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MICROFINANCE AND CAPITAL MARKETS: THE INITIAL LISTING/ PUBLIC OFFERING OF FOUR LEADING INSTITUTIONS

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1) INTRODUCTION

This paper was drafted for the Council of Microfinance Equity Funds (CMEF) on the initial public offerings (IPOs) or listings of four leading microfinance institutions (MFIs)—Bank Rakyat Indonesia (BRI) (Indonesia), Bangladesh Rural Advancement Committee (BRAC) (Bangladesh), Compartamos (Mexico), and Equity Bank (Kenya). These institutions are well known throughout the microfinance industry for their exceptional growth, robust financial performance and their ability to scale-up their outreach to the working poor. The paper is an extension of prior research sponsored by the CMEF on the commercialization of microfinance. What is unique about this paper is that this is the first time the industry has been able to address the IPO of a number of leading microfinance institutions (MFIs) Indeed, each of these institutions has listed on their national stock markets within the last few years and in a couple of the cases made their offering available to international markets.

This paper will examine these four cases from a number of perspectives. First we will examine how the capital market listing of each of these four institutions fits into the rapidly growing trend for microfinance operations of scale to commercialize. Next we will discuss each institution briefly, how it grew and developed, and its operational and financial performance leading up to its capital market listing. As appropriate, we will compare and contrast amongst these institutions. We will also discuss some of the issues these institutions face. Very rapid growth of any institution, especially a financial institution, and the scrutiny of a public offering, invariably require the institution to address a series of issues going forward. Third, we will examine the listings from a capital market perspective-- the key feature of each listing from a technical perspective and on a comparative basis, how the institutions have performed in their national markets and internationally as applicable since the listing. We will also discuss some of the implications for large commercial MFIs that may wish to follow in the footsteps of these four. Finally, we will try to reach some tentative conclusions about the meaning of these listings for the microfinance industry more broadly. Detailed data is confined to an Appendix, so as not to clutter the report with the mass of financial data and statistics that we have accumulated for this paper. Please note that all amounts, unless otherwise indicated, are stated in U.S. dollars.

2) BACKGROUND

In 1994 US AID commissioned a team to prepare an assessment of leading MFIs in the microfinance industry,

> "The purpose of this assessment is to examine programs widely perceived to be on the frontier of microenterprise finance so that recent advances in the field may be incorporated into USAID policy guidance and programming"[1]

[1] , Robert Peck Christen, Elizabeth Rhyne, Robert C. Vogel, "Maximizing the Outreach of Microenterprise Finance: The Emerging Lessons of Successful Programs, IMCC, September 1994, p.2

The resulting report was a seminal work on microfinance that examined eleven leading MFIs at the time, including BRI, one of the institutions that is part of this study of capital market listings/IPOs. The 1994 study asked a series of questions about microfinance, several of which continue to be examined by the industry as it increasingly focuses on commercialization and which are highly relevant to our study:[2]

- "How are outreach and financial viability related? Does serving the poor preclude achievement of financial self-sufficiency?
- If we wish to ensure that microenterprise finance reaches even the very poor, must we expect to support institutions that cannot become financially independent of donor subsidies?
- How financially viable can microenterprise finance institutions be? Can they reach commercial standards? Consistently or only in limited settings?
- What factors are necessary for the achievement of strong outreach and financial viability?
- What are the challenges facing frontier institutions, as well as the challenges facing institutions that have not yet reached the frontier?"

The study went on to indicate that the best programs had made large advances in outreach and financial viability over five years (1990-1994). Many of the institutions had sustained very high growth rates over three years. Ten of the eleven were fully self-sufficient operationally (meaning that they covered all of their operational costs, but not necessarily their financial costs especially when the financial costs were adjusted for subsidies such as grants from donors) and five had crossed the hurdle of full self-sufficiency (meaning that the institutions covered both their financial and operational costs with the former adjusted for subsidies or grants from donors, inflation accounting and their cost of capital to the extent they received subsidized loans from donors, authors' insert), generating returns that reflect banking standards. It is important to note that this study reached these conclusions when outside observers, if they knew anything about the industry, generally knew only a little about Grameen Bank and insiders would talk about the big three—BRI, Banco Sol and Grameen Bank.

Six years later, in 2001, Marguerite Robinson produced her seminal book on microfinance, The Microfinance Revolution: Sustainable Finance for the Poor[3], in which she defined the microfinance revolution in terms of commercial microfinance,

> "The microfinance revolution is a commercial revolution based on new financial technology and greatly accelerated by the information revolution that developed concurrently. It began in the 1970s, developed in the 1980s, and took off in the 1990s….These combinations enabled institutional profitability and long-term viability, making possible large-scale formal-sector financial outreach to low income segments of the population."[4]

[2] Ibid

[3] Marguerite S. Robinson, The Microfinance Revolution: Sustainable Finance for the Poor, World Bank and the Open Society Institute, 2001

[4] Ibid, p. 28-29

Dr. Robinson's second volume on the microfinance revolution focused on Indonesia, and provided exquisite detail on the growth of BRI's unit *desa* system, a leading institution in demonstrating that microfinance institutions could be viable, self sufficient and profitable. BRI also proved how important savings were to poor people, as BRI mobilized massive amounts of small savers in some 3,000 or more villages throughout Indonesia. However, the unit *desa* system was housed in a large bank owned by the Government of Indonesia, whose infrastructure was created by the government through a program dedicated to financing the expansion of the rice crop in Indonesia.[5] As such, BRI was an anomaly; it was one of the few state-owned financial institutions in the world to successfully build a meaningful microfinance operation. BRI has now been partially privatized through its IPO discussed in this volume.[6]

In 2005, with the commercialization of microfinance well advanced, Beatriz Marulanda and Maria Otero examined the future of microfinance in Latin America. [7] In its conclusions, amongst other things, the study projected that:

> "Two approaches to the provision of financial services to the region's low-income people have consolidated in the last years. They both have commercial criteria, which we think will prevail as a model in Latin America in the next ten years. Firstly, the microfinance institutions, as yet primarily operating as NGOs, will undergo "up-scaling,"[8] or transformation into regulated entities, while at the same time commercial banks entering the microfinance sector will adopt "downscaling" to provide a range of financial services to the poor."

The authors go on to say that:

> "The industry agrees on the importance of offering a wide range of integrated financial services including: ATMs and other aids to transactional efficiency, savings accounts, other types of credit products such as consumer and housing loans, and insurance policies…"[9]

And finally, they conclude:

> "The ability of some of the leading microfinance institutions in the region to sell bonds successfully on their local capital markets is leading the way to the ever increasing availability of private capital funding. With such funding, microfinance

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[5] See Marguerite S. Robinson, The Microfinance Revolution, Volume 2: Lessons from Indonesia, World Bank and the Open Society Institute, 2002

[6] A number of state-owned banks, especially postal banks, have been successful in mobilizing deposits from the poor. Moreover, in West Africa the large cooperatives are primarily savings cooperatives modeled after their French equivalent. But the BRI uni desas are somewhat unique in successfully mobilizing both savings and offering loans to microfinance clients.

