

Overview of Benchmark Data

Since its launch in 2005 MIX's Trend Lines MFI analysis has increased the scope for deciphering trends in the microfinance industry by isolating and tracking the performance of a common set of MFIs over a given period. The Trend Lines 2003–05 doubles the coverage of the previous historical data set, expanding to 200 MFIs. For the first time, Trend Lines brings even coverage from all regions, including sub-Saharan Africa and Asia, representing 75 countries and 21 million borrowers in 2005. Taken as a group, Trend Lines MFIs represent over two thirds of the total borrowers covered in MIX's 2005 MFI benchmarks making this the most representative data set to date for historical analysis of industry trends.

Readers interested in exploring the full range of performance benchmarks and statistics can find them in electronic copy online at www.mixmbb.org or www.themix.org as downloadable Microsoft Excel files. Starting with the 2005 MFI benchmarks, these benchmarks now include the 25th and 75th percentile for all performance ratios allowing users to paint a more complete picture of the range of MFI performance.

Talk of commercialization, once the reserve of analysis of Latin American microfinance, has captured the global microfinance news headlines over the last few years. Greenfield microfinance banks have opened their doors and grown in waves, whether as affiliates of networks like ProCredit or as independent ventures like those registering under the Pakistani microfinance bank law. Alongside these regulated MFI start-ups, many NGOs have transformed, shedding their non profit status to pursue operations as regulated financial service providers. After the numerous examples of institutional transformation in Latin America in the late 1990s and early into this decade, these last three years have seen the ranks of transformed institutions expand in Africa and Asia. The set of 200 Trend Lines MFIs from around the globe offers a unique glimpse into this phenomenon and the mark it has left on the industry in the last few years.

Trend Lines MFIs mirror the growth of commercialization in the broader microfinance sector. NGOs started the period as the single largest group in the Trend Lines sample, representing nearly 45% of the 200 institutions. Just two years later, NGOs and specially licensed financial service providers (NBFIs) vied for the top spot in the sample. NGO market share

of borrowers, while still dominating the sample, fell from 54% to 51% in two years as a number of high growth institutions changed legal status to become regulated financial service providers. NBFIs picked up market slack, increasing their share of clients by half, from 14% to 22% over the same period.

Change in legal status is not the only reflection of increasing commercialization. Across the Trend Lines MFIs, marked changes occurred in outreach and performance. Profits increased as start-up microfinance banks and their investors aimed to reach breakeven more quickly than their NGO predecessors, and transforming institutions sought to maintain the profitability that attracted their initial shareholders. Both strove for profits by driving down costs and scaling up services. As Trend Lines analysis shows, these trends spilled over into the broader microfinance sector, especially in markets where competition had increased. High growth, positive returns, increased commercial funding, and increasing efficiency are not the reserve of for-profit MFIs.

Strong, persistent growth ...

The scale of microfinance services has grown substantially in the last three years. Successful

retail institutions have built on existing products and brought in new clients at a rapid pace. While median compound annual growth rates hovered at nearly 25% over the period, the top quarter of high growth MFIs added new borrowers at rates above 40% annually. In total, the 200 Trend Lines MFIs added over seven million new borrowers, more than 50% above the number served by the end of 2003. Deposit-taking services, while growing at a slower rate, reached another six million savers over the same period, as **figure 1** demonstrates. The continuing commercialization of the sector has also meant more optimal asset management, with loan portfolio growing faster than total assets to reach a total of over US\$7 billion by end 2005.

Leading the growth charge, specialized commercial institutions — non bank financial institutions (NBFIs) — grew at an average rate of just under 40%, well above the sample median and just a few points below the top quarter of all Trend Lines MFIs. Their unregulated NGO and cooperative peers grew at rates on par with or below Trend Lines averages. Within the group of NBFIs, institutions that became regulated between 2003 and 2005 grew the fastest, adding nearly 55% more clients in the year 2004–05 alone, as **figure 2** portrays. With few exceptions these newly regulated MFIs parlayed their new legal structure and capital base into some of the highest client growth rates in borrowers served in the sector. Only the institutions transforming under the new Ugandan regulatory status stagnated in borrower outreach as they cleaned up portfolios and focused on developing savings services. Excluding the Ugandan transformers, borrower outreach increased by an average annual 70% in transforming MFIs between 2003 and 2005.

