluent de la même manière. Depuis quelques années, leur volume double tous les ans. L'enthousiasme des investisseurs pour la microfinance est une bonne chose... pour autant que les investisseurs sachent où leur argent va.

Pour l'heure, le danger réside dans le fait que trop de fonds de microfinance essayent de placer leur argent dans un secteur trop étroit de la microfinance. Etant donné que ces fonds rivalisent entre eux, la progression commence à ralentir. Dans plusieurs cas, les taux auxquels les fonds prêtent aux IMFs sont trop bas pour couvrir à la fois les risques de crédit et les risques politiques. Même si c'est plutôt positif pour les IMFs, cette situation n'est pas tenable à long terme. Par ailleurs, il est important que ces fonds ne délaissent pas la notion de microcrédit.

Le microcrédit ne revient pas seulement à accorder un très petit crédit aux pauvres. Les prêteurs sur gages le font depuis des centaines d'années. La caractéristique du « microcrédit » réside dans le fait que ces prêts fonctionnent comme des catalyseurs pour permettre aux emprunteurs d'être productifs. En effet, les microcrédits permettent aux emprunteurs de créer de la richesse pouvant non seulement rembourser leur prêt mais aussi augmenter leur standard de vie. Dès lors, il est essentiel que les IMFs soient capables de distinguer les emprunteurs potentiels qui pourront utiliser efficacement leur prêt de ceux qui ne le pourront pas. Si ce n'est pas le cas, le crédit accordé à l'emprunteur le placera malheureusement dans une spirale d'endettement.

Dans leur volonté d'augmenter rapidement le volume de leur portefeuille de crédits, certains fonds ignorent encore la différence fondamentale entre, d'une part, le microcrédit productif et, d'autre part, le fait de prêter aux pauvres – quelle que soit l'utilisation du prêt. Les agences de crédit à la consommation en particulier captent de plus en plus de fonds que les investisseurs avaient destiné à la microfinance. Dans ces cas, que le crédit à la consommation finisse ou non par financer une activité productive, l'investisseur ne le sait pas.

La microfinance n'est pas victime de son propre succès – du moins pas encore! Au contraire, il s'agit d'un outil de développement puissant et un exemple qui démontre comment les lois de marché peuvent être complémentaires et prendre le relais des agences de développement. Mais il est facile de voir comment la microfinance pourrait devenir une victime si les investisseurs continuent de confier leur argent à tout ce qui se prétend être de la microfinance, sans accorder d'importance à l'utilisation du microcrédit.

Damian von Stauffenberg
MicroRate

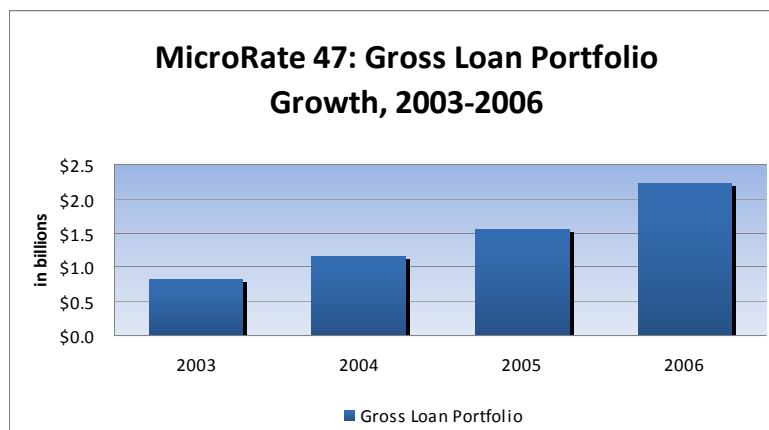
NB: MicroRate est la première agence de notation spécialisée dans l'évaluation d'institutions de microfinance. MicroRate et sa compagnie « sœur », Micro Credit Ratings International, ont évalué 128 IMF en 2007. A travers ses contacts permanents avec les micro-entrepreneurs, MicroRate bénéficie d'une position idéale lui permettant d'observer les tendances se dégageant de l'industrie de la microfinance.

(Texte traduit de l'anglais par ADA)

Is Microfinance a Victim of its own Success?

28 January 2008

Growth seen in Latin American MFIs



3 MFI Case Studies

Compartamos - Mexico

Indicators	2001	2002	2003	2004	2005	2006
Total Portfolio Size	\$24,848	\$42,067	\$63,159	\$101,032	\$180,796	\$273,468
Borrowers	92,773	144,991	217,454	309,637	453,131	651,826
RoE	37.8%	53.2%	52.1%	48.7%	51.0%	55.0%
Portfolio at Risk (>30 days)	1.2%	1.1%	0.7%	0.6%	1.2%	1.1%

