

BULLETIN HIGHLIGHTS

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Before the Crisis: A Look at MFI Trends in 2005 – 2007

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Overview of Benchmark Data

By the third quarter of 2008, as the financial crisis was consuming large investment and commercial banks and the flow of credit dried up, the microfinance community asked itself how the crisis in the broader economy would impact microfinance institutions (MFIs). Evidence from analysis¹ of past crises has shown that MFIs have weathered earlier financial sector upheavals in Asia and Latin America with only slight increases in arrears and a negligible rise in actual credit default. Yet, microfinance institutions have changed substantially since those crises of the late 1990s. Sustained growth rates of 25 percent or more have become the norm in many countries since 2000, bringing more MFIs face-to-face with each other in many local markets. To finance this growth in loan portfolio, MFIs have turned from their earlier public funding sources towards their clients and external creditors, both domestic and foreign. Retail deposits and, for a growing number of MFIs, domestic and cross-border debt enabled these sustained growth rates in the lending portfolios. Forthcoming 2008 operational and financial results will yield early insights into the impact of the current crisis on MFIs, but an analysis of the preceding years will describe the stage as it was set before the crisis began in full. What, then, were the salient evolutions in years leading up to the crisis?

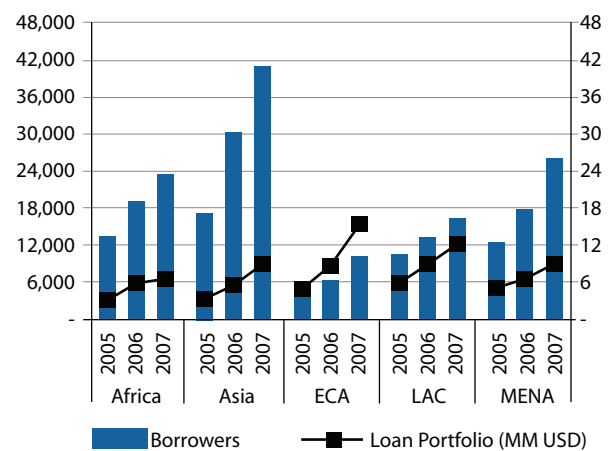
This analysis highlights several key trends that MFIs underwent in the 2005 – 2007 period. The publication of MIX's Trend Lines 2005 – 2007 MFI Benchmarks offers readers the first quantitative view on MFI operational and financial performance in that period. Covering a pool of 487 MFIs, these benchmarks represent microfinance in 78 countries. Taken together, these MFIs represent 82 percent of outstanding loans and 75 percent of borrowers at the end of 2007, a robust prism through which to view the evolutions in microfinance institutions in the lead up to the financial crisis. In addition, this analysis draws on a new data set of funding liabilities for microfinance institutions as of 2007. Benchmarks and further analysis of that data set are forthcoming.

At a Glance

Microfinance institutions underwent several changes in the 2005 – 2007 period. The following graphics highlight some of the more important trends:

- Borrower outreach grew at a persistent rate (26 percent) across all regions, along with the loan portfolio which grew faster (47 percent) in USD terms in 2007 due, in part, to a depreciating USD. At a regional level, the MFIs in Eastern Europe and Central Asia (38 percent) and Middle East and North Africa (41 percent) expanded credit outreach the quickest. Asia added the greatest number of borrowers (12 million borrowers), for the sample analyzed. (**Figure 1**)

Figure 1 Growth in Borrowers and Portfolio 2005 – 2007

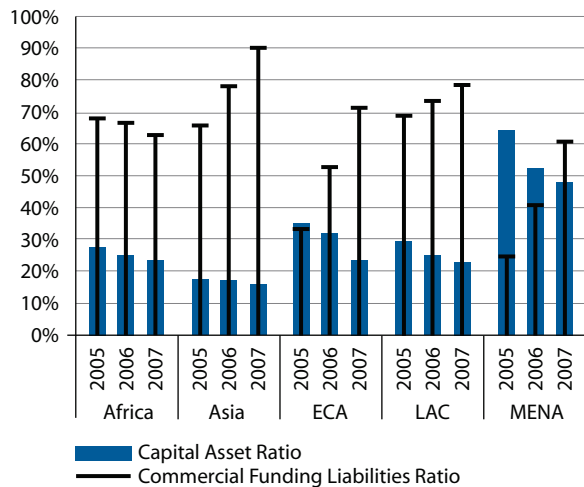


SOURCE: MIX Trend Lines Benchmarks 2005 – 2007. Data represent medians.