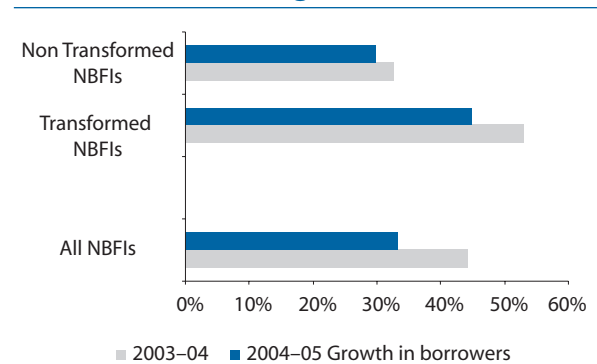
Greenfield MFIs also pulled ahead of global average growth rates, with the median start-up institution

Figure 1: Growth in microfinance services

	2003	2004	2005
Borrowers (millions)	14.0	17.2	21.2
Savers (millions)	35.6	38.3	41.5
Offices (thousands)	11.2	13.1	14.8
Employees (thousands)	85.9	113.2	128.0
Assets (USD billions)	7.3	8.9	10.7
Loan Portfolio (USD billions)	4.3	5.7	7.1
Voluntary Deposits (USD billions)	4.4	5.0	5.7

Source: Microfinance Information eXchange, Trend Lines 2003–05 MFI benchmarks. Results are totals.

Figure 2: High growth in borrowers from transforming MFIs

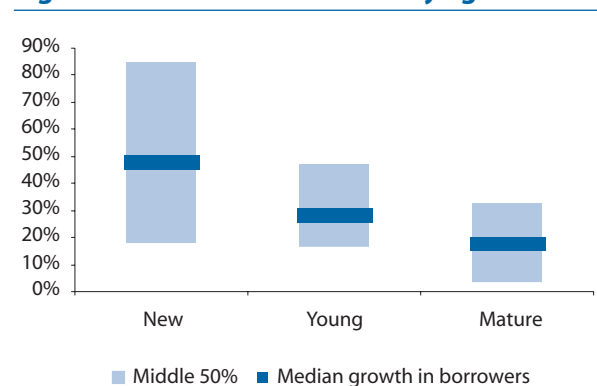


Source: Microfinance Information eXchange, Trend Lines 2003-05 MFI benchmarks. Results are averages.

annually adding 50% more borrowers. It is this group of new institutions, with their small relative client bases, that shows the greatest variance in growth rates, with the middle half of MFIs growing at rates varying from 20% to nearly 90%, as **figure 3** highlights. Maturity generally slows the relative pace at which MFIs build their client base, but even then specific regional examples diverge from the norm.

Around the globe, Asian MFIs and those from the Middle East and North Africa (MENA) exceeded global annual growth rates in borrowers. In Asia, home to some of the world’s largest unserved microfinance markets, leading MFIs grew at rates above 50%, placing them among the top quarter of the world’s fastest growing institutions. Among them, two Indian MFIs grew at rates over 100% for both years despite already serving more than 100,000 clients each. Other Asian markets also saw rapid growth in borrowers, as Bangladesh, Pakistan, Cambodia and the Philippines all had at least one institution in the top 25% of all high growth MFIs. In MENA, a

Figure 3: Growth in borrowers by age



Source: Microfinance Information eXchange, Trend Lines 2003–05 MFI benchmarks. Results are medians, first and third quartiles.

relatively young microfinance region, MFIs in four of the six markets covered in this survey ranked among the top quarter globally. Moroccan MFIs took the top spots, rapidly expanding client outreach even as their market penetration remained higher than in any other country in the region.

... leads a surge in commercial funding ...

Rapid growth in borrowers outreach has been funded by record growth in commercial borrowings. As MIX's 2005 benchmarking analysis already highlighted, 2005 marked a watershed year for commercial funding of microcredit, with the median MFI sourcing more than half its funding from commercial sources, including commercial borrowings and customer deposits. A look at the three year horizon underscores just how rapid this change has been. From just 40% in 2003, the median institution's commercial funding of its loan portfolio jumped to 60% by 2005, an increase of nearly half, as **figure 4** makes evident. This trend holds across nearly every region and every type of institution. In sum, the balance sheets of Trend Lines MFIs held US\$1 billion more in commercial borrowings in 2005 than two years prior. With the rotation of capital on MFI balance sheets over the period, total new commercial borrowings entering these MFIs probably reached a multiple of this amount.

