

BULLETIN HIGHLIGHTS

2004 Benchmarks: Profitable Growth Continues to Drive Down Costs

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OVERVIEW OF BENCHMARK DATA SETS

MIX's *MicroBanking Bulletin* 2004 benchmarks bring the reader the broadest coverage ever of the performance of microfinance institutions around the world. The following *Bulletin Tables* present the median financial and operational results for 302 MFIs, covering the spectrum of institutions providing microfinance services in 67 markets around the globe.

This number represents a significant increase over the coverage, up 71 MFIs overall (+30%), from 231 MFIs in 2003 coverage. Coverage grew rapidly in a number of areas. In geographic terms, Latin America continues to lead and nearly doubled, to 97 MFIs from 52 in 2003, reflecting the greater access to quality information available from regulated institutions – and unregulated, alike – across the region. Eastern Europe & Central Asia (60 from 49) and Asia (68 from 57) also showed large increases.

By Charter Type, 2004 saw the most significant increase of coverage of Non-Governmental Organizations (NGOs) & Non-Bank Financial Institutions (NBFIs), up 39 and 24 MFIs respectively. By Age, Mature institutions increased in number to 151 (up 55 from 2003), while Young MFIs increased to 111 (up 23); with fewer start-up institutions added to coverage, New MFIs actually fell to 40 from 47 in 2003.

Given this significant expansion to some peer groups' coverage, users of MBB 12's *Bulletin Tables* are urged to remember these sample changes when looking at prior year results, as these changes likely impact the median values presented. Serious researchers should check the entire set of 2004 benchmark tables posted at www.mixmbb.org for a complete statistical representation of the 2004 results. All users should bear in mind that the undoubted value-added of expanding the coverage in the annual *Bulletin Tables* always comes with some trade-off to continuity of the results and therefore the validity of conclusions one may draw from comparisons with prior periods' results.

The second edition of the *MicroBanking Bulletin Trend Lines*, presented in this issue, is intended to address the pressing need to meaningfully track industry performance over time. Up 50% in size from the first publication of *Trend Lines*, the 91 MFIs that compose the *Trend Lines* 2001-04 benchmarks offer the microfinance public a unique glimpse into evolving trends in MFI performance around the globe.

The combined 2004 survey and *Trend Lines* 2001-04 present the most comprehensive picture available on state of microfinance and its development over the last few years. The results show an industry with strong growth, increasingly drawing on more market-based funding. As MFIs make continual gains in efficiency and drive down transaction costs, they shore up their returns increasing their attractiveness to investors and enabling them to reduce costs to clients.

The following pages offer short **Highlights** of these results and trends.

Significant growth in borrowers and loan portfolio, greater with savings-led institutions

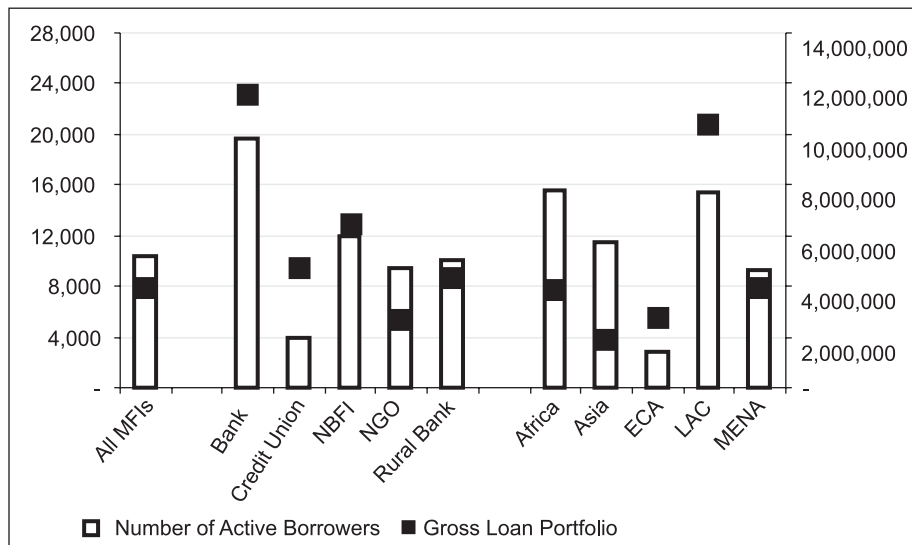
As growth in the median number of borrowers by MFI topped 50% in some regions, total outreach for

the 2004 benchmark data set grew to 6.7 billion USD in loans to nearly 19 million clients. MFIs' borrower base grew by 30 percent in 2004, but MFIs in S. Asia averaged 50 percent growth from 2003 to 2004, continuing strong outreach trends from the prior periods. For South Asian MFIs, these new clients build on some of the largest client bases globally. With MFIs averaging nearly 100,000 new borrowers each in the 2004 survey, leading MFIs in this region are both fast growth (relative) and high growth (absolute) institutions.