[7] Beatriz Marulanda and Maria Otero, examined the future of microfinance in Latin America, "The Profile of Microfinance in Latin America in 10 Years: Visions and Characteristics," Accion International, Cambridge and Washington D.C,.2005

[8] Ibid, p. A

[9] Ibid, p.A

> in the region will see the elimination of what in past years was the key constraint to growth of the industry, that of access to sufficient capital."[10]

In two papers published in 2006--- the first by Elizabeth Rhyne and Brian Busch, "The Growth of Commercial Microfinance,"[11] and the second by Elizabeth Rhyne and Maria Otero, "Microfinance Through the Next Decade: Visioning the Who, What, Where, When and How,"[12] there was further confirmation of the exponential growth of commercial microfinance. In the CMEF sponsored study by Rhyne and Busch, the authors compared growth of commercial microfinance as of 2006 with an earlier CMEF sponsored study in 2004. Of 120 institutions, the 2006 study found sufficient comparable data on 71 commercial MFIs. The loan portfolios of these institutions grew 231% over the three years in question or an average of 77% per year, reaching almost $5 billion from $1.5 billion three years earlier. The number of borrowers had increased by 73% or some 24% a year to some 4.1 million borrowers up from 1.7 million borrowers in 2004. Moreover, this growth was widespread globally with portfolio growth at 119% in Africa, 249% in Asia, 396% in Eastern Europe, and 169% in Latin America over this same period.[13] The authors concluded that the 199 MFIs in the study provided a snapshot of shareholder (commercial) microfinance throughout the world in 2006. Together they accounted for a combined portfolio of 11.5 million borrowers and $8.7 billion in portfolio assets. Their combined equity was $1.5 billion with assets of some $13.7 billion.[14]

Large MFIs—portfolio over $100 million and clients in excess of 100,000-- also increased in numbers – 20 institutions had over 100,000 borrowers (and 20 had assets over $100 million, with the ProCredit Banks operating as both micro finance and small and medium enterprise (SME) focused, full service, banks, dominating that list. Six MFIs met both criteria—TEBA, ACLEDA, BRI, Banco Solidario, Compartamos, and MiBanco.[15]

The CMEF study by Rhyne and Busch focuses on commercial institutions do it does not address the large NGOs in Asia, particularly Bangladesh—BRAC, Grameen, and ASA as examples. However, while BRAC's microfinance operations have remained under the wings of its NGO, BRAC Bank, one of the institutions that has gone public and is a subject of our study, focuses on small and medium size businesses (SMEs), an important niche in the highly competitive Bangladeshi market. BRAC's microfinance NGO and its SME bank cover a very large number of borrowers and have an asset base which meet the criteria of the largest institutions.

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[10] Ibid, p. B

[11] Elizabeth Rhyne and Brian Busch, "The Growth of Commercial Microfinance," Council of Microfinance Equity Funds (CMEF), September 2006

[12] Elizabeth Rhyne and Maria Otero, "Microfinance Through the next Decade: Visioning the Who, What, Where, When and How" Accion , November 2006

[13] Rhyne and Busch, Opus Cited, p.6

[14] Ibid, p. 9

[15] Ibid, pp.11-12

The Rhyne and Busch paper does not address institutions that mobilize a large amount of savings.[16] In our study BRI, Equity Bank, and most recently BRAC Bank, are highly successful in their ability to capture a large amount of savings, with BRI and Equity Bank doing so through a large number of very small or micro savings accounts.

The Rhyne and Otero study looks at what the drivers are of success in microfinance and the quality gap, which goes beyond massive outreach by large MFIs. One of the drivers, noted by the study, is commercial entry. The authors note,

> "The entry of commercially oriented providers will substantially change the microfinance field…. The right conditions for rapid entry by new commercial players are now present in the marketplace: demonstrated profitability, business models that can be copied, and competencies for working with low income populations. The history of financial innovation suggests that once such conditions are present, spread can be very rapid."

We see this study as a further confirmation of the rapid progress made by commercial microfinance and the potential for the industry to reach a new take off stage in terms of its growth and outreach to the poor, while maintaining the profits, return on assets (ROA) and return on equity (ROE) necessary to attract private equity investors on a substantial scale. This new stage of development in the industry will not necessarily come from the ability of institutions to do IPOs, but rather by the signals these successful IPOs send to commercial investors, such as private equity investors or venture capitalists, and their ability to eventually exit investments they make in MFIs or microfinance equity funds.

By commercial microfinance, we mean MFIs that operate commercially and meet the following criteria:

- They are structured as shareholder owned institutions
- That they seek to and in time operate profitably;
- They raise a heterogeneous mix of funds in commercial markets through a combination of-- mobilizing deposits, borrowing in the inter-bank market, retaining a percentage of their profits as capital for expansion, from recently created internal debt or equity funds and most recently through capital markets by way of securitizations, bond offering or IPOs; and,
- They operate as regulated non-bank financial institutions or commercial banks, largely focused on microfinance, but increasingly are expanding their product offerings to, inter alia, the following—insurance products, money transfers, housing improvement loans, and small business loans.

[16] Ibid, P.17

3) THE INSTITUTIONS

As we noted in the introduction, each of the institutions have approached the capital markets somewhat uniquely, just as they have evolved and grown under different political and economic conditions within their respective countries. In this section of the paper, we will discuss briefly the nature of each of these four very important financial/ microfinance institutions, its background and history as a financial institution, its growth and financial performance and its ability to reach scale and impact those without access to formal financial services.

a) BANK RAKYAT INDONESIA (BRI)

BRI listed on the Jakarta Stock Exchange on October 31, 2003 in the aftermath of the East Asia crisis that began in Thailand in 1997 and spread rapidly throughout much of East Asia, most deeply in Indonesia. BRI was listed as part of a package of three banks majority owned by the Government of Indonesia. The crisis adversely affected the banking sector in Indonesia, forcing the Government to intervene and re-capitalize many of the state-owned banks, especially the large commercial banks such as BRI.[17] While the microfinance operations of BRI, the unit *desa* system (Village Units), performed exceptionally well during the crisis, the unit *desas* have always been part of a large state-owned bank that has not performed nearly as well.[18] In fact, with high financial returns from the unit *desas* and a savings base in excess of the lending base, the larger bank was able to drain funds from the rural areas and intermediate these as corporate loans, often through politically tied lending. During the East Asian crisis this resulted in large scale defaults and the need to re-capitalize the bank.

The IPO of BRI brought with it a new strategic focus for the institution, as a full service commercial bank but largely focused on micro and small business (retail) lending at its core. In fact, the Ministry of Finance as part of a memo of understanding with the International Monetary Fund (IMF), enjoined BRI from making corporate loans to new customers. The agreement with the IMF was to sell off the bank's corporate loans, but that aspect of the agreement was not fully implemented, at least as of the time of the IPO. The Bank was instead required to develop a strategy that would build on its strengths—the unit *desa* system, retail or small business lending and as a complementary line of business, consumer lending.[19]

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[17] The Indonesian Government was forced to close 16 banks, and transfer 54 distressed banks to IBRA, the Indonesian Bank Restructuring Agency. See Kawai, Lieberman and Mako, "Financial Stabilization and Initial Restructuring of East Asian Corporations: Approaches, Results and Lessons," in Ed. Adams, Litan and Pomerleano, Managing Financial and Corporate Distress: Lessons from Asia, Brookings Institution Press, Washington D.C. 2000, p. 104; More than half of BRI's capital was impaired as a result of the crisis 1997/1998 and it accumulated large-scale losses. The Government was forced to re-capitalize the bank which it did in 2000. See Detlef Holloh, "Microfinance Institutions Study," Indonesia, The Ministry of Finance of the Republic of Indonesia, Bank Indonesia, GTZ, p.47.