¹ Gonzalez, Adrian "Resilience of Microfinance Institutions to Macroeconomic Events," www.themix.org

- By the end of 2007, the median MFI in all regions accessed commercial funding, such as deposits or commercially priced loans, to fund more than half its loan portfolio. MFIs in Eastern Europe and Central Asia (71 percent) and Middle East and North Africa (61 percent) crossed the 50 percent threshold in 2006 and 2007, respectively. This shift underscored the cross-border debt and local market refinancing activity that has expanded rapidly in the last few years. (Figure 2)

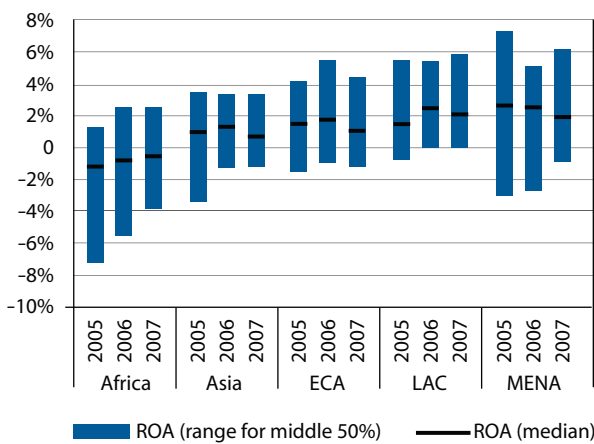
Figure 2 Shift to Commercial Funding, 2005 - 2007



- After years of growth, MFIs' profits have flattened in recent years relative to their asset bases. Small gains in operating expenses have been offset by rising funding costs as MFIs shift more funding to commercial sources. Returns narrowed in all regions with the spread between top earners and bottom earners dropping to 5 percentage points in all regions except the Middle East and North Africa. (Figure 3)

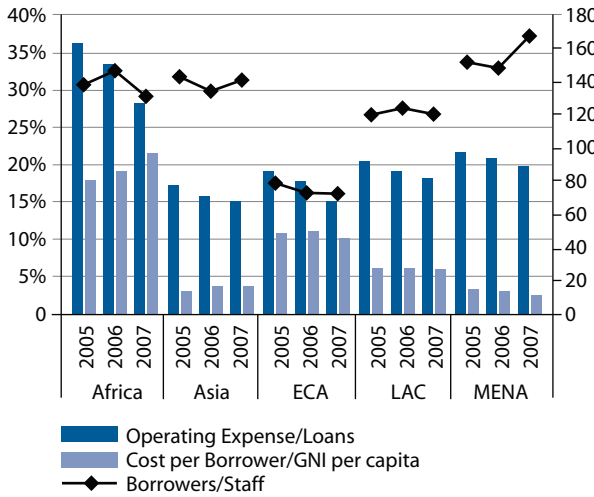
- As microfinance institutions mature, efficiency gains have become slimmer. Across the board, only MFIs in Middle East and North Africa made productivity gains that impacted efficiency; otherwise, the cost to serve a borrower remained constant across all regions. Cost per dollar in loans continued to drop in sub-Saharan Africa and Eastern Europe and Central Asia as a direct result of increasing loan sizes. (Figure 4)

Figure 3 Stable Returns Narrow 2005 - 2007



SOURCE: MIX Trend Lines Benchmarks 2005 - 2007. Data represent medians.