Globally, banks reached the most clients and served the largest loan portfolios, as **Figure 1** demonstrates. In every size category (small, medium, large) and in almost every region (Africa, Asia, Latin America), MFIs which source deposits from the public and members manage larger loan portfolios than credit-only institutions, while reaching broadly the same number of borrowers. In general, outreach and loan portfolio size increase with institutional age, average

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Figure 1: Growth in borrowers and portfolio



Source: MIX 2004 Benchmarks; Results are peer group medians.

loan balance size, profitability, and level of retail financial intermediation.

Within the regions, Latin American MFIs lead in borrower outreach and loan portfolio size. Larger absolute loan sizes boosted loan portfolio size, and branch-based networks covered more clients than community-owned or single-branch institutions common in other parts of the world. Africa tied Latin America in outreach but lagged in loan portfolio size, given smaller absolute average loan balances. MFIs in regions where microfinance is a more recent development — Middle East / North Africa and E. Europe and Central Asia — still lag behind other regions in loan portfolio size and outreach, though some leaders in Morocco are pulling norms in the region.

As with earlier *Bulletin* analysis, the *Trend Lines* covering 2001 to 2004 once again demonstrated that profitable MFI lead the charge in expanding access to finance. Over the period, the 91 MFIs in the *Trend Lines* data set added five million borrowers. Of these new clients, 90% relied on profitable MFIs for service, an unsurprising result given that these same MFIs served nearly six times as many clients, on average, as those still unable to cover financial and operating costs.

MFIs increasingly grow through leverage, but unequal access to debt remains

Accompanying strong growth in outreach, industry leverage improved globally over 2003 levels, as the capital/asset ratio slid from 39 to 33 percent. MFIs at a global level increasingly relied on debt to fund their activity, moving away from donor grants towards capital markets, including lines of credit from the

banking system. At the same time, the proportion of commercially-priced debt financing the loan portfolios increased at a similar pace (from 44 to 49 percent), meaning that market-priced funds made up an increasingly important share of MFI funding.

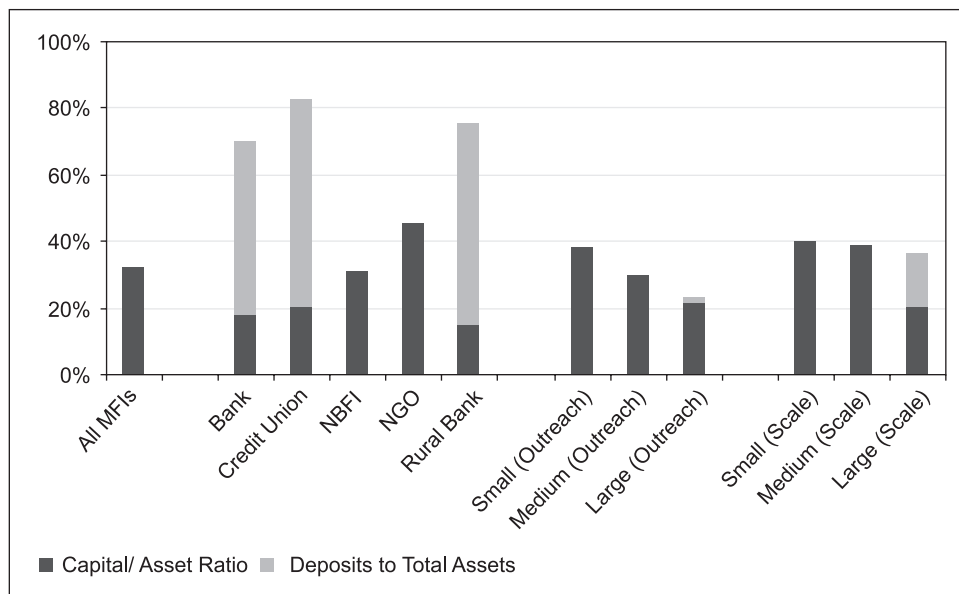
Also noticeable is that larger-scale institutions leveraged capital. Larger-scale institutions — whether in terms of their outreach or loan portfolio — were more than twice as leveraged as their smaller peers and exceeded the global median capital/asset ratios by 50 percent, as **Figure 2** captures. Moreover, growth was increasingly funded by market rate liabilities, both savings and borrowings. As they leveraged more funds, large scale actors relied on commercial financing for funding nearly three-fourths of their portfolio, twice the rate of smaller size institutions.