[18] For a n excellent discussion of the crisis see Marguerite S. Robinson , The Microfinance Revolution Volume 2: Lessons from Indonesia, The World Bank and the Open Society Institute, Washington D.C, 2002, pp. 46-58;.

[19] BRI, Offering Circular 2003

BRI is among the oldest banks in Indonesia, established in 1895, and the unit *desa* system, as it presently operates, is one of the largest microfinance institutions in the world, established in 1984. [20] The current system emerged from efforts by the Indonesian Government in the early 1970s to substantially increase the size of the rice crop, by subsidizing the financing of inputs for the farmers such as fertilizer and seeds. BRI administered the financing by establishing some 3,600 village units at its peak under the BIMAS (Mass Guidance) credit program. The village units were also responsible for providing rural non-agricultural loans. Employment levels at the village units grew rapidly to some 14,000 employees. While the effort succeeded in terms of increasing the rice crop, by the early 1980s it was clear the program of subsidized financing was very costly to the Government, a culture of non-payment developed rapidly and the program was clearly unsustainable in the long-term.[21]

In 1984 utilizing the infrastructure of the BIMAS program and with the technical assistance and advice of a team from the Harvard Institute of Development, the Government and BRI, with little precedent to draw upon, developed the unit *desa* system. The key was the development of the KUPEDES loan product and a number of savings deposit products introduced slightly later than the loan product --TABANAS, the national savings program sponsored by the Bank of Indonesia since 1976 was continued, SIMPEDES, a new product was introduced after extensive research in the villages, and became the primary savings product of the rural villages, SIMASKOT was an urban savings product meant to be the counterpart of SIMPEDES. DEPOSITO and DEUMUNA are variations of conventional time deposits.[22] Though the products have been somewhat modified in the last several years, the unit *desa* remains much as designed in 1984.
From 1984 to 1996, BRI generated 18.5 million KUPEDES loans and during 1996 the unit *desas* were extending some 160,000 loans per month, averaging $1,007 (approximately at GNP per capita) with some 70% of loans below this average. By the end of 1996, the loan portfolio was about $1.7 billion.[23]

Perhaps even more impressive was the growth in savings during this same period. Before the transformation of the Village Units from 1973-1983 savings mobilized through the national savings system was $30 million in total. As of end 1996, total unit *desa* savings were about $3.0 billion or nearly $800,000 per village unit, in 16.2 million savings accounts. Equally impressive was that the average size of these deposits from the primary savings products was US$184. This represented, some 30 percent of the total number of savings accounts in Indonesia, serving some 10 percent of Indonesia's population.[24]

[20] For a comprehensive discussion of microfinance in Indonesia and in particular BRI's Unit Desa system, see Robinson, Opus Cited.
[21] See S. Charitonenko, Richard H. Patten and Jacob Yaron, "Indonesia: Bank Rakyat Indonesia-Unit Desa, 1970-1996, Sustainable Banking with the Poor," The World Bank, May 1998, pp. ix-x
[22] Ibid, pp. x-xiii.
[23] Ibid, p.xiv; see also BRI Unit Products, Bank Rakyat Indonesia and U.S. AID,, International Visitor Program.
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[24] Ibid, p. xv.

The BRI unit *desa* system broke even after just 18 months in operation, in part due to the advantage of inheriting the BIMAS Program village unit infrastructure, and with profits of just $6 million in 1986, profits rose to $177 million by 1996. Return on average equity (ROE) was some 63% from 1990-1993, more than doubling in 1996 to 134%.[25] Return on assets averaged some 4.6% over the seven years 1990-1996. The long-term loan loss ratio of the program averaged some 2.15% over this period of time, with the 12-month loan loss rate at 1.59% in 1996.[26]

These high growth years for the unit *desas* ran parallel to the growth of the overall Indonesian economy. The economy experienced more than a decade of uninterrupted growth. In 1970 about 60% of Indonesians lived below the poverty line and by 1996 just 11% of the population lived below the poverty line.[27] Clearly the unit *desas* benefited from this period of stable and strong economic growth, but in turn the working poor in rural villages benefited from the extensive village network of BRI, the opportunity to save safely with a decent return and loans readily available to credit worthy individuals under KUPEDES. However, 1996 was a watershed year for the Indonesian economy. By 1997, the economy was deeply enmeshed in the East Asian crisis that spread rapidly to each country in the region from its origins in Thailand. Indonesia's GDP which had expanded by some 8.0% a year for more than a decade, plunged by 13% in 1998.[28]

The unit *desa* system weathered the crisis which was prolonged in Indonesia due to political instability and conflict in Indonesia during the crisis. While the unit *desas'* loan portfolio, savings balances, and profits were reduced substantially in dollar terms during the crisis (1997-2000), in Rupiah terms, the system continued to grow and all measures of financial soundness remained solid and actually improved after 1998, when the crisis was at its deepest. As Robinson has noted, "By examining the unit *desas'* performance from 1996-2001 it would be impossible to learn that the country had been in deep crisis."[29]

BRI as a corporate bank, 100% owned by the state, did not do as well during the crisis. It had to be intervened and re-capitalized by the Government through an injection of Government bonds into the capital of the bank. As a result of the crisis, the IMF and the Government of Indonesia agreed that BRI would be enjoined from corporate lending and its corporate portfolio passed to other banks. The focus starting in 2000 would be on micro, retail and SME loans.[30] In fact that never completely occurred, but it's clear from data on BRI's outreach data that the average size of the unit *desa's* loans have been reduced and that the institution is reaching further down scale, with respect to average loan size as compared to per capita GNP. Average loan size was $878 or some 55% of GNI per capita, as of end 2006. Savings balances continue to reflect the enormous core

[25] It is not clear how much equity was allocated to the unit desa system, therefore, its real equity base might be understated and these very high returns on equity misleading.
[26] Ibid, pp. xvi-xx; see also BRI Unit Products, Bank Rakyat Indonesia and U.S. AID,, International Visitor Program; see Robinson, Vol. II Indonesia, Opus Cited, p. 388 for the loan loss percentage data..
[27] Robinson, Opus Cited, p.38.
[28] Ibid, p. 48.
[29] Ibid, p.397
[30] Holloh, Opus Cited, p. 47.; see also Robinson, Vol. II Indonesia, Opus Cited, pp. 398-399.

group of poor savers, with the average savings balance at $158 or some 9% of GNI per capita, as of end 2006.[31]

Table 1: Unit Desa Savings and Lending					
Indicator	**1996**	**1997**	**1998**	**1999**	**2000**
Value of Outstanding Loans					
Billions of Rupiah	4,076	4,685	4,697	5,957	7,827
Millions of U.S. Dollars	1,711	1,008	585	841	816
Number of Outstanding Loans (thousands)	2,488	2,616	2,458	2,474	2,716
Long-term Loss Ratio*	2.15%	2.17%	2.13%	2.06%	1.90%
Portfolio Status**	3.65%	4.73%	5.65%	3.05%	2.51%
Value of Savings					
Billions of Rupiah	7,092	8,837	16,146	17,061	19,115
Millions of U.S. Dollars	2,976	1,900	2,012	2,408	1,992
Number of Savings Account (thousands)	16,147	18,143	21,699	24,236	25,823

*The long-term loss ratio measures the cumulative amount due but unpaid since the opening of the unit compared with the total amount due. **Portfolio status measures the aggregate amount of overdue principal installments compared with total principal outstanding.