Foundation Banque Populaire – Morocco

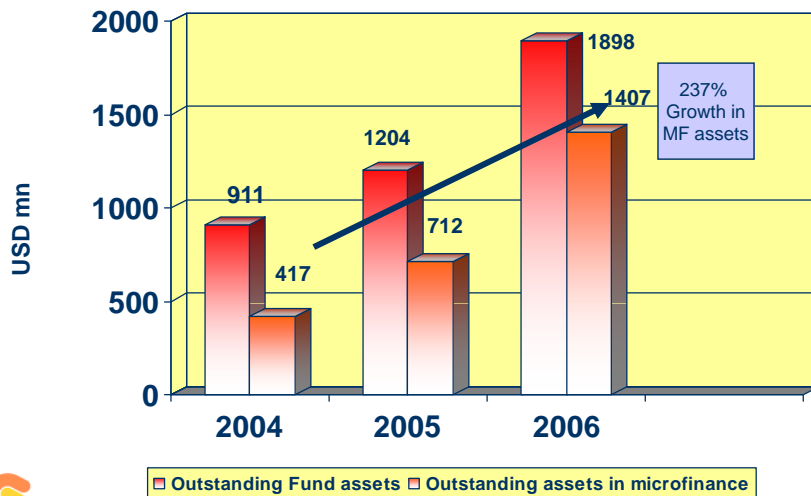
Indicators	2001	2002	2003	2004	2005	2006
Total Portfolio Size	\$4,209	\$7,058	\$15,786	\$25,002	\$32,865	\$69,983
Borrowers	16,706	25,249	51,653	68,394	82,651	131,781
RoE	-1.9%	4.4%	5.9%	8.8%	9.2%	16.2%
Portfolio at Risk (>30 days)	0.2%	0.1%	0.1%	0.6%	0.1%	0.1%

WWB Cali – Colombia

Indicators	2001	2002	2003	2004	2005	2006
Total Portfolio Size	\$16,933	\$21,493	\$36,614	\$64,111	\$97,518	\$146,195
Borrowers	38,063	49,119	70,200	92,533	116,725	149,090
RoE	24.2%	23.4%	27.0%	27.0%	24.0%	19.2%
Portfolio at Risk (>30 days)	1.7%	1.2%	0.9%	0.9%	1.5%	1.6%

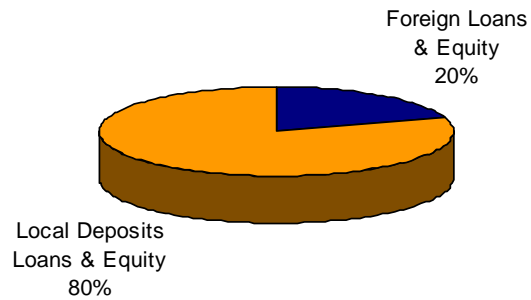


Growth of MFI and MIV Assets, 2004-2006



MFI Financial Funding Sources

Local vs. Foreign Funding



Microcredit

Working capital for the working poor

■ Characteristics

- Fuels wealth creation
- Loan decision based on repayment capacity more than on collateral



- Loan Size: \$100 - \$2,000
- High Interest Rates
 - Wide range, depending on the maturity of markets
 - 25%: Bolivian Avg.
 - 85%: Mexican Avg.
- Very low loan losses (less than 2%)





Microcredit vs. Consumer lending

- Both involve lending to the poor!
- Difference is not a matter of loan size, difference is in their focus on productive capacity – on wealth creation

Consumer credit: lending decision based mainly on collateral

Microcredit: decision based mainly on ability to create wealth



How to distinguish one from the other?

- **Portfolio quality**
 - Because of its concentration on borrower's productive activity, quality of microcredit is much higher (average write off in 2006: 0.9%)
 - Consumer credit typically has write offs of 10% +
- **Focus of Lender's Attention**
 - Microlenders analyze borrower's business
 - Consumer lenders focus on repayment capacity



Case Study: African Consumer Finance Agency (AFCA)

- Only makes salary backed loans
- Many consumer finance institutions charge effective interest rates greater than 200% per annum



AFCA vs. Average Latin American MFI in 2006

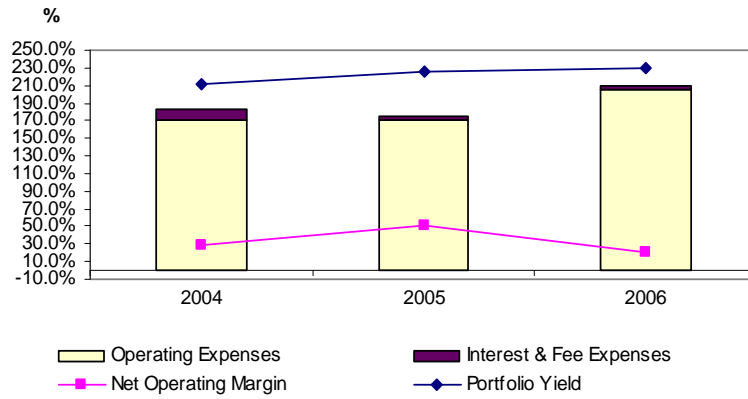
	AFCA	Average Latin American MFI
Portfolio Size	\$26.2 million	\$36.9 million
Portfolio Yield	234.9%	40.1%
Write-Offs	15.0%	0.9%
Loan Loss Provision Expense Ratio	-	2.4%
Operating Expense Ratio	143.7%**	23.5%