Savings provided the leading source of funds for retail financial intermediaries, while capital (equity, retained earnings, grants) persisted in dominating NGO financing. Banks, credit unions and rural banks sourced more than half their funds from retail microfinance customer deposits, and funded over 95 percent of their portfolio from commercial sources. NGOs, on the other hand, continued to depend on donated capital and retained earnings (for the profitable ones) for 50 percent of their funding. As a result, regions like the Middle East / North Africa — where NGOs dominate institutional models — drew less than 10 percent of loan portfolio funding from commercial sources.

Returns increase as costs come down

Sustainability gained ground and coverage as profitable MFIs flourished in 2004. Profit-making institutions added 25 percent more borrowers than

Figure 2: Financing growth through debt



Source: MIX 2004 Benchmarks; Results are peer group medians.

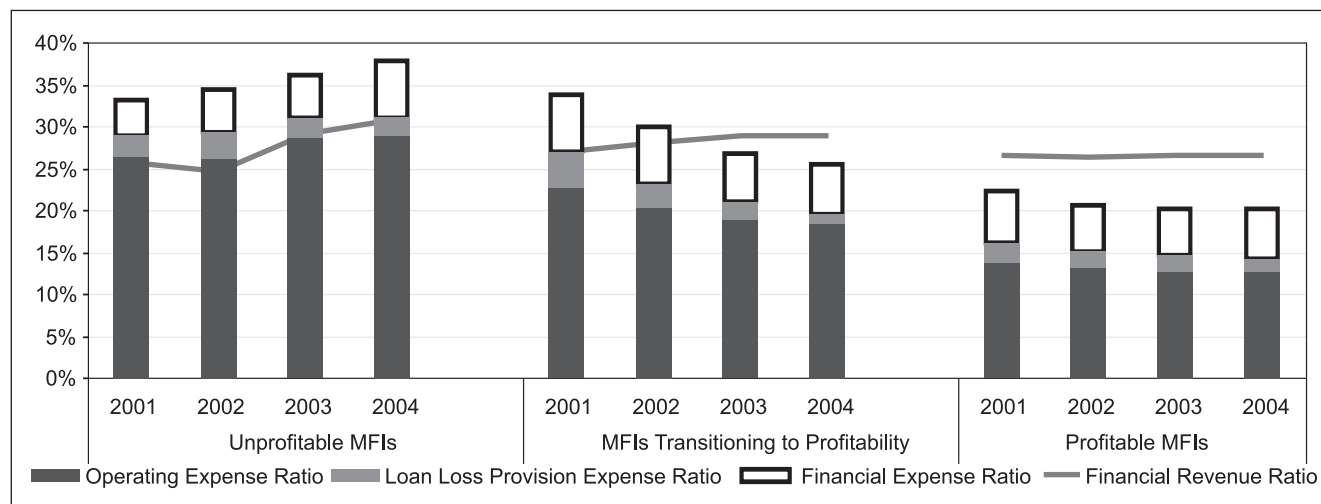
their unprofitable peers in relative terms, topping average growth of 30 percent. In absolute terms this means that sustainable MFIs added over double the number of borrowers, on average, as loss-makers. By year's end, the 70 percent of MFIs earning profits reached well over 90% of total borrowers.

Regulated institutions continued to beat down costs, but offer larger loans. Banks, credit unions and regulated MFIs brought down the bar on operating and financing costs. Compared with their NGO peers, regulated MFIs managed assets and offered services at one third less expense than unregulated institutions. With little to no difference in financing costs, regulated institutions gained on operations. This trend overlaps with a broad pattern of generally

decreasing operating costs with larger size loans. Banks and other regulated institutions offered loans that are two to three times larger in relative terms, compared with those managed by NGOs.

Analysis of trends over the four year period, confirms previous observations on revenue and expense levels of institutions across the profitability spectrum. When grouped by profitability (Unprofitable, Transitioning to Profitability, and Profitable), the *Trend Lines* MFIs demonstrated once again that profitable MFIs earn positive returns through lower operating costs and strict delinquency management. **Figure 3** presents a striking picture of these trends, as profitable MFIs beat down operating costs to improve margins and institutions breaking the profit barrier did so through

Figure 3: Profitability and cost structure



Source: MIX Trend Lines 2001-04; Results are weighted averages.

greater control over their portfolio quality, while also lowering operating costs.