Figure 4 No Gains in Efficiency, 2005 - 2007



SOURCE: MIX Trend Lines Benchmarks 2005 - 2007. Data represent medians.

MFIs Experienced Sustained Growth, but Some Hot Spots Emerged ...

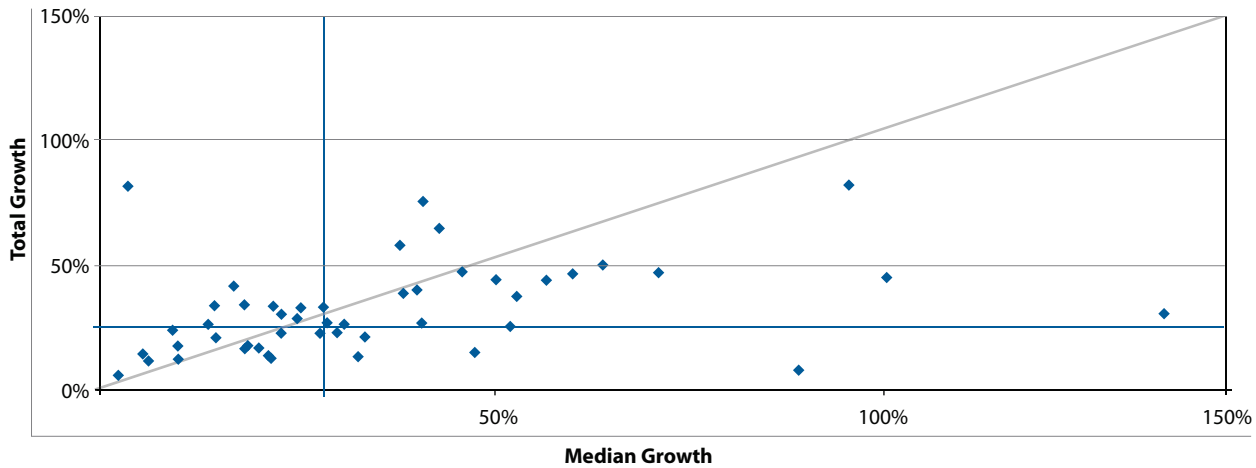
At a global level, microfinance institutions expanded their outreach in 2005 - 2007 at much the same pace as they had over the prior years. As the total number of borrowers served rose by an average 26 percent over the period, the median growth rate rose by a few more percentage points at 30 percent per annum. At the same time, figures of borrowers served worldwide did not show any difference in pace of growth over

