



**Enterprising Solutions Brief No. 2**

# **Intermediating Capital To MFIs:**

## **A Survey of Financial Intermediation to Microfinance Institutions**

Enterprising Solutions Global Consulting, LLC

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Since 1999, Enterprising Solutions has provided technical assistance, management consulting, evaluation and research services on microfinance and small- to medium-sized enterprise (SME) to international financial institutions, foundations, private-sector companies, bilateral agencies, national governments and NGOs. Working with a variety of investors, Enterprising Solutions also provides financial advisory services to microfinance institutions and SMEs.

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# Intermediating Capital To MFIs:

## A Survey of Financial Intermediation to Microfinance Institutions

### Introduction

This Enterprising Solutions Brief summarizes part of a longer report on the nature of capital flows to microfinance institutions (MFIs) in emerging markets.<sup>1</sup> That report details the findings from several research projects conducted over the past two years by Enterprising Solutions Global Consulting (ESGC).

The report suggests that, when it comes to increased investment in microfinance, there exists a viable alternative to the institution-to-institution model of financing. Rather than a direct channeling of new investment to ever larger or more numerous MFIs, expansion may best be spurred through the growth of specialized investment funds that target MFIs.

A significant number of these private or quasi-private investment funds – MFI financial intermediaries (MFI-FIs) – emerged in the late 1990s.

Our analysis is based in part on some 50 MFI technical assistance assignments over the past few years and on an MFI-FI survey conducted last year.<sup>2</sup> Though the current level of MFI-FI activity is still too small to alter the overall nature of capital flows to MFIs, it is rising and may absorb a much greater volume of capital in the not-too-distant future.<sup>3</sup>

More research is needed, both to better understand the potential of MFI-FIs for capital mobilization and delivery and to promote the growth of new and existing funds, particularly those located in developing countries. Social investment capital, channeled through MFI-FIs, could play a key role in catalyzing the market. Support for the development of an MFI-FI infrastructure that is able to attract social investment capital will serve two purposes: it not only will raise the volume of capital available to MFIs, but also will allow social

investment to serve as a bridge between the microfinance sector and more conventional capital markets. (See *Enterprising Solutions Brief No. 3 – Social Investment in MFIs: A Potential Bridge to Private Sector Capital?*)

Conventional capital market will open increasingly to the microfinance sector as greater scale leads to more standardized investment practices; if asset benchmarking can be developed for MFI-FI portfolios; standardized reporting and greater transparency; and, of course, if there is a decrease in the level of subsidized donor capital competing with private funds. Once these conditions are achieved, access to conventional, commercial capital markets, domestic and international, will no longer be confined to isolated cases. It will become the norm. This evolution will be essential for the sustainability of microfinance and its role in reducing poverty.

## A Survey of MFI-FIs

MFI growth has long depended largely on donor funding,<sup>4</sup> but recent years have seen important advances in private and quasi-private MFI investments.<sup>5</sup> In the late 1990s, a handful of MFIs made relatively sophisticated forays into a range of commercial capital markets. One method was to use third-party guarantees and portfolio debt (e.g., from donor or government agencies) to leverage local commercial bank capital. Other efforts included Banco Sol's issuance of American Deposit Receipts on the New York Stock Exchange, the issuance of domestic bonds by MiBanco and Compartamos and the occasional private equity investment by high net-worth investors.

### Current MFI-Financial Intermediaries

Also in the late 1990s, a significant number of specialized investment funds targeting MFIs emerged. These MFI financial intermediaries, or MFI-FIs, based some of their strategies on the early and pioneering work of such funds as the ACCION Bridge Fund and the Wisconsin Coordinating Committee for Nicaragua Fund, both of which sold promissory notes to the public to provide debt financing to partner MFIs.

One of the most important advances in terms of microfinance capital intermediation was the creation of ProFund in 1995 by a consortium of multilateral investors and NGOs. ProFund is a \$23 million, private-equity, venture capital fund

managed by Omrix of Costa Rica. With investments in 15 MFIs in Latin America, it is the largest MFI equity fund and has provided significant advances in understanding MFI financing. ProFund was followed by LA-CIF in 1999. Managed by Cyrano Management of Lima, Peru, LA-CIF originally sought to provide guarantee facilities for MFIs across Latin America. Cyrano is now launching a family of funds, each offering different types of capital to MFIs and, conversely, different investment risk profiles to investors.

Blue Orchard Finance is another innovative and recent MFI-FI. Incorporated as the world's first investment company exclusively targeting MFIs, Blue Orchard accepts investments from social investors and places debt in MFIs. The company now manages over US\$15 million and is currently exploring how it might securitize packages of MFI loans. Other important fund initiatives include Oikos Credit in Holland and the Calvert Foundation in the United States, both of which have significant commitments to emerging market MFIs. Also, after a long start-up period, the Dakar-based fund, AfriCap, recently began offering a range of instruments for investment in either cooperative, NGO-owned or private-sector MFIs in Africa.