Source: BRI monthly unit *desa* reports

For the last few years, growth has been modest but steady, reflecting the maturity of the unit *desa* system and the need for the bank to regenerate its capital. Growth in borrowers has averaged 3.7% a year reaching a total of 3.5 million borrowers at the end of 2006. The loan portfolio has grown to some $3.0 billion. Savings accounts have somewhat peaked, growing at 1.23% per year over the last three years and in fact declining by 4.1 % in 2006. However, the unit *desas* had some 31 million savings accounts, with a total deposit balance of $4.9 billion at year-end 2006.[32] See Table 2 on BRI's performance 2004-2006.

Despite its great success to-date, the unit *desa* system still faces a number of issues and risks many of which are discussed by Marguerite Robinson in her seminal work on Indonesia, Volume II of the Microfinance Revolution: Lessons from Indonesia.[33] Some of the primary threats are political direction from the government, the stability of Indonesia, banking regulations, and the potential to be drawn back into the corporate lending business.

BRI's achievements in microfinance to-date are remarkable. The institutional infrastructure, systems and products are in place to continue performing as one of the giants of the industry. There are clear advantages for the future in having BRI publicly listed and the unit *desas* operating within a full scale commercial bank, with non-governmental shareholders, even if the government still owns a majority of the shares in the company.

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[31] The Mix Market
[32] Ibid
[33] Robinson, Opus Cited, pp. 398-402 Challenges; see also BRI Offering Circular, pp. 18-33 Risk Factors

Table 2: Bank Rakyat Indonesia (BRI)

Year of Establishment	1895		
Country	Indonesia		
Number of Branches	324 , and over 3,900 unit *desas*		
Mission	"To perform the best banking activities by delivering services mainly to small and medium enterprises in order to support economic development. To provide excellent services to its customers through a widely distributed network supported by professional human resources and to conduct good corporate governance practices. To provide optimal profit and benefit to its stakeholders."		
Number of Borrowers (year over year growth %)	2004	3,210,678	3.6
	2005	3,313,532	3.2
	2006	3,455,894	4.3
Average Loan Balance per Borrower	2006	$878	
Gross Loan Portfolio (year over year growth %)	2004	$2,044,532,205	18.9
	2005	$2,321,540,457	13.5
	2006	$3,035,685,400	30.8
Average Loan Balance per Borrower/GNI per Capita (%)*	2005	54.74	
Number of Savings Accounts (year over year growth %)	2004	31,271,523	4.7
	2005	32,252,741	3.1
	2006	30,907,566	(4.1)
Average Saving Balance Per Saver	2006	$158	
Saving Balance (year over year growth %)	2004	$3,503,488,748	8.0
	2005	$3,748,591,984	7.0
	2006	$4,869,688,137	3.0
Average Savings Balance per Borrower/GNI per Capita (%)*	2005	9.08	
ROA (%)	2006	6.88	
ROE (%)	2006	129.96	
Profit Margin (%)	2006	31.17	
Borrowers per Staff Member	2006	90	
Operating Expenses/Loan Portfolio (%)	2006	8.26	
Portfolio Risk (%)	2006	5.07	
Write Off Ratio (%)	2006	0.83	

All data taken from The Mix Market Website
****2006 data unavailable***

b) Bangladesh Rural Advancement Committee (BRAC)—BRAC Bank

BRAC is a non-governmental organization (NGO), which started in 1972 as a relief and rehabilitation effort after the Bangladesh War of Liberation. Over the years, BRAC has evolved as one of the largest national NGOs in the world, if not the largest, involved in a myriad of social support services, financial services, business entities and training programs with the twin objectives of poverty alleviation and empowerment of poor people, especially poor women, in some 62,000 villages and 64 districts in Bangladesh. In addition to providing social services such as health care, BRAC also operates BRAC University, to provide tertiary education.[34] In short, BRAC is a highly successful social conglomerate. It has achieved its size and excellence under a highly dedicated management team led, for more than thirty-five years, by Fazle Abed and tight knit team under him.

In addition, BRAC has created and manages a very extensive microfinance program, the BRAC Economic Development Program. By the end of 2006, the program had reached some 4.6 million poor people throughout Bangladesh, mostly women, as borrowers and 45,000 savers, organized into 119,836 Village Organizations, each having 30 to 40 members. BRAC's microfinance operations were conducted through 1,205 service offices. Its loan portfolio was $350 million with an average loan balance per borrower of $77 or some 14% of GNI per capita at end 2006. Savings mobilization was more modest at $538,000, with average savings balances of $11 or at 2.86% of per capita income. BRAC continuously tries to reach further downscale to the poorest of the poor largely through grant programs that prepare their clients economically, until they are able to borrow.[35] Despite its effort to reach as far downscale as is economically feasible, BRAC's microfinance operations have operated profitably with a return on assets (ROA) of 6.9%, return on equity of 23%, operating costs of 13% and portfolio write-offs at 0.63% as of end 2006.[36] BRAC's microfinance operations have extended to Sri Lanka, Afghanistan, and sub-Saharan Africa, making BRAC a multinational MFI. See Table 3 for a summary of BRAC's microfinance operations.

BRAC did not choose to commercialize its microfinance operations that has stayed within the NGO. Instead, BRAC's management chose to float BRAC Bank, a commercial bank servicing small and medium sized companies (SMEs) in Bangladesh, through an IPO on the Dakha and Chittagong Stock Exchanges, on December 11, 2006. BRAC Bank raised some $13 million through the IPO, all of which will be utilized to expand the bank's operations throughout Bangladesh.[37]

As of end 2006, BRAC Bank operated some 280 unit offices with a gross loan portfolio of $293 million. During 2006, monthly loan volume averaged $5.8 million dollars, and average loan size was $4,761 dollars. Savings deposits totaled $344 million dollars

[34] BRAC Website, www.brac.net, Annual Reports 2003-2006
[35] Ibid
[36] The MIX Market website, The MIX Market.org
[37] Prospectus of BRAC Bank Limited, September 9, 2006..

coming from 259,000 savings accounts. During 2006 net profits were $5 million, up from $530,000 in 2003. ROA was 1.42% and ROE was 23% in 2006.

Table 3: Bangladesh Rural Advancement Committee (BRAC)-Microfinance NGO			
Year of Establishment	1972		
Country	Bangladesh		
Number of Branches	1205 (referred to as team offices)		
Mission	"BRAC works with people whose lives are dominated by extreme poverty, illiteracy, disease and handicaps. With multifaceted development interventions, BRAC strives to bring about change in the quality of life of poor people in Bangladesh."		
Number of Borrowers (year over year growth %)	2004	3,993,525	14.3
	2005	4,159,793	4.2
	2006	4,550,855	9.4
Average Loan Balance per Borrower	2006	$77	
Gross Loan Portfolio (year over year growth %)	2004	$243,146,287	20.6
	2005	$268,859,260	10.6
	2006	$350,160,812	30.2
Average Loan Balance per Borrower/GNI per Capita (%)*	2005	13.75	
Number of Savings Accounts (year over year growth %)	2004	27,208	0.7
	2005	32,548	19.6
	2006	45,234	39.0
Average Saving Balance Per Saver	2006	$11	
Saving Balance (year over year growth %)	2004	$538,405	(2.7)
	2005	$437,523	(18.7)
	2006	$515,572	17.8
Average Savings Balance /GNI per Capita (%)*	2005	2.86	
ROA (%)	2006	6.90	
ROE (%)	2006	23.27	
Profit Margin (%)	2006	26.94	
Borrowers per Staff Member	2006	186	
Operating Expenses/Loan Portfolio (%)	2006	12.91	
Portfolio Risk (%)	2006	3.76	
Write off Ratio (%)	2006	.63	