** average operating expense ratio for AFCA and its two top competitors



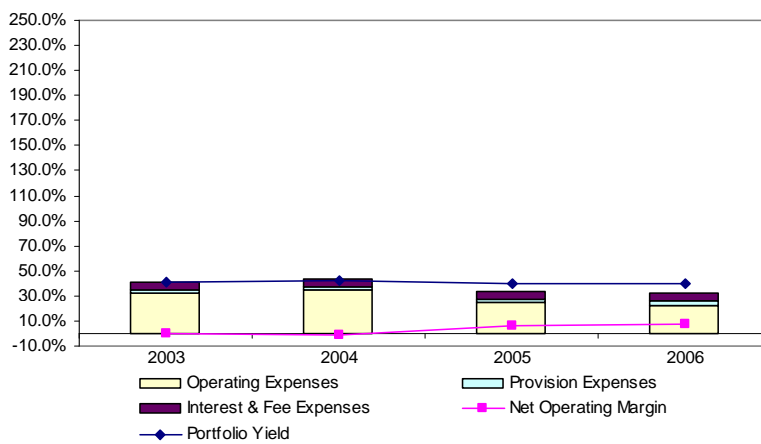
AFCA: Consumer Lending

ACFA Margin Analysis, 2004-2006



Average Latin American MFI: Microcredit

Average Latin American MFI Margins, 2003-2006



-sample of 47 Latin American microfinance institutions followed yearly from 2003 to 2006



Why the Difference Matters

- Market for consumer credit among the poor is limited - only a few earn salaries or have assets they can pledge
- Since microcredit creates wealth, it creates its own demand. Growing microenterprises require more credit.



Recent Trends in Peruvian MFIs

- Still unmet demand, increasing portfolio growth by an average of 40.0% per year
- Increasing Competition
 - Dropping Portfolio Yields: 39.0% to 34.7%
 - Greater Efficiency: 21.8% to 17.2% operating expense ratio
- Commercial Funds Have Replaced Donor Money





Dangers to Watch Out For

- Growing foreign exchange exposure
- Microfinance or consumer lending?
- Microfinance has been thriving in a benign environment, how will it stand up under stress?



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BusinessWeek

The Ugly Side of Microlending

How big Mexican banks profit as many poor borrowers get trapped in a maze of debt

by [Keith Epstein](#) and [Geri Smith](#)

In a gleaming office tower in Mexico City secured with retinal scanners, bulletproof glass, and armed guards, dozens of workers in white lab coats dart around a large operations center monitoring long rows of computers. Along one wall, 54 enormous screens flicker dizzily with numbers, graphs, and fever charts: a relentless stream of data. You'd think the urgent mission involved tracking the trajectory of a spacecraft or the workings of a national power grid, not tiny amounts of cash and credit for Mexico's working poor.

The transactions are so minuscule they hardly seem worth the bother. The average loan amounts to \$257. But for Banco Azteca, a swiftly growing bank affiliated with Latin America's largest household retailer, the small sums represent a torrent of revenue that has caught even its founders by surprise. For three decades, micro-lending was seen as a tool of nonprofit economic development. Now poor people are turning into one of the world's least likely sources of untapped profit, primarily because they will pay interest rates most Americans would consider outrageous, if not usurious.

With no legal limits on interest levels and little government oversight, for-profit banks in Mexico impose annual interest rates on poor borrowers that typically range from 50% to 120%. That compares with a worldwide average of 31% among nonprofit micro-lending institutions, and the 22% to 29% that Americans with bad credit histories incur on credit-card debt. Azteca's business model succeeds not only because it can charge credit-starved clients almost whatever it wants. Equally important is that low-income Mexicans anxious about maintaining their reputation tend to pay back what they owe, regardless of the hardship. Those who slip behind receive frequent visits from motorcycle-riding collection agents. Default rates are infinitesimal. "We lend to them as much as they can borrow," says Azteca Vice-Chairman Luis Niño de Rivera, "and they can borrow as much as they can pay."

WHIFF OF PROFITS

In a Mexico that is modernizing economically even as most people still struggle to make ends meet, Azteca has discovered an improbable market for financial services. Much larger companies based in the U.S. and Europe also have picked up the whiff of profits. Wal-Mart Stores ([WMT](#)), which obtained a Mexican banking license a year ago, began offering loans for purchases at 16 of its 997 Mexican outlets in November. In the U.S., the retailer markets

itself as a friend to the budget-conscious. In Mexico, it charges interest rates that might set off popular and political revolts back home, although Wal-Mart describes its terms as appropriate to the Mexican market. At one store west of Mexico City, a 32-inch LG plasma TV with a price tag of \$957 can ultimately cost as much as \$1,474, thanks to a 52-week payment plan that carries an annual percentage rate (APR) of 86%.

Banamex ([C](#)), Mexico's second-largest bank and a wholly owned unit of Citigroup, is stepping up its pitches of personal loans to the working poor in 127 cities where it operates shops called Crédito Familiar, or Family Credit. HSBC Holdings ([HSBC](#)) last year bought a 20% stake in Financiera Independencia, a high-interest consumer lender that went public on Nov. 1. The Swiss insurer Zurich Financial Services ([ZFSVY](#)) is underwriting term life insurance policies that are sold along with small loans in Mexico. And homegrown nonprofit Compartamos morphed into a full-fledged commercial bank last year; it went public in April, reaping hundreds of millions of dollars for investors. All are examples of how financial players worldwide are pursuing profits by putting loans within reach of deprived borrowers.