Figure 5 Growth in Borrowers Served, 2005 – 2007

Country/Region	Growth in Total Borrowers	Growth in Median Borrowers	Higher Growth Rates from Larger or Smaller MFIs?	Change in Growth Pace (total) Faster or Slower?	Total Borrowers (2007)
Globe	26%	30%	even	even	49,176,522
Africa	24%	32%	smaller	even	4,176,238
Cameroon	8%	93%	smaller	slower	112,225
Ethiopia	15%	50%	smaller	even	1,390,877
Ghana	33%	27%	larger	slower	227,251
Kenya	65%	45%	larger	slower	757,979
Mali	-2%	12%	smaller	slower	121,091
Mozambique	22%	35%	smaller	even	49,077
Tanzania	3%	-3%	larger	slower	153,416
Uganda	4%	-3%	larger	faster	176,919
Asia	26%	54%	smaller	even	32,078,101
Afghanistan	47%	74%	smaller	slower	261,258
Bangladesh	18%	10%	larger	even	19,110,889
Cambodia	27%	43%	smaller	faster	780,617
India	50%	67%	smaller	slower	9,354,509
Indonesia	82%	4%	larger	faster	75,690
Nepal	5%	2%	even	even	150,748
Pakistan	46%	105%	smaller	faster	717,747
Philippines	21%	15%	larger	faster	1,361,986
ECA	38%	55%	smaller	slower	2,146,133
Albania	14%	34%	smaller	faster	55,033
Armenia	27%	30%	even	faster	189,116
Azerbaijan	76%	43%	larger	slower	179,277
Bosnia and Herzegovina	48%	48%	even	faster	366,100
Bulgaria	20%	-27%	larger	faster	66,354
Georgia	31%	141%	smaller	slower	123,186
Kosovo	34%	23%	larger	faster	109,782
Kyrgyzstan	45%	52%	smaller	even	160,781
Macedonia	34%	15%	larger	slower	42,511
Mongolia	23%	9%	larger	slower	343,783
Romania	35%	19%	larger	even	49,679
Russia	59%	40%	larger	slower	66,665
Serbia	42%	18%	larger	slower	108,019
Tajikistan	83%	100%	smaller	faster	88,657
LAC	23%	24%	even	even	9,002,012
Bolivia	16%	19%	even	faster	699,687
Brazil	23%	29%	smaller	faster	327,853
Chile	13%	23%	smaller	even	285,431
Colombia	31%	24%	larger	even	1,609,218
Costa Rica	8%	-10%	larger	even	9,649
Dominican Republic	18%	20%	even	faster	124,967
Ecuador	13%	23%	smaller	even	498,519
El Salvador	12%	11%	even	faster	163,330
Guatemala	29%	26%	even	even	238,307
Haiti	39%	40%	even	slower	65,019
Honduras	14%	6%	larger	faster	162,631
Mexico	27%	15%	larger	even	1,777,789
Nicaragua	17%	21%	even	slower	472,219
Paraguay	12%	6%	larger	slower	326,159
Peru	27%	32%	smaller	even	2,188,890
MENA	41%	42%	even	slower	1,774,038
Egypt	34%	30%	even	faster	349,210
Jordan	47%	63%	smaller	even	70,745
Morocco	44%	59%	smaller	slower	1,245,378

SOURCE: MIX Trend Lines Benchmarks 2005 – 2007. Data represent totals or medians for growth in borrowers served, as indicated. The 2007 total borrowers should not be taken as total borrower outreach in the listed regions at the end of 2007. It represents total borrowers for the sample of pool of MFIs analyzed as part of this trend analysis series, and its relationship to total known outreach varies.

Figure 6 Country Growth in Borrowers Against Global Trends, 2005 - 2007



SOURCE: MIX Trend Lines Benchmarks 2005 - 2007. Data represent the total and median growth in borrowers by country. The diagonal line draws out even growth distribution of growth. The horizontal and vertical lines represent global growth rates.

the two years, with total growth rates for each year either one percentage point above or below the total period annualized growth rate. In other words, growth in borrowers maintained its steady pace.

Such even growth, however, masks the underlying evolutions in many countries with active microfinance markets, as **Figure 5** and **Figure 6** depict. Some countries witnessed increased growth over the period, while growth in borrowers served slowed for others. The vertical and horizontal lines in **Figure 6** mark global growth trends. At a regional level, the more mature markets in Latin America grew less quickly than the global norm, as did the more sparsely served countries in sub-Saharan Africa. Only Peru and Haiti stand out for their above average rates, and the growth in the latter stems from renewed activity after years of disrupted growth from socio-political instability.