All data taken from The Mix Market Website
****2006 data unavailable***

BRAC has developed a strategy of providing financial services for micro-entrepreneurs and SMEs through a dual track-- with the NGO continuing to expand its microfinance operations, both within Bangladesh and internationally, and the formal financial institution, BRAC Bank, providing full scope financial services to SMEs. This strategy differs markedly from the approach taken by BRI and Equity Bank that provide microfinance and SME services within full scale commercial banks that are largely servicing the working poor. Each of these institutions have developed and evolved out of very different conditions and this leads us to conclude that no single model is likely to emerge as the industry develops However, operating as a full service commercial bank offers a number of advantages including the ability to offer clients a range of savings products and deposit insurance to the extent the government provides such insurance to the banking sector, mobilization of savings as the primary funding source for the bank, the ability to offer a range of loan products and other services, and the branch infrastructure and technology of a bank. In the future BRAC may want to consider merging its microfinance operation into the bank.

Table 4: BRAC Bank—SME bank

Number of Borrowers (year over year growth %)	2004	-	-
	2005	37,584	-
	2006	61,526	63.7
Average Loan Balance per Borrower	2006	$4,761.09	
Gross Loan Portfolio (year over year growth %)	2004	$99,975,273	98.6
	2005	$178,133,580	78.2
	2006	$292,930,698	64.4
Average Loan Balance per Borrower/GNI per Capita (%)	2006	1,013	
Number of Savings Accounts (year over year growth %)	2004	-	-
	2005	124,289	-
	2006	258,601	108.1
Average Saving Balance Per Saver	2006	$1,333.32	
Saving Balance (year over year growth %)	2004	$140,343,076	128.8
	2005	$202,610,141	44.4
	2006	$344,798,781	70.2
Average Savings Balance /GNI per Capita (%)	2006	283.69	
ROA (%)	2006	1.42	
ROE (%)	2006	23.0	
Profit Margin (%)	2006	16.09	
Borrowers per Staff Member	2006	20.2	
Operating Expenses/Loan Portfolio (%)	2006	6.54	
Portfolio Risk (%)	2006	3.76	
Write off Ratio (%)	2006	0.63	

All data taken from 2006 Annual Report and Prospectus

c) BANCO COMPARTAMOS, S.A, (COMPARTAMOS)

Compartamos is one of the largest microfinance institutions in all of Latin America.[38] Its origin lies in a Mexican youth organization developed to improve the life of poor

[38] See Beatriz Marulanda and Maria Otero, "The Profile of Microfinance in Latin America in 10 Years: Vision and Characteristic," April 2005 for a comparison of Compartamos with other large LAC MFIs.

Mexicans, living in marginalized communities. Compartamos was launched with a village banking pilot program in 1990 as an NGO titled *Asociacion Programa Compartamos*.[39] Compartamos operated as an NGO until 2000. In 2000, with a client base of 64,000 borrowers, Compartamos became a for profit company as a regulated financial institution, a SOFOL (*Sociedad Financiera de Objecto Limitado*), and in June 2006 a licensed commercial bank.[40]

Compartamos' early financing was somewhat typical for MFIs at this time. In the initial years, the Management managed to secure funding in increasing amounts from various donors --an initial grant from US AID in 1990 of $50,000, an Inter American Development Bank (IDB) grant of $150,000 and a loan from IDB on soft terms of $500,000 in 1993, and an equity investment from one of its founders, and funds invested by its management team. Then in 1996, it received a large grant of $2 million from CGAP to support its expansion and capacity building efforts.[41]

By 1996 growth was robust and remained so through the time it went public. From 1996-2000, Compartamos expanded its client base 24% a year as an NGO, and from 2000-2006 as a regulated financial company, growth averaged some 46% a year.

Compartamos reached some 600,000 clients with its loan portfolio at $271 million at year end 2006. All profit measures were exceptionally strong as a result of high real interest rates and exceptionally low loan loss rates. At end 2006, ROE was 57.53 %, ROA 23%. Portfolio at risk was 0.62% and loan write–offs 0.57% (see table 5 below).

Yet Compartamos continues to reach down scale to some of the poorest populations in Mexico with average loan size at end 2006 at $440, or some 5.45% of GNI per capita. Loans are focused towards rural villages and women entrepreneurs (98% of its clients) without adequate access to finance.[42] The client base is widely diversified regionally across Mexico, but the largest concentration of clients is in the poorest, indigenous, states of Mexico such as Chiapas, Guerrero, Oaxaca and Veracruz. Although Compartamos has diversified its products over the years, it's Income Generator (IG) for women in groups of 15 or more, with a solidarity guarantee, accounts for some 87.4 % of its loans.[43]

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[39] Offering Circular, p. 86; Accion, "The Banco Compartamos Initial Public Offering," In Sight, Number 23, June 2007, p.1

[40] Richard Rosenberg, CGAP Reflections on the Compartamos Initial Public Offering: A Case Study on Microfinance Interest Rates and Profits," No. 42, June 2007.

[41] Ibid, p.5 Richard Rosenberg and Robert Christen initially evaluated Compartamos and recommended that CGAP fund its expansion. Ira Lieberman was the CEO of CGAP at the time and brought that proposal to CGAP's Credit Committee as one of CGAP's earliest and largest grants. Rosenberg and Christen continued to provide advice to CGAP's management in its early years .

[42] Accion, InSight, Opus Cited, p. 2

[43] Offering Circular, p. 71 and Accion InSight, Opus Cited, p. 3.

Table 5: Banco Compartamos, S.A. (Compartamos)			
Year of Establishment	1990		
Country	Mexico		
Number of Branches	187 (located in 28 different states)		
Mission	"Compartamos is a social company committed to the people. We generate development opportunities within the lower economic segment, based on innovative and efficient models on a wide scale as well as transcending values that create external and internal culture, fulfilling permanent trusting relationships and contributing to a better world"		
Number of Borrowers (year over year growth %)	2004	309,637	43.8
	2005	453,131	46.3
	2006	616,528	36.1
Average Loan Balance per Borrower	2006	$440	
Gross Loan Portfolio (year over year growth %)	2004	$101,023,790	59.4
	2005	$180,630,956	78.8
	2006	$271,098,542	50.1
Average Loan Balance per Borrower/GNI per Capita (%)*	2005	5.45	
ROA (%)	2006	23.18	
ROE (%)	2006	57.35	
Profit Margin (%)	2006	44.82	
Borrowers per Staff Member	2006	192	
Operating Expenses/Loan Portfolio (%)	2006	33.45	
Portfolio Risk (%)	2006	0.62	
Write Off Ratio (%)	2006	.57	

All data taken from The Mix Market Website
****2006 data unavailable***

Unable to mobilize deposits as a SOFOL, Compartamos financed this expansion through a combination of retained earnings from strong profit performance, and an injection of some $6 million in equity investments from international investors focused on microfinance. The international investors included Accion and ProFund, the latter Latin America's first microfinance investment fund, as well as the World Bank Group's International Finance Corporation (IFC).[44] However, it was Compartamos' ability to tap both the inter-bank market and the capital markets, which really made a substantial difference in its ability to expand its client base. That early entry into the capital markets in turn conditioned the institution and the market for its IPO. In July 2002, Compartamos issued $20 million of bonds, with a three year maturity rated by Standard & Poors as MxA+ and in February 2004, with a 34% guarantee from the International Finance

[44] Ibid, p. 3 and Rosenberg, Opus Cited, p.5 Accion's investment of $2 million in Compartamos was funded by USAID and CGAP funding for Accion's Gateway Fund that was intended for equity investments in unspecified MFIs.) USAID also provided Compartamos with an additional $2 million through Accion in 2000 that went partially to the NGO for technical assistance and primarily to the for profit institution as a loan..