Today, we estimate that 30 to 40 private or quasi-private funds provide, or will soon provide, varying forms of finance to MFIs around the world. Over the last year, Enterprising Solutions

**Table One**  
**34 MFI Financial Intermediaries: Region of Activity and Network Affiliation**

Region of Activity	All Funds				Network Funds		Fund Type	
	Number of Funds	% of Total Funds	US or European Based		Number of Funds	% of Total Funds	MFI Dedicated	MFI and SME
			Number	% of Funds				
Country-Specific	4	12%	0		2	6%	4	0
Africa	1	3%	1	0%	0	0%	1	0
Central America	1	3%	1	100%	1	3%	1	0
Latin America	6	18%	3	50%	2	6%	6	0
Mixed	2	6%	2	100%	0	0%	2	0
Worldwide	20	59%	20	100%	3	9%	12	4
Total	34	100%	27	76.5%	8	24%	26	4

began to track the performance of these funds.<sup>6</sup>

### A Note on the Data

The following five tables presents data on 34 MFI-FIs. (Some information is only available for 33, 32 or 28 of the institutions, as indicated.)<sup>7</sup> The information was collected during 2001 and subsequently updated in mid-2002. MFI-FIs were contacted directly and information was also drawn from promotional materials. Nine funds were surveyed in depth with a detailed questionnaire, yielding a wealth of information of which it is only possible to present a small part here.

### Geographic Outreach

Table One shows the funds' regions of activity. "Network Funds" refers to eight funds that provide financing specifically to networks of MFIs or affiliated groups. Of the funds tracked, 20 provide funding worldwide, six focus exclusively on Latin America and four are country-specific; two

funds that focus on more than one country but not a whole region are categorized as "mixed"; one fund focuses on Africa; and one on Central America. For the most part, funds are not focused on particular regions; only in Latin America is there a small concentration of such funds. It is also important to note that of the 34 funds, eight were established within the last three years and five have yet to begin operations. These facts underscore the nascent nature of MFI financial intermediation. Also noteworthy is the fact that of the 34 funds in the survey, 27 of them, or 77%, are based in the North.

<b>Table Two MFI Financial Intermediaries: Total Assets &amp; Projected Assets</b>					
	<b>Current Assets</b> (\$US millions)	<b>% Total Assets</b>	<b>Projected 2006*</b> (\$US millions)	<b>Assets as % Total Projected Assets</b>	<b>Growth (%)</b>
CountrySpecific	45.1	6.8%	47.9	6.5%	6.2%
Africa	13.3	2.0%	15.0	2.0%	12.8%
Central America	0.5	0.0%	10.0	2.0%	16,500%
Latin American	48.1	7.3%	48.1	6.6%	0.0%
Mixed Regions	22.5	3.4%	22.2	3.0%	-1.3%
Worldwide*	531.9	80.5%	583.9	79.8%	9.8%
<b>Total</b>	<b>661.0</b>	<b>100.0%</b>	<b>727.1</b>	<b>100.0%</b>	<b>10.0%</b>

Not all funds provided projections. Except for funds with time-limited lives we assume the same asset base as 2002.  
\*One fund is a third party fund manager.

Table Two shows total assets of tracked funds at US\$661 million. The bulk of assets are not dedicated to any particular region; again, Latin America is the only region with any concentration of assets.<sup>8</sup>

Financing available for microfinance in Africa is expected to grow 12.8% by 2006, while worldwide MFI financing is expected to grow by 10.0%. The lone Central

<b>Table Three 32 MFI Financial Intermediaries: Distribution by Size (Not all funds could be classified)</b>						
	<b>Funds</b>		<b>Assets</b>			
	<b>Number</b>	<b>% of Total</b>	<b>Current</b> (\$US millions)	<b>% Total Assets</b>	<b>Projected 2006</b> (\$US millions)	<b>% Total Assets</b>
< \$10 million	19	59%	62.3	9.4%	81.1	11.2%
> \$10 million < \$20 million	8	25%	115.7	17.5%	140.0	19.3%
> \$20 million < \$50 million	3	9%	110.0	16.6%	133.0	18.3%
> \$50 million < \$100 million	0	0%	0.0	0.0%	0.0	0.0%
> \$100 million plus	2	6%	373.0	56.4%	373.0	51.3%
<b>Total*</b>	<b>32</b>	<b>100%</b>	<b>661.0</b>	<b>100.0%</b>	<b>727.1</b>	<b>100.0%</b>

One fund is a third party fund manager.