Retail financial intermediaries profited through low costs – their clients profited through lower interest rates. In Africa, Eastern Europe / Central Asia and Asia, deposit-taking MFIs outshined same-size regional peers with lower cost structures. Customer deposits kept overall costs of funds down, as much as 50 percent lower than for non deposit-taking institutions. Globally these retail financial intermediaries have developed lending and deposit taking systems that earn them significant operational efficiencies, providing the greatest savings in overall costs. As a result, borrowers of these institutions paid less for their credits than those borrowing from credit-only MFIs. Compared with a global average of 35 percent, portfolio interest rates at deposit-taking MFI were six points lower.

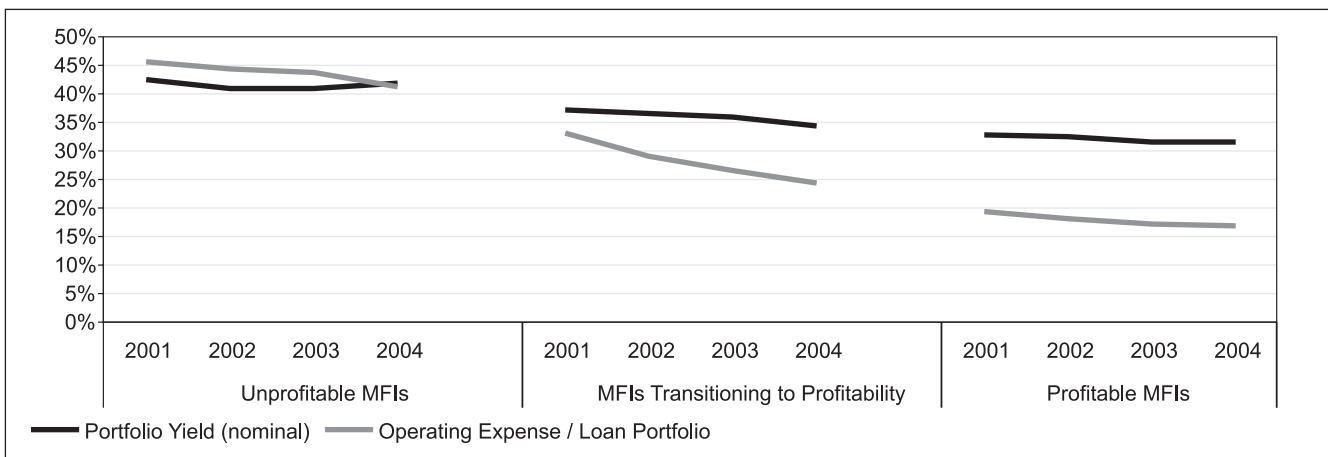
The strong efficiency gains demonstrated by profitable institutions also translated into lower costs for their clients. *Trend Lines* MFIs continued to demonstrate

that the profit seeking strategies that institutions implemented relied on pushing down transaction costs. The greater efficiencies that **Figure 4** depicts, allowed profitable institutions to shore up their returns while simultaneously decreasing costs to their clients. Over the period, unprofitable institutions charged clients an average 42 percent, while profitable MFIs used efficiency gains to decrease their yields from 34 to 31 percent and still maintained enough spread to cover financial costs and loan loss and make six percent adjusted returns on assets.

Productivity gains achieved through scale help MFIs push down transaction costs

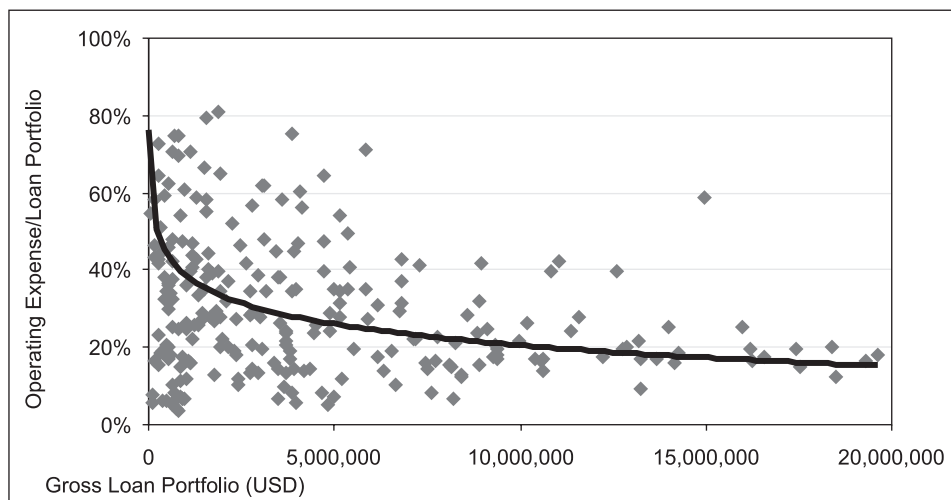
Transactions costs dropped dramatically with scale. Operating costs plummeted relative to loans under management as portfolio size increased. **Figure 5** shows that MFIs made significant gains on operational expenses – dropping by two thirds – as the portfolio increased to 10,000,000 USD, leveling