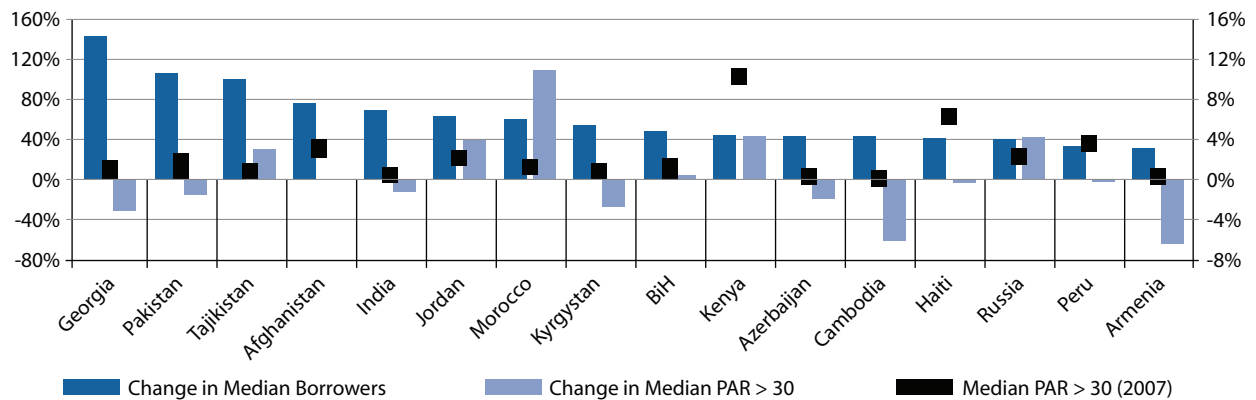
Fast growing markets and MFIs face unique risks in a sudden downturn: access to subsequent loans forms a cornerstone of the microfinance credit model, and any sudden reduction in lending activity may undermine that incentive system. Two regions, the Middle East and North Africa and Eastern Europe and Central Asia, quickly added new borrowers throughout the 2005 - 2007 period. Eastern Europe and Central Asia dominates the list of countries with annualized borrower growth rates above global norms during the period. Seven (Armenia, Azerbaijan, Bosnia, Georgia, Kyrgyzstan, Russia, and Tajikistan) of the 16 countries in the list are from the region. For three of them (Armenia, Bosnia, Tajikistan), the growth rate actually increased in 2007. In countries

like Bosnia, where MIX analysis shows existing high penetration rates, such growth may well indicate market overheating in the lead up to the crisis. In the Middle East and North Africa, both Jordan and Morocco maintained greater than average growth rates, with Moroccan microfinance reaching high penetration levels by 2007. In this country, at least, the risk associated with high growth going into the crisis had already attenuated by 2007, as outreach to microborrowers grew at half the 2006 rate.

In several countries, the market share of borrowers served became increasingly concentrated in larger MFIs over the period. Such concentration may create institutions for which repayment crises have market-wide impacts. These countries show up in **Figure 5** where growth in total borrowers outpaces growth in the median number of borrowers per MFI. They also appear just above the diagonal line in **Figure 6**. Many of these countries were in Eastern Europe and Central Asia and also represented markets with above average growth levels, such as Azerbaijan, Macedonia or Serbia. In other words, a handful of institutions led market growth in these developing microcredit markets. At the other end of the spectrum, market leading MFIs grew faster than smaller institutions in the well established Bangladeshi market, further consolidating borrower outreach in this country with high microcredit penetration and concentration.

High growth in borrowers served tests an MFI's systems, particularly its risk management and controls, and may lead to portfolio quality problems that become more apparent as growth slows, as it might during a financial and economic crisis. At the

Figure 7 Changes in Portfolio Quality for Countries with High Growth Rates, 2005 – 2007



SOURCE: MIX Trend Lines Benchmarks 2005 – 2007. Data represent changes in the median values. PAR > 30 = portfolio at risk over 30 days; BiH = Bosnia and Herzegovina.

end of 2007, high growth markets continued to show good portfolio quality, as **Figure 7** depicts, though, in several portfolio countries quality had already started to decline. In countries like Tajikistan, Jordan and Russia, portfolio quality declined quickly relative to the 2005 base year, but remained low against global benchmarks. In two countries portfolio quality changes looked more worrisome at the end of 2007. In Morocco, while the median MFI posted portfolio at risk over 30 days less than 2 percent, the portfolio quality had reached that level from near zero risk levels in 2005. Kenyan microcredit faced this problem at a greater magnitude, amplified by socio-political unrest at the 2007 year end. Short term arrears doubled between 2005 and 2007, as total portfolio at risk rose to 10 percent for the median MFI, and over 17 percent for the 75th percentile. In either case, growth in borrowers coupled with rising arrears sets up any market for increased default risk in an economic downturn, including the associated costs of managing a deteriorating portfolio.