American fund expects to grow nearly twenty-fold, from \$500,000 to \$9.5 million.

Country-specific funds project slower growth at 6% and mixed region funds foresee a marginal contraction. Overall growth, as indicated by the survey and by other research, is not expected to result in a significant shift of asset distribution by geographic focus.

### Assets Under Control

Table Three shows that two funds control over \$370 million, or 56%, of the surveyed funds' combined assets. Of the two largest funds, one has only an estimated 40% of its assets in MFI investments. This same fund is only 70% invested for a total estimated MFI portfolio of approximately \$48 million). Nineteen funds have assets of \$10 million or less, representing 59% of the total number of funds but only 9% of fund assets. A smaller number of mid-sized funds, controlling between \$10 and \$50 million, represented 34% of total survey assets; by 2006, they are projected to control approximately 39%.

Smaller funds will see assets grow by about two percentage points, from 9.4% to 11.2%, while "large" funds are expected to see their share contract by about five percentage points, from 56.4% to 51.3%.

### Fund Types

Table Four shows the MFI-FIs distributed by type. Guarantee funds comprise the largest block

of capital, at 35%, followed by Debt funds, at 21%. Mixed funds, which primarily offer debt, comprise 34% of all funds. Equity funds total \$80 million in assets or just 12% of all fund assets.

Mixed funds also report small equity portfolios. Not surprisingly, equity funds tend to be smaller in size, with the largest being just over \$23 million.

### Rates of Return and Sustainability

Table Five shows that nine of the funds in the survey expect commercial rates of returns on investments. For equity funds, the return expectations are in the 15% to 20% range. Guarantee funds typically back local commercial debt at interest rates set to a multiple of LIBOR or the local equivalent.

Some 43%, or 12 of the funds in the survey, for which we have information, do not charge rates sufficient to achieve operational or financial self-sufficiency.<sup>9</sup> The majority source free or well-below market rate capital and charge subsidized, or below market rates to MFIs. Significantly, the two largest funds in the survey do not (or cannot, due to internal reporting reasons) report financial self-sufficiency, though they are both operationally sufficient.

There are eight funds that aim to be "operationally self-sufficient", or to charge clients sufficiently to cover operating costs. These funds, however, do not offer market rates of return to investors. As with the funds we refer to as "subsidized funds", the operationally self-

**Table Four**  
**33 MFI Financial Intermediaries: Fund Type**  
(Main investment vehicle only)

Investment types	Number of funds	Assets (\$US millions)	Percentage of Funds
Equity	6	80.1	12.3%
Debt	11	134.9	20.8%
Guarantee	7	211.3	32.6%
Mixed Funds	9		
Includes Equity	9	222.8	34.3%
Includes Debt	9	222.8	34.3%
Includes Guarantee	3	7.3	1.1%
Total	33	649.0	100
One fund under development could not be classified			

**Table Five**  
**28 MFI Financial Intermediaries: Distribution by Type**

	Number of Funds	% of Total Funds*	Assets (\$US millions)	% of Total Assets*
Charge Commercial Rates	9	40%	144	21.8%
Financially Self-Sustainable	8	29%	91	20%
Operationally Self-Sustainable	8	29%	432	80%
Subsidized	12	43%	48	10%
Total	28	0%	571	0%
* Twenty-eight funds classified. ** Twenty-five funds classified.				

sufficient funds still require investors to subsidize costs of capital. The operationally self-sufficient funds differ from subsidized funds, however, in that they do not require ongoing financing subsidies to sustain activities.

The final type of fund are those which seek to be financially sustainable. There were eight of these in the survey. All of the equity funds in the survey attempt financial self-sufficiency.

Evidence on MFI-FI performance is largely anecdotal, as few funds have been willing or able to share performance information.<sup>10</sup> We know that ProFund reported an internal rate of return of just over 10% (May, 2002); LA-CIF reported profitability of 18% ROE (December 2001); and Blue Orchard reported just-under-7% annualized rate of return on loan capital in 2001.<sup>11</sup> These reports suggest that professionally-operated MFI-FIs can compete against conventional investment. For example, the average emerging-market US mutual fund returned -39% over the three-year period ending in 2001, and -23% over the five-year period ending 2001.<sup>12</sup>

## Summary

Despite the existence of some fairly well-established MFI-FIs, financial intermediation to MFIs remains largely dominated by donor institutions. The eventual establishment of a critical mass of MFI-FIs would constitute a financial intermediation infrastructure very different from that which exists today.

Currently, however, MFI-FIs remain much like the sector they serve: limited in size and coverage, relative to the scale they would require in order to achieve financial sustainability. They typically rely too much on donor funding and seldom seek private sector capital. Moreover, information on best practices among MFI-FIs is limited. Indeed, except for modest analyses such as that presented here, little is really known about them.