Corporation (IFC) Compartamos raised 5 year bonds in an amount of $50 million, rated by Standard and Poor and Fitch Mexico mxAA.[45]

In June 2006, Compartamos received a commercial banking license from the Mexican Ministry of Finance and Public Credit and changed its name to Banco Compartamos SA, Institucion de Banca Multiple. Commercial bank status allows Compartamos to continue diversifying its sources of funding and its product offering, especially the ability to mobilize savings deposits.

On April 20, 2007, Compartamos went public through an IPO that listed it on the Mexican Stock Exchange and also offered shares to international institutional investors under US SEC Rule 144A. The offering was unusual for an IPO in that the Bank received none of the proceeds from the sale, it was a 100% secondary offering that raised some $474 million and allowed the principal shareholders who had founded Compartamos and run it since 1990, to recoup their investment and, as it turned out, earn very substantial profits.[46]

Compartamos' IPO focused attention on its profitability and robust ROA and ROE performance, in large part due to its quite high interest rates. The IPO also generated quite a bit of controversy in the microfinance industry and also the business press[47] due to the large returns to Compartamos' investors. The debate over the IPO has resulted in two sets of responses in the industry--- one currently being pursued by CGAP would like to increase "truth in lending" in the industry by making sure that clients (borrowers) are well informed about the effective interest rate on all loans and other financial products offered by an MFI. This seems sensible and in line with good consumer lending practices. The other response is a vague proposal that the profits of MFIs should be somehow limited, it is part of a larger thesis espoused by Professor Yunus, founder of Grameen Bank, that socially motivated enterprises should not generate profits.. Frankly, this proposal goes contrary to the evolution in the sector to commercialize. In our view, the most likely outcome, as in most sectors of a market economy that are subject to reasonable entry and competition, is that highly profitable MFIs will face competitors and interest rates, margins, profits and ROE/ ROA will all decline as that competition manifests itself. This has already happened in some markets such as Bolivia and to some extent is now occurring in Mexico.[48]

[45] Offering Circular, P. and IFC documents.
[46] Offering Circular, April 20, 2007.
[47] Business Week Online Magazine, December 13, 2007, "The Nobel Prize-winning microfinance pioneer refuses to mention the words "Compartamos" and "microfinance" in the same breath, see also Keith Epstein and Geri Smith," How big Mexican banks profit as many poor borrowers get trapped in a maze of debt," and Keith Epstein and Geri Smith, "Online Extra: Microlending is no cure-all".
[48] We recognize that there has been harsh criticism of the Compartamos IPO from a number of commentators, in particular one blogger. We believe that Richard Rosenberg's note for CGAP has largely addressed those issues and we propose not to comment further on this matter, Richard Rosenberg, CGAP Reflections on the Compartamos Initial Public Offering: A Case Study on Microfinance Interest Rates and Profits," No. 42, ,Washington D.C, .June 2007

While becoming a regulated bank is an important step for the future development of Compartamos, the institution has a number of challenges to face. These challenges include the need for effective cash mobilization and handling, efficient savings mobilization, product diversification. In addition, as Compartamos continues to post high earnings, there is an expectation that the level of competition will increase.

d) EQUITY BANK LIMITED

Equity Bank was founded as the Equity Building Society (EBS), in Nairobi in 1984 and initially focused on providing term loans and in mobilizing deposits. Less than a decade after its inception, the high risk of term loans, a stagnant deposit base, under capitalization, poor management and a difficult macro economic and political environment led the bank to the brink of collapse. The Central Bank of Kenya declared EBS insolvent in 1993 with more than 50 percent of its loan portfolio at risk of default and deposits being used to cover operating expenses.[49]

In 1994, the Chairman of the bank realized that the bank needed help. Under the leadership of James Mwangi, the current CEO, the bank began a major restructuring effort which focused on the economically active poor In addition, the bank began a major marketing effort to mobilize savings deposits. The vision evolved over the years, but ultimately the goal was to become the leading retail bank in East Africa by providing the full range of financial services to the economically active poor.[50]

During its restructuring, EBS reached out selectively to the international microfinance community for assistance. In 1999, it reached out to EU-MESP and UNDP's Micro-Start, but it was Micro-Save Africa and Swiss Contact, followed thereafter with assistance from the British Department of International Development (DFID), that made a major difference in Equity Bank's turnaround. For example, a DFID grant of $411,000 allowed EBS to upgrade the technology and increase the scale of its mobile banking units that reach clients in remote rural areas. The mobile units began operating in 2000 with some $262,000 of EBS' own capital. Technical assistance, from Micro-Save and Swiss Contact, based on market research in Kenya, brought a new focus to EBS on product design and service appropriate to the microfinance and small business market. Just as BRI was able to implement a massive savings program through carefully researched product design, EBS developed a range of savings products that met its clients' needs. Savings provided a source of low cost capital, allowed the bank to rapidly expand its branch footprint throughout the country and also allowed the bank to validate clients' creditworthiness prior to lending. Commenting on Equity's business model, AfriCap noted,

[49] Gerhard Coetzee, Kamau Kabbucho, Andrew Mnjama, "Understanding the Rebirth of Equity Building Scoiety in Kenya," MicroSave-Africa, August 2002, pp.4-5 ; also seeDouglas Pearce and Myka Rensch, "Equity Building Society Reaches Rural Markets," CGAP Case Study, Agricultural Microfinance, August 2005, p.1

[50] Micro-Save Africa, Opus Cited, AfriCap, "Investment Report," January, 2003, p.10; also see CGAP, opus cited, pp. 2-3 on the mobile banking product and pp.3-4 on technical services assistance to EBS..

> "The company attracts savings by providing comparatively high rates, flexible products and outstanding customer service. As an example, the savings account offers a very low minimum balance, no fixed fees, and no restrictions on withdrawals and deposits. Loyal savers are progressively converted into borrowers on the basis of their savings patterns. As a result the company incurs little additional marketing costs while building its loan portfolio."[51]

The bank also offered a full range of loan products; however, until recently the bank's strength has been in its savings products.[52] Portfolio at risk has remained high by microfinance standards, even though the bank has performed as well or better than many of its banking competitors in Kenya. Equity Bank needed to invest a significant amount of funds and effort in MIS software and credit risk management systems to comply with changing banking regulations in Kenya, and perhaps more importantly to tighten its control over its portfolio performance.