Access to credit opens [opportunities for the poor](#) (BusinessWeek, 12/14/07). But it creates tempting hazards as well, which in Mexico are drawing many unsophisticated families into a maze of debts. Pawnshops and loan sharks, whose interest rates of up to 300% have plagued generations of Mexicans, now face rivals offering terms that are less harsh. But along the road to previously unavailable financing, some Mexicans are stumbling badly.

The Arana family is but a blip on one of the wide screens at Azteca's operations center. Beneath the digital glimmer lies a story of striving. Adrián Arana Sánchez, his wife, Francisca, and their extended family take whatever work they can find, adding a few pesos here and there. Last July, Adrián lost an \$80-a-week job delivering soft drinks to stores in gritty, exhaust-choked San Martín Texmelucan, a city of 143,000 two hours southeast of Mexico City. He now brings home half that amount peddling vegetables door to door and making plaster-cast statuettes of Jesus. Francisca sells crunchy slices of jicama root outside an elementary school. With four children, two grandchildren, and a son-in-law, they live in a four-room cinderblock house in the shadow of snow-capped volcanoes once revered by the Aztecs.

Although indigent by U.S. or Western European standards, the Aranas see themselves as aspiring consumers and even as entrepreneurs in a society that makes all manner of goods and services available for what seem like manageable weekly payments. Banco Azteca plays a central role in that emerging credit economy. Started five years ago, it operates from the nearly 800 locations of its parent, Grupo Elektra, Latin America's largest electronics and home appliance chain. Elektra/Azteca has the sort of ubiquitous presence that Wal-Mart enjoys in the U.S.

SEEKING A MIDDLE-CLASS LIFE

The dazzling yellow facades of Elektra/Azteca outlets shout for attention in rundown neighborhoods. Inside the store across from the Catholic cathedral in San Martín Texmelucan, a tag on a six-speaker sound system throbbing with *ranchero* music carries a price of \$691, but larger bold print stresses weekly payments of only \$16. An installment plan can be arranged by Azteca staffers who work from metal desks at the back. Over 18 months, the weekly payments nearly double the price, to \$1,248. That's an APR of 88%. APR is

commonly used in the U.S. to compare total loan costs. In Mexico, Azteca isn't legally obliged to disclose it—and doesn't. (Mexican loans include a 15% tax on financial services.)

Adrián Arana, 50 years old and with a sixth-grade education, has become a regular customer at this branch of Elektra/Azteca. He and Francisca, who completed only the second grade, have obtained a series of small loans over the past four years to purchase a CD player, bicycle, TV, video camera, and bedroom furniture. In 2006 they took the next step, borrowing \$920 to pursue a long-cherished ambition: opening a dry-goods store in the front room of their house. They saw the store as a means to achieve stability, and maybe a middle-class life. But like many tiny businesses started by inexperienced proprietors, this one soon failed. A neighbor had just opened a similar but better-stocked home shop. The Aranas toiled diligently at their other jobs to pay back the loan, missing some weekly payments and incurring late fees. With an APR of 105%, the loan ended up costing about \$1,485 over a year. But they paid it off.

Determined to try again, they were back at Azteca in February with a new plan, this time to start a gift shop. Azteca granted them a bigger loan, for \$1,380 over 18 months, but deducted \$65 up front, leaving the Aranas with \$1,315 and an APR of 90%. They say they didn't understand these terms. They focused instead on the weekly payment of only \$32. "They never tell you what the interest rate is," says Adrián. "They say, 'Sign here,' but they don't give you time to read everything."

Some Azteca executives concede that borrowers sometimes walk away confused. "Terms are explained to them, maybe not as clearly as they should be, but many clients don't understand," says Pedro Morales, head of the bank's local legal department. "They take on financial commitments they can't meet." But Niño de Rivera, the bank's vice-chairman, says: "There is no pressure to sign loans, and consumers are encouraged to shop around freely for what best suits their needs."

The Aranas used the \$1,315 to buy picture frames, toys, and inexpensive cosmetics, which they displayed in their front room, beneath a dangling lightbulb illuminating a portrait of the Virgin of Guadalupe. Once again, their business faltered. Two textile factories in the area had closed recently, throwing thousands out of work. Mexico offers no government benefits to cushion such adversity. The Aranas saw few customers.

For six months they made their payments, but then, in July, Adrián lost his soft-drink delivery job. By September, past-due notices and interest charges were piling up, and an Azteca collection agent was visiting regularly. "We either eat or we pay off the loan," says Adrián. The despairing family resorted to borrowing \$200 from a loan shark at 10% a month. Informal lending of this sort, despite its attendant threat of violence, is not prohibited in Mexico. Azteca's local collections chief, Alejandro Tejeda, says it's a shame that borrowers can land in such trouble. "But these people made a commitment, and they need to live up to it," he says.

With no money to pay the loan shark or Azteca, and fearing that the bank will seize their few belongings, the Aranas are trying to sell their house. So far they haven't found a buyer, and if they do, it's not clear where they would live. They're keeping food on the table, barely, with Adrián's door-to-door sales of tomatoes and herbs, which he transports in the basket of a large tricycle. "We never thought this would happen," he says. "We're sinking fast."