Figure 4: Efficiency for profit means savings for clients



Source: MIX Trend Lines 2001-04; Results are weighted averages.

Figure 5: Decreasing transaction costs with scale



Source: MIX 2004 Benchmarks; Results are individual MFI observations.

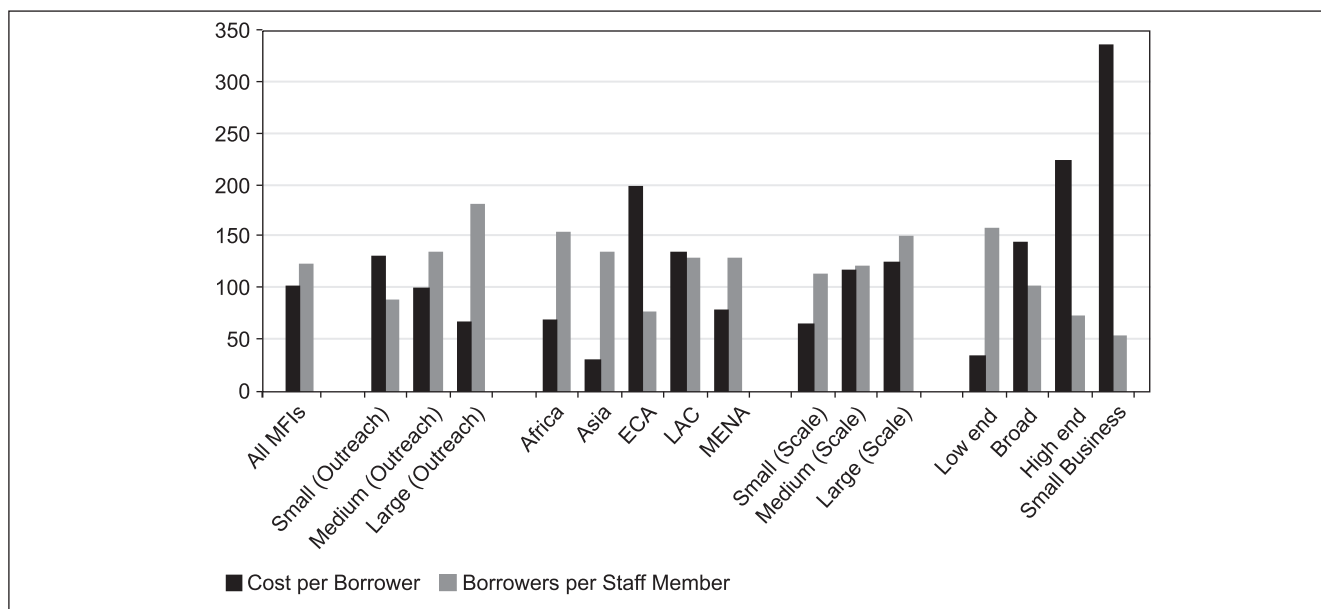
off thereafter. While few MFIs pushed the operating efficiency frontier lower, South Asian MFIs stood out with operating costs hovering around 12 percent, thanks to low personnel costs combined with highly leveraged delivery channels.

Productivity gains also boosted efficiency as MFIs reach scale. Gains in efficiency related to outreach were tightly linked to staff productivity. Cost per borrower dropped quickly by successive thirds as MFIs reached 10,000 and 30,000 clients, falling from 130 to 65 USD per borrower. As the **Figure 6** demonstrates,

staff productivity drove lower costs associated with increased outreach. Median productivity doubled between small and large outreach institutions, reaching 180 borrowers per staff.

Costs to clients continue to decline as MFIs seek to meet the twin goals of improving their bottom line while increasing service to their clients. This year's *Trend Lines* MFIs once again clearly demonstrate that finance for the majority can be profitable to both clients and the institutions serving their financial needs.

Figure 6: Productivity pushes down costs



Source: MIX 2004 Benchmarks; Results are peer group medians.