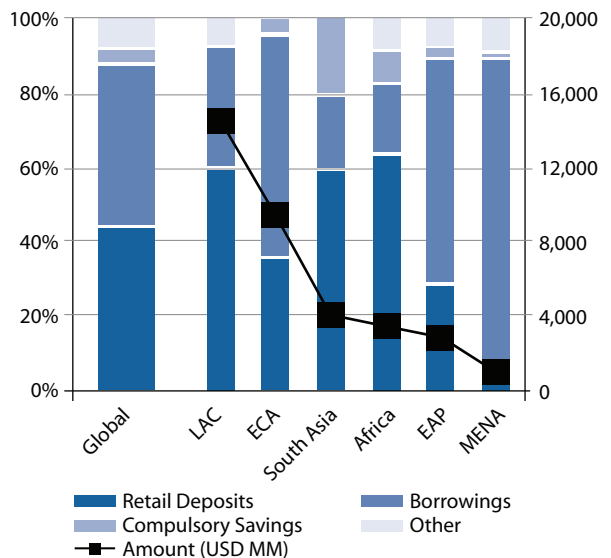
Funded Through New Cross-border and Local Market Debt

The growth trends highlighted above relied on new and varied sources of funding. Exploring how MFIs finance their microlending helps to identify risks inherent in the microfinance industry at the outset of the current financial crisis. As earlier figures have already shown, debt financing has enabled the sustained growth in borrower outreach in the last few years, and the rapid growth in outstanding portfolio. By 2007, Latin America and Eastern Europe and Central Asia carried the bulk of that funding, as portrayed in **Figure 8**, totaling more than 70 percent of global

deposits, borrowings and other funding liabilities. At a global level, deposits (45 percent) provided as much total funding as borrowings (45 percent), but non deposit debt has two characteristics that make it worth further investigation in the context of this 2005 – 2007 analysis: 1) more MFIs rely on borrowings than deposits to fund their portfolios because of the limited number and deposit taking MFIs, and 2) the regions with the strongest growth over the period relied heavily on non deposit financing.

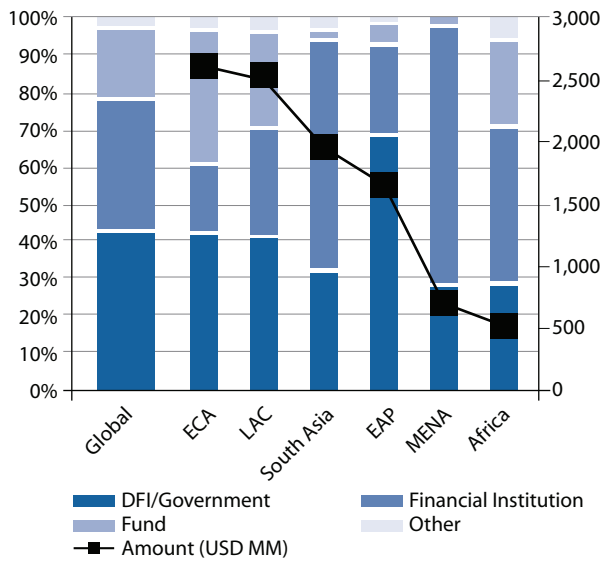
Cross-border debt has played an important role in funding growth over the period. The importance of