Banco Azteca and Grupo Elektra are key parts of Grupo Salinas, an amalgam of media, telecommunications, and retail businesses controlled by billionaire Ricardo B. Salinas Pliego. A maverick among Mexico's business elite, he has sparked controversy. In 2006 he settled civil fraud allegations by the U.S. Securities & Exchange Commission concerning the finances of his TV network, then traded on the New York Stock Exchange. He denied wrongdoing but paid \$7.5 million and was barred for five years from serving as an executive or director of companies listed in the U.S.

The Salinas family began selling furniture on credit more than a century ago in the northern city of Monterrey. Ricardo, 51, says he learned early in life that those who work in Mexico's informal economy, without pay stubs or much collateral, and who can't afford sofas or blenders outright, will snap up merchandise if offered seemingly manageable terms. "If you want to become rich, sell to the poor," he recalls his grandfather instructing him.

He learned to get even richer by lending to the poor, and to those who are better off. Azteca targets 14.5 million Mexican families earning \$5,100 to \$33,600 a year. Mexico has a total population of 109 million, with a median annual household income of \$7,297. Mainstream Mexican banks cater to the wealthier elite, while less than one-third of working-poor families have access to any banking services at all.

Azteca has absorbed Elektra's ethos of high-pressure employee quotas and incentives. Elektra clerks, clothed in the store's signature bright yellow, earn commissions on top of their standard weekly salary of \$120 for tacking on extras such as warranties, life insurance, and even long-distance bus tickets. The biggest score comes from persuading a customer to spread payments over the longest possible period, 104 weeks. "Sell on credit and earn much more money!" an online company training manual states.

MOTORBIKE CAVALRY

The strategy has far exceeded the expectations of Grupo Elektra executives. The bank already contributes one-fifth of its parent's \$5 billion in annual revenue. It boasts a consumer loan portfolio of \$2 billion and a healthy 22.3% return on shareholder equity.

The main Elektra/Azteca branch in San Martín Texmelucan aims to meet a daily target of \$9,000 in fresh loans. The money isn't spewed out carelessly. With efficiency unusual in the Mexican marketplace, the bank deploys a cavalry of credit and collection agents on motorbikes. These *jefes de crédito y cobranza* visit borrowers within 24 hours of a purchase or loan application.

Juan Carlos Pérez Lopanzi, a 25-year-old college graduate who studied international commerce, serves as one of 13 credit agents in San Martín Texmelucan. One October morning, he rumbles up to the home of Maria Teresa Hernández as neighbors peer from their windows. Hernández, a 50-year-old street vendor, wants to borrow \$460 for a new hot dog wagon. She isn't home, so Lopanzi questions her adult daughter about the family's finances. Do they rent or own? Have they lived there at least two years? What do they spend on food?

With each answer, Lopanzi taps the screen of a handheld computer. Data will be routed to Azteca's operations center in Mexico City. The state-of-the-art system keeps the cost of processing 7 million transactions a day to a mere 3 cents per transaction, according to Azteca.

"It's amazing—all this is for poor people," says Juan Arévalo Carranza, the bank's technology chief.

Back in dusty San Martín Texmelucan, Azteca's proprietary software alerts the agent, Lopanzi, that Hernández, who earns \$276 a month, doesn't qualify for a \$460 loan. He offers \$370 instead. That will require \$10.60 weekly payments for 12 months for an APR of 85%. Hernández will end up paying \$551. "If she had more income, she could have a shorter payback period, and the interest rate would be lower," the agent explains to the daughter. She shrugs, then nods in acceptance.

"Tell her she can go by the store this afternoon for her check," Lopanzi says, as he registers the serial numbers of the daughter's stereo, DVD player, TV, and refrigerator. The items' resale value, preprogrammed into Lopanzi's digital device, must add up to around double the value of the loan. If the woman fails to pay, Azteca will cart away the daughter's possessions and sell them in a Grupo Elektra used-goods store.

Azteca deducts the depreciated value of seized goods from outstanding loan balances, so if someone who doesn't pay has enough possessions to cover the debt, the bank considers it paid. Azteca bars such customers from borrowing again but doesn't count them as having defaulted, which helps explain its stated loan failure rate of just 1%. Banks serving more prosperous clients average a 5.3% default rate on consumer loans.

Mexican lenders benefit from attitudes cultivated in a society lacking a welfare safety net, personal bankruptcy system, or meaningful consumer protection laws. Credit bureaus have recently sprung up in Mexico, including one that Elektra helped start in 2005, and many among the working poor worry about sullyng their new credit ratings. They assume that, one way or the other, they or their relatives will just have to pay back whatever they borrow, says Gustavo A. Del Angel, an economic historian who studies micro-finance at the Center of Research & Economic Teaching in Mexico City.

`BAD MANNERS'

Borrowers who fall behind realistically fear public embarrassment. Photocopies of debtors' national identification cards sometimes turn up on telephone poles and at central marketplaces with warnings that say "DON'T LEND TO THIS PERSON!" Six months ago, an Azteca agent in San Martín Texmelucan posted such flyers. The company fired him. "Our system is not intended to be publicly shaming," says Niño de Rivera, Azteca's vice-chairman, but he acknowledges it "is intended to exercise peer pressure."

