Characteristics and Tendencies of the Market of Microfinance Suppliers in Nicaragua

Commissioned by Grassroots Capital Partners

Written by: Mercedes Cuadra s.

April 2008

Grassroots | Capital

EXECUTIVE SUMMARY

1. This study was commissioned by the Grass Roots Capital Management Corporation, a company specializing in microfinance investment fund management. The purpose of the study is to analyze the major characteristics and future trends of the microfinance market in Nicaragua. The focuses of this analysis are: (1) How will the market of microfinance suppliers evolve? Who will be the major stakeholders? and (2) Are mergers, alliances or acquisitions possible? This study was conducted through interviews with a group of leaders from microfinance institutions and from the sector, and an analysis was performed of statistics and reports from microfinance institutions, from the Nicaraguan Association of Microfinance Institutions (ASOMIF), the Microfinance Information Exchange (MIX) Market, and the Superintendency of Banks.

2. Nicaragua makes an excellent case study for understanding the competitive implications of a microfinance market with high market penetration and for understanding how the different suppliers act in the market. The major findings and key aspects are detailed below.

Major Findings

3. The market of microfinance suppliers has entered a new phase of development: consolidation, specialization and differentiation. The majority of the organizations have plans for considerable growth along with plans to strengthen their systems and develop products for their prioritized target groups. The competition in specific segments of the market is high, but there is still significant unmet demand for financial services for the micro, small and medium enterprise sector.

4. In the past four years, the portfolio of microfinance institutions has grown over 300%, with growth of 128% in clients, and more than 72% in agencies. The average credit balance also has grown, from 69% of the per capita gross domestic product (GDP) to 94% of the per capita GDP[1]. The current credit portfolio of microfinance institutions in Nicaragua is approximately US$500 million.

5. Through 2007, the microfinance market has been led mainly by non-governmental organizations (NGOs); some have taken steps to become regulated institutions and have even become banks, and others remain unregulated by the Superintendency of Banks and Other Financial Institutions (SIBOIF). Credit unions have also been a significant sector in microfinance, although their participation in the market is minor. The most pronounced future trends are the transformation from NGOs to regulated financial institutions and the development of banking institutions that enter into the microfinance sector with suitable methodology.

6. There are three types of movements within this trend toward transformation into regulated microfinance institutions:

A) The microfinance institutions that already are regulated as of 2007, which are projected to experience rapid growth and expansion: ProCredit and Findesa.

B) The microfinance institution which has recently become regulated, the Foundation to Support Microenterprise (FAMA), and those to be regulated, the Association of Consultants for the Development of Small, Medium and Microenterprise (ACODEP) and the International Foundation for Community Assistance (FINCA), which state that they have initiated the process to become

[1] The growth rate of the GDP has been around 5-4 point each year from 2004 to 2007.

regulated with the SIBOIF in 2008. It is anticipated that these institutions will experience a slower growth process given the adjustment to the culture of regulated activity.

C) The NGOs that are developing the activities necessary to be considered for regulation in a mid-term future of three to seven years: the José Niebrowski Foundation (FJN), the Local Development Foundation (FDL), the Foundation for Socio-economic Development (FUNDESER), and the Center for the Promotion of Local Development and Poverty Eradication (CEPRODEL). However, there is not total certainty that this transformation will occur.

7. Regarding the trend among banking institutions to enter the microfinance sector, there are two types of movements:

A) The banks that are entering the sector beginning in 2007 and 2008 with the microfinance methodology: Bancentro and Banco de Finanzas. Both banks are developing a Small and Medium Enterprise (SME) Division specializing in microfinance methodology. Banco de Finanzas recently initiated a re-engineering of its processes, appointing a new SME manager and starting pilot programs in two agencies. As of April 2008, Bancentro's SME division had been operating for 10 months with a new manager and the microfinance methodology, serving 5,000 borrowers with a portfolio of US$14.0 million in 20 of the 62 banking branches. Rapid growth and expansion is expected from these stakeholders, mainly in the sector of consolidated microenterprise, and in the small and medium enterprise sectors. Credits range from US$2,500/5,000 to US$50,000.

B) The banks with new international owners have developed experience in consumer credit and have designed specific products for the population that still does not access banking services, such as GE-Money of the Bank of America, CitiGroup which acquired Banco Uno. GE-Money has been experimenting for two years with consumer products directed at clients that do not have access yet to banking services; sectors with an average income of US$2,000. These products are mainly linked to commercial establishments. At the time of this study, a national product directed at loans for motorcycles was to be launched.

8. The majority of the remaining unregulated NGOs, medium and small scale microfinance institutions is undergoing processes to consolidate their systems and is developing strategies for differentiation and specialization. Some of them are deeply rooted in the local areas, as they were founded in the provinces of the country and have expanded their services to the national level. Credit unions continue a process of consolidation, with a tendency toward the organization and strengthening of networks.

9. Despite the rapid growth mentioned above, MIX and the Central American Microfinance Network (REDCAMIF) report better positioning of the industry in Nicaragua versus its peers in Central America on a variety of important indicators: returns on assets, at-risk portfolio for more than 30 days, leveraging of its capital, operating costs over portfolio, productivity of loan officers, and other aspects. The struggle to achieve greater economies of scale in order to dilute the financial costs indicates the influence of commercial sources on the need to develop greater efficiency and specialization. It can be said that the microfinance market in Nicaragua is a mature and consolidated market with the institutional basis to improve access to financial services by the population that does not yet access them.