Regulated institutions have helped attract increasing volumes of commercial borrowings to microfinance. Just under half of the additional US\$1 billion was added to balance sheets of NBFIs, with another quarter absorbed by banks. Comparisons to total equity reveal the quickening pace of this trend. In 2003, commercial

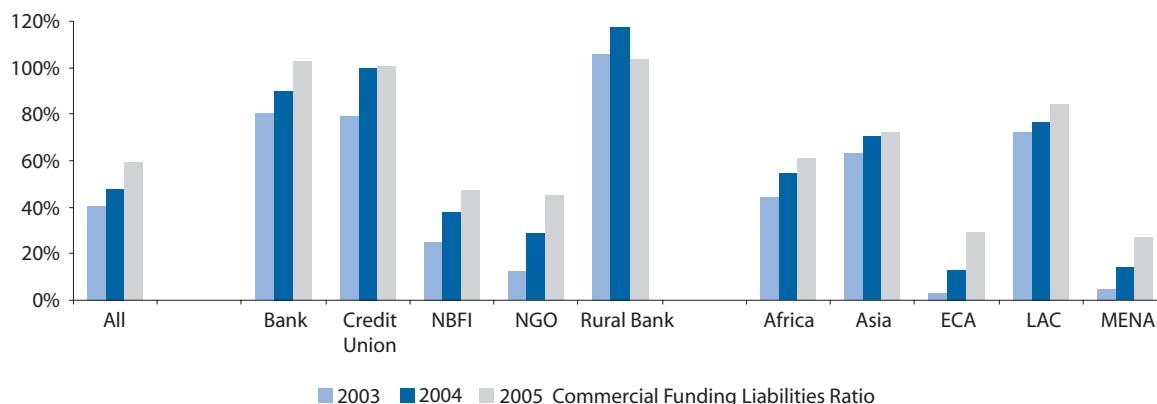
borrowings leveraged NBFIs equity one-to-one, but by 2005 that leverage had increased 50%. The strong uptake in commercial borrowings has also spilled over into unregulated institutions. NGOs, some of the largest service providers globally, added just under a third of the additional commercial funding, but did so at a much lower rate than NBFIs. By the end of 2005, less than 75% of the non profits' capital was leveraged with commercial debt. As commercial investor interest grew during the period, regulated institutions captured the majority of the growing capital flows.

Commercialization is also evident in the quickening pace of commercial financing of the sector. Around the globe, market-priced borrowings grew faster than total loan portfolio. Latin America, the earliest region to commercialize, still accounts for the lion's share of new commercial borrowings, drawing in more than half of the additional market-priced debt. Well ahead of MFIs in other regions, the median Latin American MFI sourced nearly 90% of its loan portfolio from commercial debt and customer deposits by the end of the period. Growth and solid returns attracted investor attention to ECA and MENA, as well. While the median institution remains dependent on donated capital, retained earnings, and concessional debt for financing its microcredit portfolio, the share of commercial borrowings has rapidly increased in both regions, expanding from less than 5% of total loan portfolio in 2003 to over a quarter by 2005.

... attracted by positive but slowly growing returns ...

Around the globe growing returns helped attract greater investor confidence and commercial funding.

Figure 4: Rapid growth in commercial funding of microloan portfolios



Source: Microfinance Information eXchange, Trend Lines 2003–05 MFI benchmarks. Results are medians. NBFIs = Non Bank Financial Institution; NGOs = Non Government Organization; ECA = Eastern Europe and Central Asia; LAC = Latin America and the Caribbean; MENA = Middle East and North Africa.

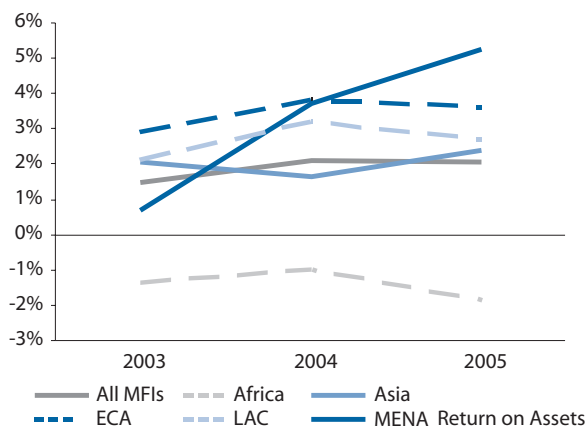
In all regions expect Africa, returns on average assets crept up over the three years, as the gently sloping arcs in **figure 5** depict. In Africa, a combination of high operating costs, low yields and poor portfolio quality continued to drain revenues. MENA institutions, still relatively unfettered by high financing costs, bolstered their earnings by leveraging institutional infrastructure to expand outreach while reducing operating costs.