Even as Mexico's economy modernizes, companies operate with minimal oversight from government. Luis Pazos, head of Condusef, Mexico's regulator of consumer financial transactions, says his agency logs complaints about Azteca's collection methods and the adequacy of its disclosure of credit terms. "We've talked with that bank about the bad manners they've had," he says. But Condusef hasn't taken any substantial action against Azteca, which says it scrupulously polices the behavior of its employees. Last year, in a brash move characteristic of Grupo Salinas, lawyers for Azteca went to court rather than comply with a new law requiring banks to inform clients of the total financing costs they are charged. Azteca sought a type of protective order with which individuals or companies can shield themselves from application of a particular law or other government action. A federal judge granted the exception.

Freed of disclosure requirements, Azteca continues stressing weekly payments rather than long-term interest rates. When pressed for its average annual rate, Azteca asserts that it is about 55%. But Chuck Waterfield, a consultant based in Lancaster, Pa., who specializes in financial modeling for micro-lenders, points out that if Azteca's average rate is translated to make it comparable with APRs in the U.S., it comes to 110%. That's because Azteca charges interest on the full amount borrowed throughout the life of the loan, even as the principal declines—not on the declining balance, as is common in the U.S. An adjunct professor at Columbia University's School of International and Public Affairs, Waterfield has no relationship with Azteca.

When Azteca loans go bad, the results can be bruising for borrowers. Porfirio Soriano Pérez and his son Zalatiel bought a \$1,435 Chinese-made motorcycle last year on an 18-month plan that required \$29 weekly payments. They intended to use the bike to scout out customers for the parsley they grow on several acres just outside San Martín Texmelucan. The Sorianos knew the 68% financing would boost the motorcycle's total cost to \$2,289, but they lacked cash to pay up front.

In February, disaster hit. A hailstorm wiped out their crop and with it their \$350 monthly income. "Suddenly," says Porfirio, "we had nothing to sell, and no money." They fell behind on payments. Soon a collection agent began showing up at the extended Soriano family's unpainted home. In October, Azteca delivered written warning of legal action. "The problem is that people go into the store and buy out of pure emotion," says Morales, chief of Azteca's local legal department.

The Sorianos already had paid \$1,560 on the motorcycle—more than the original sticker price—and owed about \$700 more, but ended up returning the purchase. That erased the debt in Porfirio's name. The company will resell the bike and recover the money it's owed. The Sorianos, meanwhile, have nothing left to plant a new crop.

[Debate Room](#): Does access to credit help or hurt the poor?

[Epstein](#) is a correspondent in *BusinessWeek's* Washington bureau. [Smith](#) is *BusinessWeek's* Mexico bureau chief.

The changing face of microfinance funding

Elizabeth Littlefield

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In the three decades since Muhammed Yunus gave his first \$27 loans to women in Chittagong, Bangladesh, the microfinance industry has come a long way. What began as a collection of individual non-governmental organisations funded by development donors has become a professional business offering not just credit, but a full range of banking services to poor people.

In Pictures: Superstars of Microfinance

Hundreds of microfinance institutions have matured and become profitable. Local commercial banks are beginning to see opportunities at the low end of their retail market. Even mobile-telephone operators are innovating with cellphone-based banking services.

It's attracted a flood of new money from investors and big commercial banks. There are now 80 investment funds that specialise in microfinance, 30 of which were established in the last three years. These funds are still small and highly concentrated in the leading institutions in Latin America and Eastern Europe, but their pool of capital available is growing fast. Big banks are also getting in the game: Citigroup, Deutsche Bank, TIAA-CREF, Morgan Stanley, ABN AMRO and Société Générale are deploying their structuring and fund-management skills to offer investment products that appeal to a broad range of investor-risk profiles and social motivations.

However, public commercial-investment agencies, such as the World Bank's IFC, the German KfW or the European Investment Bank, are currently the largest investors in microfinance. IFC, for example, currently has \$640 million in outstanding commitments to microfinance and plans to double this amount over the next three years. These investors offer equity, loans and guarantees -- and were a natural follow-on from the early grant money that helped build microfinance institutions into credit-worthy investments. Several are now providing local currency loans. IFC, for example, broke new ground in 2006 with its first local currency loan to Fundación WWB Colombia.

Thus a heated and healthy debate has emerged over whether these public-sector investments are now "crowding out" the private-investment funds by flocking to the same successful institutions. So what is the role of public agencies when so much investment capital is flowing in?

Traditional public donors were the angel investors of microfinance in its formative years, providing the seed capital for fledgling microfinance institutions, often through grants. Now, decades later, there are still critical gaps that the traditional aid agencies are best placed to fill despite the flood of new money:

Nascent markets: First, since the commercial-oriented investment is going mainly to advanced microfinance institutions and markets, many countries are left behind. Who will build the microfinance field in Sudan? Reaching poorer, more rural clients remains a key challenge. Research shows that microfinance actually tends to reach those at or around the poverty line, rather than those at the very bottom of the pyramid. The aid agencies, with their grant money and willingness to take higher risks for social aims, will be the ones to support early-stage microfinance in these markets.

Training: Second, most institutions need to strengthen managerial, information technology, product development and financial skills in order to grow. Technical assistance and training are the domain of development agencies.

Consumer protection: Third, governments all over the world are recognizing the potential of microfinance and are increasingly eager for advice on how to make it grow. Helping governments create laws and regulations that stimulate poor people's access to finance, while protecting customers, has long been a key role of organizations like the World Bank.