Notwithstanding these limitations, we believe that with the appropriate resources, MFI-FIs can play a strong role in establishing a more market-driven infrastructure for financial intermediation to MFIs.

We also believe that MFI-FIs may facilitate greater access by microfinance industries to sources of social investment capital, a development which could pave the way for expanded access to more conventional capital markets. This hypothesis is, of course, based on the limited data and analysis currently available on MFI-FIs. Further investigation is required.

## **Annex One: Funds in this Survey**

ACCION Gateway Fund LLC  
ACCION Investments in Microfinance  
AfriCap Microfinance Fund  
Blue Orchard  
Bootstrap Banking Fund  
Calvert High Impact Fund  
Etimos  
FOLADE Guarantee Fund  
Fond de Developpement International: FONIDI  
Fond de Garantie: Développement International  
Desjardins  
Fond de Partenariat: Développement  
International Desjardins  
Fondo de Capital Social (FONCAP)  
Fonkoze  
Global Opportunity Fund: Opportunity  
International  
Grameen Fund  
Hivos Triodos Fund (HTF)  
Internationale Micro Investitionen  
Aktiengesellschaft (IMI)  
Latin American Bridge Fund  
Latin American Challenge Fund  
Local Currency Fund: Bankers Trust Company  
Luxmint  
Microcredit Development Fund: Bankers Trust  
Company  
Microfinance Alliance Fund  
MicroVest  
Nica Fund  
Oikos Credit  
Planet Bank  
Profund Internacional S.A.  
RAFAD  
Triodos-DOEN Foundation  
UNITUS  
Village Bank Capital Fund  
WWB Facility for Affiliate Capitalization  
WWB Loan Guarantee Program

## Notes

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<sup>1</sup> Emerging markets, as defined by the International Finance Corporation of the World Bank Group, include all countries with GNI (Gross National Income) per capita below \$9,265.

<sup>2</sup> The survey included both existing funds and funds planned for offering within one year. Data was self-reported or taken from promotional materials. The survey is not exhaustive. The survey also reports on funds that were in the planning process. Subsequent to the survey, some funds have changed plans or have closed operations.

<sup>3</sup> In this brief, our analysis focuses on the general desirability of MFI-FI intermediation of funds (such as investment cost transactions, fund pricing and sourcing), as opposed to some of the more technical issues affecting the flow of private capital to MFIs. Those issues, of course, also bear directly on the ability of MFI-FIs to invest in MFIs.

<sup>4</sup> MFI growth finance refers primarily to the development of MFIs and their potential for expansion, as opposed to portfolio investments. Historically, MFIs have grown through equity investments, volunteer equity, some limited amounts of debt and retained earnings.

<sup>5</sup> Private and quasi-private MFI-FIs means those funds that are not majority-owned by a public institution, but, in the case of quasi-private MFI-FIs, could have significant minority share-owner control by, or investment contributions from, public-sector institutions (e.g., multilateral banks, national or sub national governments, etc.).

<sup>6</sup> The Enterprising Solutions' MFI fund survey is an ongoing project intended to track private and quasi-private MFI-FIs. The survey tracks both for-profit and not-for-profit funds, owned either by private companies or not-for-profit agencies. The purpose of the survey is to understand the nature and potential of private-sector financing of MFIs. For this reason, multilateral finance agency funds and government-controlled funds (such as apex funds) are not tracked, despite their importance; nor are investments related to foundation programs. The survey relies on information provided by fund managers. Our list is not necessarily exhaustive and is subject to change as some funds in development may or may not have commenced operations. Indeed, since the inception of our survey, three fund initiatives have been abandoned and at least one has stalled significantly.

<sup>7</sup> For confidentiality reasons, some data assessments are not fully disaggregated or detailed (e.g., fund detail for data categories with two or three funds may reveal fund identity).

<sup>8</sup> Some funds do not provide official accounts of their geographic distribution of assets, though through interviews we can confirm that the majority of funds not reporting such distribution are in fact invested in Latin America.

<sup>9</sup> Operational self-sufficiency is defined as income sufficient to cover operational costs, but not necessarily all costs of funds. Financial self-sufficiency is defined as income sufficient to cover operational costs and all costs of funds.

<sup>10</sup> Many funds owned by non-governmental organizations do not have separate accounting systems for funds and therefore are unable to estimate how much income is used to fund operations (and thus the costs of operation).

<sup>11</sup> Funds did not report returns in a consistent fashion.

<sup>12</sup> MFI-FIs tend to offer a far more low-risk investment than direct investments in MFIs. Many of them simply deposit funds in USD CDs and similar vehicles. In a bull market, however, they would likely under-perform, providing fixed-income type returns.