personnel costs relative to local income levels, as well as a greater incidence of portfolio delinquency. The net result is a median African MFI with negative returns that have deteriorated in the three years. In contrast, the young MFIs in MENA's microfinance sector boosted efficiency in their operations thanks to consistently above average staff productivity, while maintaining strong portfolio quality. The combined gains allowed them to pursue growth in returns over the period, even as financial costs began to rise.

Figure 6 highlights the impact of the rapid expansion in commercial borrowings on overall returns. In all regions except Latin America, financing costs increased relative to average assets over the period, dampening gains in efficiency to produce slower growth in returns. For African MFIs, these additional costs came on top of operations plagued by high

Increasing financial costs also dampened returns for specialized regulated MFIs. Despite small gains in efficiencies over the three years, the median NBFI faced increases in funding costs as the share of commercial debt grew in its funding mix. By the end of the period, funding costs had risen 20% relative to total assets. NGOs managed to continue their strong returns by decreasing operating expenses faster than the rise in financing costs. On the whole, these non profits still ended the period spending a third more on operating expenses than their regulated peers, translating into higher costs of service for microfinance clients.

Figure 5: Growing returns begin to slow

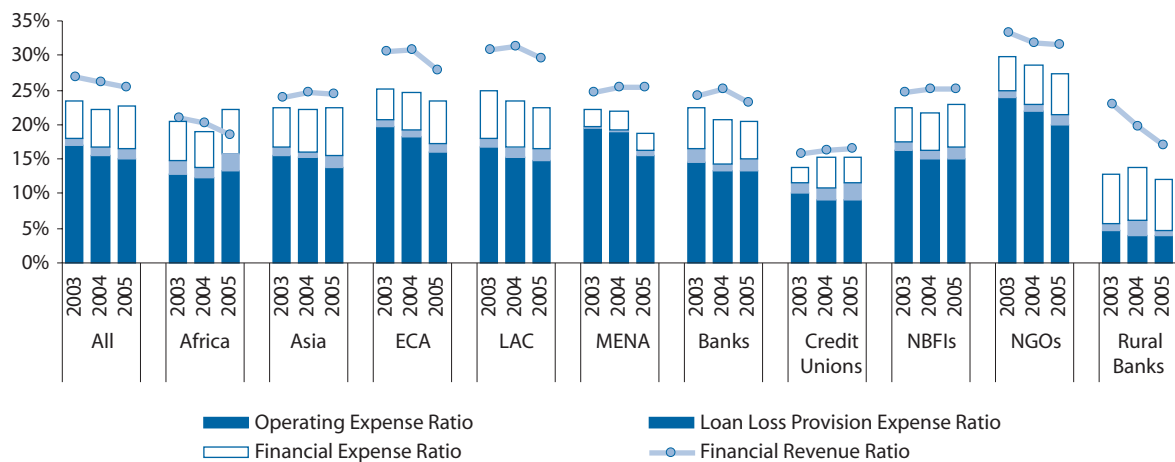


Source: Microfinance Information eXchange, Trend Lines 2003–05 MFI benchmarks. Results are medians. ECA = Eastern Europe and Central Asia; LAC = Latin America and the Caribbean; MENA = Middle East and North Africa.

... and led by market competition that drives down prices.

As the trends of the past years show, greater access to commercial funds helps fuel growth in client outreach. Yet, it also raises the cost structure that the institutions must overcome in order to make a profit. In response to elevating financial expenses that have drained the momentum behind rising returns, MFIs have had to continually strive to reduce operating costs to keep their margins. Successful ones achieved greater