Financial infrastructure Fourth, creating local financial markets in poor countries that can work efficiently for their citizens means creating public goods like credit bureaus, payment systems, rating agencies. These require subsidies and technical assistance that traditional agencies can provide.

The endgame, of course, is for microfinance to principally fund itself -- as most retail banks do --through local deposits. Local funding is more stable and carries no foreign-currency risk. Moreover, secure deposit services are highly valued by poor people, some say far more than loans.

New technologies -- especially wireless services --promise to dramatically transform microfinance, allowing us to bring services to even the most remote and isolated areas where no branch would be viable. But this will only happen with the cooperation and complementary efforts of public and private players to develop markets and institutions that work for poor people.

In Pictures: Superstars of Microfinance

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Money & Investing

Microfinance Fever

Matthew Swibel 01.07.08, 12:00 AM ET

A lot of people are chasing returns in barefoot banking. Here's what you should know before you follow.

Maria Guadalupe Licon, of Tulancingo, Mexico needed to expand her herd. So she borrowed \$100 for six months from a microlender that charges on average 40% interest and purchased additional sheep and pigs.

The money came from somebody like J. Alex Hartzler. He and his partners sold their Web Clients ad business to online marketing firm ValueClick for \$141 million in July 2005. A Fulbright scholar who volunteered in Bolivia with the Mennonite Church before entering law school, he wanted to put some of his gains into doing good.

So Hartzler, now 39, invested first in an equity fund and later in a debt fund managed by MicroVest of Bethesda, Md. and backed by a portfolio of notes taken out by mostly small Latin American borrowers. The debt fund's target ten-year return of 6%, net of fees, is only two percentage points better than the yield on default-proof ten-year Treasury notes. Without the do-good feel, it probably wouldn't attract much capital. Hartzler sticks one-fifth of his international holdings in microfinance and the rest in mainstream exchange-traded funds.

There are, of course, less adventurous ways to be a socially conscious investor. You could join the crowd selecting mutual funds that exclude naughty companies, such as those (depending on your taste) that make weapons, sell tobacco or run nuclear plants. The Social Investment Forum claims that socially conscious funds account for 10% of managed money, or \$2.2 trillion.

Microfinance investing can be a little less passive than the average open-end fund. The idea gained attention when Muhammad Yunus won the 2006 Nobel Peace Prize. His Grameen Bank, founded three decades ago in Bangladesh, has \$521 million outstanding on loans to small businesses in poor countries. High-profile microfinance investors include Ebay founder Pierre Omidyar and Sequoia Capital, the venture capital backer of Google and YouTube. An estimated 40 funds focused on microfinance have been created since 2005.

As many as half of the world's 3 billion poor may be eligible for microloans. Average loan sizes vary from \$100 in India to \$1,530 in Bolivia. The current \$17 billion in loans outstanding represents 10% of the potential microfinance market, notes a 2006 McKinsey & Co. report.

Fixed-income microfinance funds return an average 5.8% in U.S. dollars, according to the Consultative Group to Assist the Poor, a group of 33 public and private development agencies. ProFund, the first private equity fund in microfinance, yielded an annualized 6.6% over ten years through 2005. Making loans directly to established microfinance institutions usually requires a minimum investment of \$250,000 to \$500,000. Depending on the fund, you can invest much less.

Not all these lenders are good ideas, though. "You need to discriminate between the 11,900 that aren't worth investing a dime in," cautions Michael Chu, a Harvard Business School professor and early investor in ProFund. Four Kampala microfinance firms are under Ugandan police investigation for cheating poor borrowers and refusing to fulfill withdrawal requests.

Many microfinance lenders function like banks. They pull in deposits from people in their communities. They rely on foreign investors for their risk capital, a mix of equity and subordinated debt.

The table lists the top ten of the better microfinance institutions. To assemble the list, we asked the Microfinance Information Exchange for financial results for 641 microfinance providers, and our list includes only those that reported audited financial statements. Also helpful were credit ratings from Sanjay Sinha, managing director of Micro-Credit Ratings International Ltd. in India, and Damian von Stauffenberg of MicroRate in Arlington, Va. Table standings reflect a consolidated score for four criteria (scale, efficiency, portfolio risk and profitability). For the full list, visit www.forbes.com/microfinance.

Top-ranked Asa (Bengali for hope) was founded as a civil rights organization in 1978 by a group of young people fighting a liberation struggle against Pakistan, but it didn't start issuing credit until 1991. A staff of 23,000 working at 3,300 branches across Bangladesh services loans, which average \$110, to 5.5 million borrowers.

Crediamigo is the microfinance arm of Banco do Nordeste, a combination development, investment and commercial bank with 174 branches covering 1,955 cities in Brazil. It finances 77% of all the rural and industrial loans in the country's Northeast region. The Brazilian federal government controls 90% of Crediamigo shares with the remainder in private hands. Crediamigo caps loans at \$1,400 and mostly pushes small loans lasting 3 to 18 months. These average \$375 and come with a steep 35% interest rate.

The Top Ten Microlenders

With help from data providers (listed below), we culled these microfinance institutions from a field of 641, using a combined average score in four categories—scale, efficiency, portfolio risk and profitability.