However, EBS also needed more equity capital to support its large deposit base and rapid expansion. In April, 2003, AfriCap invested $1,500,000 in EBS, becoming its first external strategic investor. Moreover, AfriCap also provided technical services funding and support through its Technical Services Facility (TSF) and two of its management team joined EBS' board of directors, as EBS also sought to strengthen its governance as part of the bank's overall re-organization and restructuring effort. [53]

EBS' new strategy, new management team, external technical assistance and investors paid off. Between 1993 and 1997, deposits grew by 823%, the loan portfolio expanded by 1,525% and profitability improved by 323%. The bank broke even in 1998 and closed the year 2002 with net earnings of almost $2 million.[54]

In 2000, Equity Bank was being compared to other MFIs. For example, it was compared to Kenya Rural Enterprises (K-Rep), the first MFI to convert to a fully licensed bank in Africa had 15,451 clients, 369 million Ksh in loans and a market share in volume of loans of just 2%. There was also FALU, a limited liability company, had some 15,000 clients, 231 million Ksh in loans and a market share of 1%, and KWFT an NGO with 19,618 clients and 265 million Ksh in loans and a market share of 1%. Though EBS was being compared to these institutions, it was the SACOs, rural cooperatives serving small farmers, which controlled the market with over a million active clients, 23 billion Ksh in loans and 94% market share.[55] However, the SACOs, as member based cooperatives, were largely unregulated and many proved unstable with poor governance and concentrated lending to farmers with a narrow range of crops.

In 2004, EBS was given a full banking license and following its turnaround and initial take-off phase, the bank began to grow dramatically. By 2006, when the bank decided to

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[51] AfriCap Investment Report, Opus Cited, p. 10
[52] MicroSave Africa, p. 14
[53] AfriCAP Business Plan, Portfolio Summary, 2006
[54] AfriCap, Investment Report, opus Cited, p. 10
[55] MicroSave Africa, pp. 12-13

go public, there were few that continued to benchmark EBS as an MFI. Equity Bank Limited, as the bank was now renamed, was now benchmarked versus the Kenyan banks.

Box 1: [56]

***Market Intelligence 2006*: Selected Indicators for Equity Bank (2005 data)**

- Cost of Funds (0.91%): Ranked 1. (1.25% in 2004)
- Return on Capital Employed (31.40%): Ranked 3. (17.17% in 2004)
- Total Income / Total Assets (16.45%). Ranked 4. (16.39 % in 2004)
- Number of Branches (36) : Ranked 4. (89% increase over 2004)
- Number of employees (884). Ranked 5. (53% increase over 2004)
- ROA (4.37 %): Ranked 5. (3.25% in 2004)
- Before-tax Profit (501 million Kshs): Ranked 8. (129% increase over 2004)
- Total Net Operating Income (1,803 million Kshs): Ranked 9. (74 percent increase over 2004)
- Total Income (1,885 Kshs): Ranked 11. (71% increase over 2004)
- Net interest income (866 million Kshs): Ranked 12. (119% increase over 2004)
- Total assets (11,457 million Kshs): Ranked 13. (71% increase over 2004)
- Total liabilities (9,863 million Kshs): Ranked 13. (81 percent increase over 2004)

Source: *Market Intelligence Banking Survey 2006.*

Equity Bank Limited's (EBL) growth has been meteoric. From 2003 to 2006 the number of borrowers has increased from 59,000 to 240,000 at an annual average of 66%. The portfolio has grown from $15 million in 2002 to $158 million at year end 2006, at an annual average growth rate of 82%. The number of savings account during this same period have grown from 156,000 to just over a million accounts, an average growth rate of 61%, while deposit balances grew from $28 million during this same period to $236 million (2002-2006) at an annual average growth rate of 72%.

EBL was able to grow explosively, while maintaining relatively sound financial performance. Portfolio at risk remained a problem throughout this period, which EBL sought to address with a significant investment in management information systems (MIS) and with technical assistance on credit risk management, supported by CGAP. The bank's ROA was 4.85%, its ROE 40.36%, its profit margin 31.53%, capital adequacy at 11%, and debt to equity ratio at 8.10% at the end of 2006. Operating expenses increased rapidly as well to keep pace with expansion at 77% on average per year from 2003-2006; however, at 42.38% operating expenses as a percentage of loan portfolio were high. Also, portfolio at risk stayed stubbornly high at 12.19. [57]

EBL continued to reach down scale throughout this period of explosive growth with an average loan balance of $444 or 65.64% of GNI per capita and savings really reached out to the working poor at $165 on average or 36.73% of GNI per capita as of 2006.[58]

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[56] Box prepared by Marguerite Robinson for a note on Equity Bank, November, 2006.
[57] EBL annual financial statements and The Mix. .
[58] The Mix Market

As is the case with the other firms, Equity Bank faces a number of concerns. These include the need to continue to improve the portfolio at risk, an increased level of competition from corporate banks, a need to reduce expenses while maintaining production efficiency, and the possible expansion into East Africa.[59]

Table 6: Equity Bank

Year of Establishment	1984		
Country	Kenya		
Number of Branches	36		
Mission	"Mobilize resources to maximize value and economically empower the microfinance clients and other stakeholders by offering customer-focused quality financial services and solutions"		
Number of Borrowers (year over year growth %)	2004	59,306	(9.0)
	2005	110,112	85.7
	2006	239,541	117.5
Average Loan Balance per Borrower	2006	$444	
Gross Loan Portfolio (year over year growth %)	2004	$40,088,984	81.7
	2005	$38,303,996	(4.5)
	2006	$106,374,014	177.7
Average Loan Balance per Borrower/GNI per Capita (%)*	2005	65.64	
Number of Savings Accounts (year over year growth %)	2004	413,095	63.8
	2005	556,000	34.6
	2006	1,014,474	82.5
Average Saving Balance Per Saver	2006	$165	
Saving Balance (year over year growth %)	2004	$57,932,010	30.3
	2005	$108,240,431	86.8
	2006	$167,645,004	54.9
Average Savings Balance per Borrower/GNI per Capita (%)*	2005	36.73	
ROA (%)	2006	4.85	
ROE (%)	2006	40.36	
Profit Margin (%)	2006	31.53	
Borrowers per Staff Member	2006	172	
Operating Expenses/Loan Portfolio (%)	2006	42.38	
Portfolio Risk (%)	2006	12.19	
Write off Ratio (%)*	2005	1.92	

All data taken from The Mix Market Website
****2006 data unavailable***

e) SUMMARY AND CONCLUSIONS

What is it about these four institutions that have qualified them for capital market listings and IPOs? What lessons can other large MFIs considering this step take from the success of these institutions?

[59] See Equity Bank, Information Memorandum, Risk Factors pp.48-50

Management Excellence

Each of the institutions in question has long serving senior management, who are outstanding social entrepreneurs and managers. Their respective institutions have consistently generated profits . The exception is BRI who had very dedicated heads of the unit *desa* program and in the past in the bank, including Sugianto, former Managing Director of the unit *desa* system, Kamardy Arief, former President of BRI, and Ali Wardhana, former Indonesian Minister of Finance (1968-1983), but whose current leadership is concentrated in the larger bank and less known in the microfinance industry at the moment.[60] Also, when BRAC Bank, the subject of the IPO, was established, BRAC's senior management hired highly experienced bankers to run the bank, as distinct from the NGO management directing the microfinance operations.