Figure 6: Rising finance costs dampen returns



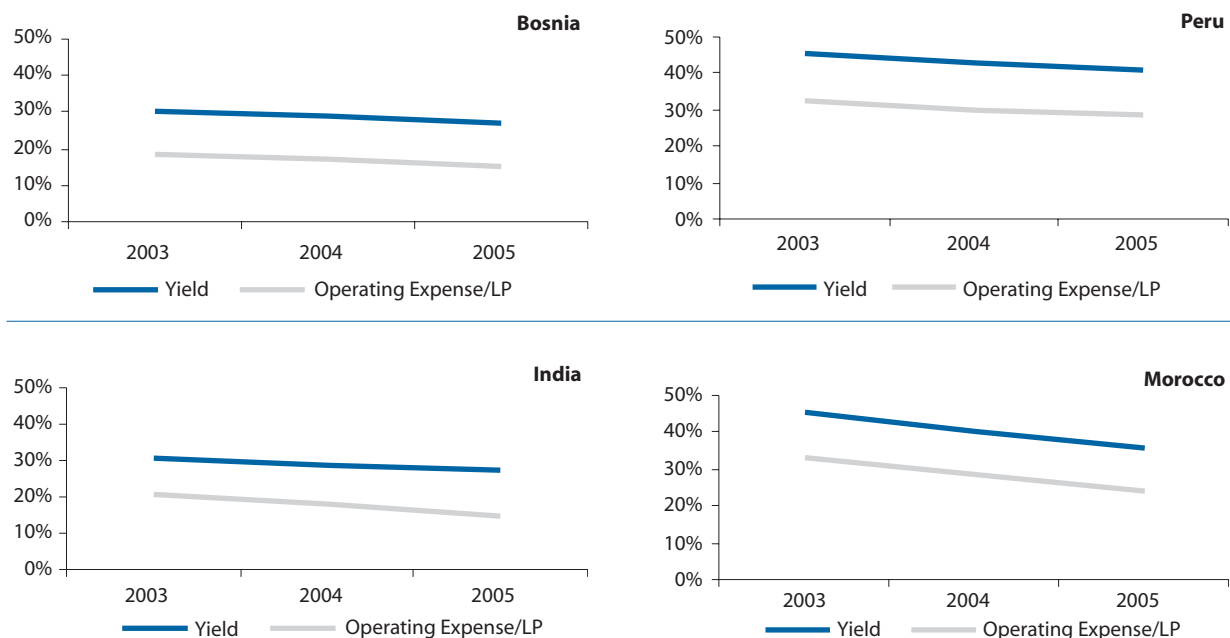
Source: Microfinance Information eXchange, Trend Lines 2003–05 MFI benchmarks. Results are medians. NBFIs = Non Bank Financial Institution; NGOs = Non Government Organization; ECA = Eastern Europe and Central Asia; LAC = Latin America and the Caribbean; MENA = Middle East and North Africa.

efficiency through better product development and roll-out, improved staff training, streamlined processes, new technologies and other systems and procedures. The momentum behind these changes often allows MFIs to maintain their margins while also passing lower prices along to their clients.

While few countries have national competitive microfinance markets, many have seen competition heat up in recent years in major urban centers. **Figure 7** shows the results of this competition and increased efficiency across four countries on four separate continents, but the same trend holds for a dozen other markets included in this Trend Lines. Across the board, operating costs have come down, by nearly ten points in places like Morocco where rapid market expansion in the past few years has put leading MFIs in closer proximity with one another and with second tier institutions. At the same time, Indian MFIs decreased their already low operating costs by nearly a third and started to lower their price to customers, even before the March 2006 crisis and political pressure brought them down further still. The end result is the same: increasingly efficiency leading MFIs define the lower bounds of service delivery costs, bringing down rates for microfinance clients.

Improving efficiency is just one of the challenges that microfinance institutions face: scaling up service delivery, training and retaining human talent, improving systems and procedures, diversifying product offering, retaining clients, and sourcing adequate funding. Yet, this Trend Lines sample shows that leading institutions are resilient in the face of these challenges. With the strong entry of commercial funding into microfinance, the hurdle in accessing funding will shift back to institutional capacity and the ability of other market actors to structure and sell the appropriate financial products for MFIs to grow. Strong growth in start-up and transforming MFIs demonstrates the continued potential for institution-based outreach in reaching massive market demand, even as new technology-based delivery channels offer the promise of services at altogether different magnitudes. In the end, though, bringing down MFI transaction costs remains the greatest challenge. Few institutions outside South Asia deliver services below the ten cent mark, and in most regions, efficient MFIs hover around 20% operating costs. Facing and overcoming most of the challenges cited above will translate into lower costs. How much lower? MIX Trend Lines will track and report on these and other market developments over the coming years.

Figure 7: Costs drop in competitive markets along with prices



Source: Microfinance Information eXchange, Trend Lines 2003-05 MFI benchmarks. Results are averages.