10. In this context, one of the key aspects to emerge in this study is the question of *whether the microfinance market in Nicaragua is saturated.* It is constantly stated that Nicaragua is one of the most saturated markets in Latin America and even the world, and that the competition continues to increase. Nevertheless, most of the leaders of microfinance institutions that were interviewed have the perception that, while there may be saturation in specific markets and competition for the good clients in those markets, there is still a considerable unmet demand in the country. However, to address that demand and to retain the good clients, there must be more precise knowledge about where to be located than before. This includes answering the questions: Who is receiving services?, What types of services are they

receiving?, How are they receiving them?, Who is offering the different types of services? and How are they being offered? The diversification and differentiation of services and the specialization in target segments are more important now.

11. In fact, the recent introduction onto the market of commercial banks with new international partners does not seem to concern the microfinance segment in general given the positioning of banks in a segment above that of the MSMEs. However, this eventually may be stiff competition for the segment of good clients that have developed their businesses with the microfinance institutions.

12. Effectively, although there are no recent studies regarding estimates of demand for credit, studies from 2002-2003 indicate that there is a low percentage of the population with access to financial services, a high percentage of the population that does not request them, and a percentage of borrowers that receive insufficient amounts. According to the last study conducted in 2006 by the International Foundation for the Global Economic Challenge (FIDEG) of 1,000 microfinance borrowers, 27.7% of borrowers apply for a larger loan than they receive, and 86% of these borrowers are not approved for the amount requested due to a lack of collateral and/or due to the institution's policy on amounts.

13. Thus the different microfinance institutions are led to seek improvement in their positioning with clients, through differentiation as well as addressing segments that are not sufficiently served, in order to diversify their clients and services, resulting in the diversification of risk as well.

14. Below are some indications of this differentiation – specialization and/or activities to address the sectors that lack service:

MICROFINANCE INSTITUTION	ACTION: DIFFERENTIATION AND/OR DIVERSIFICATION TO OTHER SECTORS
FDL	Specializing in the rural and agricultural sector. Generating special development products for the rural sector, for example, the "green package", solidarity group methodology.
FINCA	Transforming its portfolio from solidarity loans to individual loans.
FUNDESER	Diversifying to other economic sectors to decrease the high concentration in the agricultural sector.
FJN	Also diversifying to decrease its high concentration in agriculture.
FODEM (Foundation for the Development of Women)	Developing special products for businesswomen. Linking to non-financial services for women, such as health services. Entering the agricultural sector in alliance with an organization that offers technical assistance and commercialization services for small farmers.
FAMA	Entering the small business sector; previously it had almost exclusively served the microenterprise sector. Plans to enter the agricultural sector.
ADIM (Alternative Association for the Holistic Development of Women)	Working with solidarity groups in the poorest sectors.

15. There is also a fairly generalized tendency among the unregulated NGOs to develop alliances with organizations that offer other services: technical assistance, commercialization and health care, in order to extend the benefits to their clients and to complement the know-how of the microfinance institutions to serve specific sectors.

16. In this dynamic context, there is a need to increase scale in order to decrease costs and/or increase the average balance per client to achieve greater profits per service unit. Effectively, the average balance per client has increased in all the economic activities except some specific cases. The statistics on average loan balance by level in the regulated microfinance institutions reveal the tendency of these institutions to distribute a percentage of their portfolio among clients with higher average balances, although they maintain a high concentration of clients (97% to 99%) in the lower range of the portfolio.

17. The question is how much does an increase in the average balance per client correspond to a change in target group and institutional development mission, and how much does this relate to a change in the development of the clients and the capital capacity of the microfinance institution itself.

18. It is very difficult to measure this relationship. Nevertheless, there are clear indicators that unequivocally reveal the trend toward the development of a dynamic industry that is becoming more diversified in a positive cumulative macro-economy. These include:

18.1. The latest FIDEG study, *The Social Impact of Microfinance in Nicaragua*, 2007, which compares, among other aspects, the results of a study conducted of 260 borrowers in 2002, reveals a positive change for these borrowers in the following aspects: greater access to credit approved with larger amounts, gradual reduction in informality, greater movement in their businesses, generation of more jobs, increase in the average income, reduction of poverty, and improvement in their standard of living.

18.2. On the other hand, there are indicators[2] of growth in many sectors of the economy in Nicaragua in which many micro, small and medium business owners participate, for example:

- 3.5% to 5% annual growth rate of the GDP from 2004 to 2007.
- 90% increase in exports from 2004 to 2007 for the 20 major products, including coffee and beef, which are mostly produced by micro, small and medium farmers.
- 50% increase in the number of tourists that have visited the country over the last five years.
- 18% increase in direct foreign investment.
- Stable monetary policy in recent years.

19. The threat implied by the deceleration of the economy of the United States and the tendency of oil prices to rise may be compensated by domestic and foreign investment if there continues to be a climate that favors such investment.

20. In conclusion, it can be stated that a new phase of development is beginning within the market of providers and that specialization, differentiation and diversification of products and segments will play a determining role in the development of the institutions and their ability to compete successfully.

[2] - According to the Central Bank of Nicaragua and ProNicaragua.