Figure 8 MFI Funding Liabilities, 2007



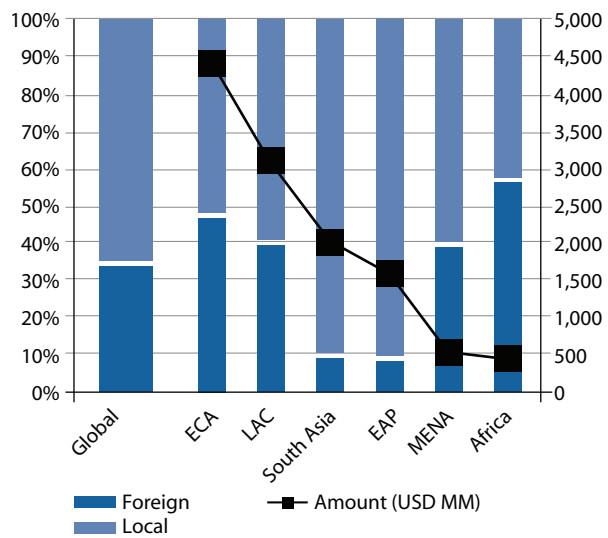
SOURCE: MIX 2007 MFI benchmarks. Data represent totals for each region. EAP = East Asia and the Pacific; ECA = Eastern Europe and Central Asia; LAC = Latin America and the Caribbean; MENA = Middle East and North Africa. Notable exclusions: BRI (Indonesia).

Figure 9 Source of MFI Debt, 2007



SOURCE: MIX 2007 MFI benchmarks. Data represent totals for each region. DFI = Development Finance Institution; EAP = East Asia and the Pacific; ECA = Eastern Europe and Central Asia; LAC = Latin America and the Caribbean; MENA = Middle East and North Africa. Notable exclusions: BRI (Indonesia).

Figure 10 Cross-Border Borrowings, 2007



SOURCE: MIX 2007 MFI benchmarks. Data represent totals for each region. EAP = East Asia and the Pacific; ECA = Eastern Europe and Central Asia; LAC = Latin America and the Caribbean; MENA = Middle East and North Africa. Notable exclusions: BRI (Indonesia).

this funding source raises some risks such as foreign currency exposure and the flight of foreign lenders in the current financial climate. The two regions with the largest USD value portfolios have also attracted the largest amount of debt, particularly cross-border debt, as shown in **Figure 10**. Countries in Eastern Europe and Central Asia depend most heavily on foreign debt, amplified by the fact that non deposit financing represents 65 percent of total funding liabilities. On the whole, development organizations, particularly development finance institutions (DFI), as shown in **Figure 9**, have provided most of this debt (40 percent). Their terms, however, temper refinancing concerns in the current crisis. Foreign DFIs offered MFIs debt with nearly five year maturities, compared with three and a half year terms for their local counterparts. Local banks arranged debt to MFIs in the region with average terms of just over two years, but accounted for less than 20 percent of total funding. While funding for growth may pose a challenge in the region in the current crisis, especially given the high growth rates in the 2005 – 2007 period, refinancing existing microcredit portfolios may present less of a risk for portfolios in Eastern Europe and Central Asia.

Other regions, on the other hand, faced less risk of capital flight from foreign lenders. South Asian MFIs and MFIs in the Middle East and North Africa ended 2007 with large pools of debt raised from