RANK	NAME OF MICROFINANCE INSTITUTION COUNTRY	COST PER BORROWER ¹	RETURN ON ASSETS ²
1	Asa Bangladesh	1.17 %	14.4%
2	Bandhan (Society and NBFC) India	0.70	9.1
3	Banco do Nordeste (Crediamigo) Brazil	1.52	17.2
4	Fundación Mundial de la Mujer Bucaramanga Colombia	3.37	8.5
5	FONDEP Micro-Crédit Morocco	2.62	19.2
6	Amhara Credit & Savings Institution Ethiopia	3.65	7.9
7	Banco Compartamos, S.A., Institución de Banca Múltiple Mexico	1.80	23.2
8	Assoc. Al Amana for the Promotion of Micro-Enterprises Morocco Morocco	2.67	4.4
9	Fundación Mundo Mujer Popayán Colombia	2.45	7.7
10	Fundación WWB Colombia – Cali Colombia	3.45	5.2

¹Cost expressed in operating expenses per active borrower as a percentage of gross national income per capita. ²Net income as a percent of average total assets. Sources: The Microfinance Information Exchange; MicroRate; Micro-Credit Ratings Intl. Ltd.

With 537,000 borrowers and another 225,000 savers (as of December 2006), Amhara Credit & Savings Institution in Ethiopia is one of Africa's largest microfinanciers. On overhead it consumes only 5 cents of every net dollar lent (that's after interest costs are subtracted).

It keeps staff costs low and is frugal on such expenses as electricity. These microlending organizations have low default rates. The share of Amhara's loans in default or more than 30 days late on interest and principal payments, as of year-end 2006, was 1.5%.

Our top ten's overhead costs are low, ranging from 0.7% to 3.65% of gross national income per capita. They spend next to nothing on marketing and not much on paperwork. Our microfinance lenders show returns on assets that would be eye-popping for a commercial bank. Mexico's Banco Compartamos has a 23.2% ROA. How does it do that? Its loans cost on average a usurious-sounding 80% in interest. Also, its equity comes to 42.3% of assets, a much higher ratio than you'd see at any ordinary bank.

Here are ways do-gooders can join in:

MicroPlace.com, launched by Ebay this past October, is a regulated broker-dealer that sells microfinance loans online as securities through the Calvert Social Investment Foundation and Oikocredit USA. Most such securities mature in three years and yield 3%. You need as little as \$100 to get in. The Web site has attracted \$500,000 so far. The prospectus can be found on the site.

So-called microfinance investment vehicles typically either resell a basket of debts held by microfinance institutions or make equity investments in lenders directly. Minimum investments range from \$100,000 to \$500,000. One of the largest, MicroVest (\$39 million in loans outstanding), is typical in that it raises money via private placements and is therefore not registered with securities regulators in states where it is offered. To gauge a fund manager, you should request a prospectus; they're usually not available on Web sites.

Downside: Expenses can be high, up to 2.5% of assets annually. Liquidity is as low as in a limited partnership or hedge fund: You have no right to withdraw before the announced close-down date (typically, in seven to ten years) and so would have to take your chances selling on the secondary market.

One other potential catch: If you invest in a microfinance fund incorporated offshore, you could get hit with a nasty "penalty tax" on "excess distributions" if the fund is liquidated and the right paperwork isn't done. (That's in addition to the normal tax on earnings from the investment, which might also drive up your tax accountant's bill.)

One way around this is practiced by Philip Smith of Tulsa, Okla., the former chief executive of Prize Energy, an oil and gas firm. He is investing in microfinance with dollars he's earmarked for charity anyway, using a donor-advised fund. Here, you donate cash, or better yet highly appreciated stock, to a fund and claim an income tax deduction now. Then you and your heirs dribble out contributions to favorite charities over the years.

Meanwhile, your charitable kitty is invested and (it's hoped) earning more for charity. Most community foundations, including ones in New York, Tulsa and Oakland, Calif., as well as religiously affiliated entities, allow donor-advised dollars to be invested in microfinance. So your dollars do good overseas, even as they earn a (modest) return for charity. And you avoid tax hassles. (Warning: Donor-advised funds affiliated with virtually all mutual fund companies, such as Vanguard and Fidelity, don't offer this option.)

Or you could buy shares in one of the handful of microlenders that are traded publicly. Alas, all but one are listed in such places as Indonesia and Kenya, where it's hard for foreigners to buy shares.

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Biographical Note

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Damian von Stauffenberg is the founder of **MicroRate**, the world's first rating agency specializing in microfinance. Through its Latin American and African operating subsidiaries, MicroRate has conducted well over 400 ratings of microfinance institutions in Latin America, Africa and Eastern Europe. Before dedicating himself to microfinance, Mr. von Stauffenberg worked for 25 years in the World Bank and its private sector affiliate, the International Finance Corporation (IFC).

Mr. von Stauffenberg has been closely associated with a number of institutions that have played pioneering roles in connecting microfinance to capital markets. He has been President of Seed Capital Development Fund (**SCDF**), Chairman of the Investment Committee of **Profund**, Chairman of the executive committee of **MicroVest** and member of the Executive Committee of the Latin American Challenge Investment Fund, **LA-CIF**.



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