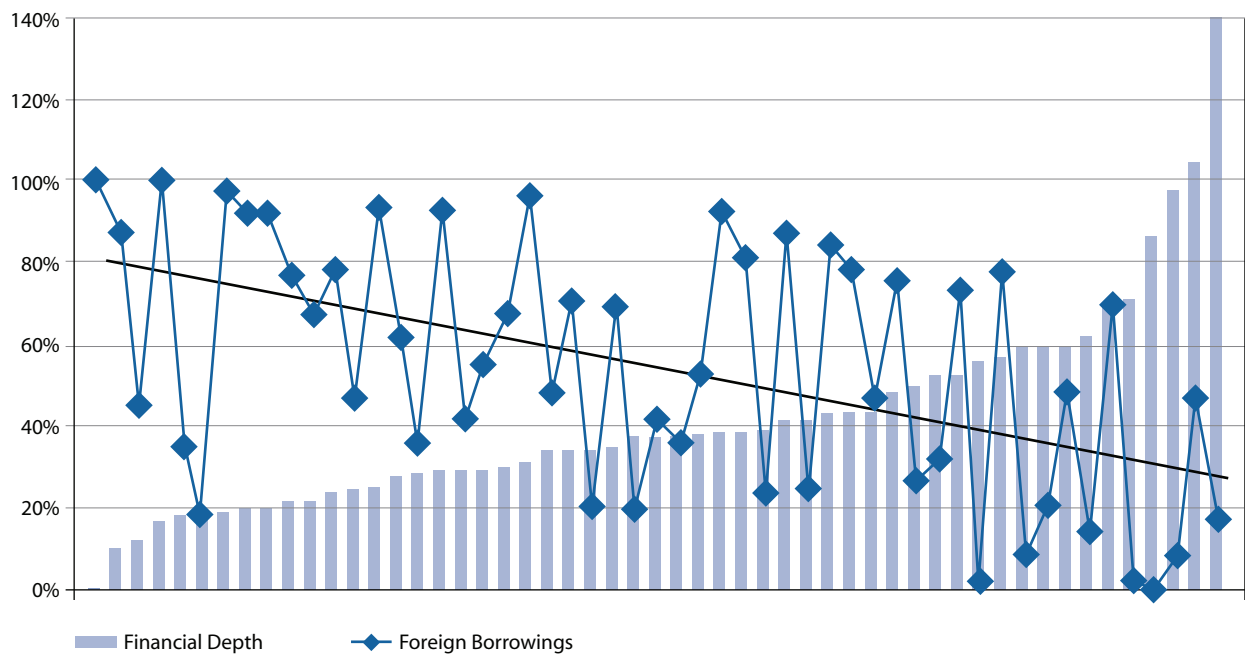
financial institutions, totaling 70 percent and 62 percent of funding liabilities, respectively. In markets like Bangladesh, Nepal and — in particular — fast growing India, borrowings from local financial institutions represented more than half (75 percent for India) of funding liabilities. Morocco, Jordan and Egypt, the fastest growth markets in MENA, also drew half of their funding from local banks. This local bank financing, however, comes with shorter maturities. The average Indian bank terms totaled two years at the end of 2007; in Morocco, just over two and a half years. As credit tightens, these shorter terms increase pressure on MFIs to manage refinancing alongside fundraising for growth.

In the long run, as MFIs seek to minimize risks from foreign capital and assure stable sources of funding for their growth, they may search for more funding opportunities in their local markets. For many institutions, deposit financing is not an option given restrictions on raising public deposits, but local financing from banks or debt issuances on local markets remain options for most MFIs. As **Figure 11** shows, MFIs operating in countries with more developed financial markets draw more funding from local sources. In other words, MFIs borrow abroad not necessarily to seek better terms, but because they have fewer options for refinancing at home. Access to local market financing by MFIs seems tightly linked to the development of local financial markets.

Microfinance has witnessed one of the strongest sustained growth periods in the years leading up to the crisis. As analysts seek to predict what will come next, which MFIs may falter, how growth may be impacted, if arrears will rise or how funding may change, it is useful to look back at the baseline from which the sector entered this crisis. Growth trends, as highlighted above, may lead some markets to overextend going into the downturn, and those countries may well constitute “watch markets.” But the global trends do not indicate sectorwide overheating. Rather, the biggest shift over the period that will catch analysts’ attention came in the change

in funding, as microfinance institutions continued their shift towards commercially priced funding. The growth of non deposit funding, in particular, helped enable some of the fastest growth rates in Eastern Europe and Central Asia, South Asia, and the Middle East and North Africa. With this increased commercial funding, funding costs have risen, eliminating many of the efficiency gains that have boosted returns in recent years. In the year ahead, analysts will not only want to monitor how MFIs manage their refinancing from a liquidity perspective, but also how it impacts their bottom lines and perhaps, those of their clients.

Figure 11 Local Market Funding Increases with Financial Market Development, 2007



SOURCE: MIX 2007 MFI benchmarks. Data represent results by country, including foreign borrowings as a percentage of total MFI borrowings for each country.