Good Governance

A second condition precedent for an IPO is that the institution follows good governance practices. For international institutional investors financing under Rule 144a, that would include practices that comply closely with Sarbanes Oxley (SOX) guidelines with respect to such matters as independent and qualified audit committees and MIS and accounting systems that provide high standards of internal controls. They also will look to the independence of and qualifications of directors. The four institutions we have examined have all made a serious effort to recruit diligent and competent directors and to implement good governance practices. Best governance practices remains a very under-examined issue in the microfinance sector and more attention will need to be spent on it as MFIs seek to attract significant amounts of external.[61]

Management, Director and Employee Ownership Incentives

In two of the institutions that listed, Equity Bank and Compartamos, management and director ownership of each of these the institutions is an important issue. It stands to reason, that long serving management and directors should have incentives tied closely to the long range success of their institution. The fact that these individuals have been rewarded for their success is a good signal to the industry and should help to attract first class talent as the critical issue of management succession is addressed in a number of MFIs. In both of these cases, management acquired their shares through investment. However, going forward, as public entities they will be able to use stock incentives such as options or stock grants as incentives to existing management and employees, as appropriate, and to attract new management into the company, depending on the tax treatment and stock market regulations in each of their respective countries.

[60] Ali Wardhana went on to be Coordinating Minister of Economics, Finance, and Industry, and continues to be an Economic Advisor to the government. Although he remained in the background, Wardhana has been a vital supporter to the unit *desa* system. See also Robinson, Vol. II Indonesia, Opus Cited, p. xxxi

[61] See Ira W. Lieberman and Elizabeth Rhyne, "The Practice of Corporate Governance in Shareholder-Owned Microfinance Institutions," Consensus Statement of the Council of Microfinance Equity Funds (CMEF), May 2005; see also Equity Bank, Information Memorandum, Corporate Information, Board of Directors, Governance, PP. 37-41

Many MFIs have operated with the same senior management team over the last 15-20 years or more, from the early emergence of microfinance in the developing world. Incentive compensation could play an important role in an orderly succession both out and into these institutions. BRI, with majority ownership by the Government of Indonesia, could presumably not offer such incentives and in the case of BRAC Bank the very small ownership stake of the senior management of the NGO, as Board members of the bank , speaks wonders about their commitment and selflessness as individuals to their support of the very poor in Bangladesh. But this is not the answer for the industry more broadly that is operating increasingly on commercial terms. MFIs structured as shareholder owned institutions, that go public and list on a credible exchange, will have the ability to offer such incentives. We would expect to see stock options as an important form of incentive compensation for management recruitment and employee stock plans as more MFIs go public in the future.

Scale and Massive Outreach

Each of these institutions has achieved massive outreach or scale within its respective market and this has translated into a strong capital base and profits. As banks by any international measure, they are quite small, but within their markets BRI and Equity Bank are important banks. BRAC has also reached substantial scale, especially if we look at the combined microfinance and SME operations, the latter within BRAC Bank. Compartamos is a niche bank in Mexico, but it is among the largest microfinance institutions in Mexico and in Latin America. The profitability, ROA, ROE and low loan loss ratios of these institutions rank them among the best performing banks and financial institutions in their respective markets. The four institutions have performed exceptionally well and they benchmark well within the industry and within the financial sector in their respective country. In marketing terms, they carry a very strong brand image that is recognized favorably by the investing public in their country and increasingly by knowledgeable investors in international markets.

Quality of Products and Services[62]

It seems clear that each of the institutions have figured out what it takes to meet the needs of their clients, to provide service and products that their client want and will pay for, even at high real rates of interest with respect to loans. First rate microfinance institutions operating within a bank are better able to offer a full range of products and services to their clients. Although to-date Compartamos, BRAC and BRI's lending activities have not moved too far beyond plain vanilla, traditional, microfinance lending products. BRI does have a range of savings products and Equity Bank offers a range of products for both savings and loans. In addition, Compartamos serves as an agent for insurance product offerings.

Moreover, as these banks add small business finance on a sound basis, they are able to improve their economics, for example, in larger average loan and deposit size, without abandoning their social mission. BRAC, for the moment, has chosen to keep the

[62] For an interesting discussion of this issue see Rhyne and Otero, "Microfinance Through the Next Decade," Opus Cited, p 14 the quality gap and pp.21-28 who will deliver microfinance

microfinance and SME operations separate and Compartamos is strictly a microfinance bank for now and is yet to mobilize savings in a meaningful way. However, BRI and Equity Bank combine these offerings. The quality of services and products is reflected in high profits, low loan loss ratios and low portfolio at risk (with Equity bank something of an outlier with respect to portfolio at risk), but also in the case of BRI and Equity Bank in savings that provide low cost of funds to these institutions. Not only can they reach a critical mass of clients, but they can also reach them with a variety of products and services that allow these banks to add to fees and earn income in a diverse set of ways and also provide the services their clients need and in time will come to expect.

Technology and Infrastructure

Each of the institutions discussed herein have had to build an extensive infrastructure of branches or service offices to reach their clients. For example, Equity Bank in its prospectus discusses moving from 31 branches in 2005 to 61 branches by 2009. BRAC Bank since its founding in 2001 has grown to 18 branches and 313 regional marketing/ field offices. BRI of course has an extensive village network that exceeded 3,900 unit *desas* at their peak and Compartamos now faces the task of converting a very extensive service office network to full bank branches if they are going to intermediate savings. Complementing that is a need to continuously invest in technology such as ATMs, credit and debit cards, and MIS systems. BRI and Equity Bank, for example, discuss extensive investments required in MIS systems, the former as a use of proceeds and the latter before listing. It seems clear that MFIs that want to go public will need to be using the latest in technological product and system advances to ensure they can compete within the banking sector.

The Social Bottom Line

Microfinance has received a great deal of positive publicity in the last few years. There is a growing public perception about its value to the poor. There seems to be an important market segment of individual investors and institutions that will invest a portion of their funds in institutions that support a double bottom line. Initially, debt funds who can guarantee their investors a minimum social return were uniquely placed to tap into this market segment. We have seen this in the development of microfinance funds such as Blue Orchard, the Responsibility Fund, Deutsche Bank's[63] Microfinance Fund and the Calvert Social Funds, in general, as a socially responsible investor and in particular for its foundation, which makes loans to and invests in MFIs. Sound MFIs with the qualifications to go public are perfectly placed to tap into this positive market sentiment and segment of investors keen to invest in socially responsible institutions.

The question then is whether or not public offerings and the entry of commercially funded equity investments generally, make it harder for MFIs to focus on a social bottom line. The evidence from the four IPOs/listings discussed in this paper seems to suggest that for the moment these institutions are respecting the double bottom line. It is possible

[63] Deutsche Bank's microfinance investments started through Bankers Trust, which Deutsche Bank subsequently acquired. Banker's Trust Foundation, run by Gary Hattem, were able to tap into their high net worth individuals in their private banking operations to raise several million dollars that they lent/ invested in a select number of microfinance institutions in the latter part of the nineties.

that market pressure to maintain stock price will force mission drift over time, but it is too early to tell if this will be the case.

Outside Strategic Investors

These institutions, with the exception of BRI, had participating external investors with international recognition take equity stakes prior to the IPO. In addition to the capital they provided, having IFC, Accion, AfriCap or ShoreCap International or their respective equity funds as a strategic investor is meaningful to institutional investors in particular and provides just one more measure of confidence in the institution pre-listing or IPO. In addition, each of these institutions, with the possible exception of BRAC, have received significant technical assistance from the donor community and micro-finance experts to ensure that amongst other areas their product lines, lending methodologies, credit management systems, MIS, management structures and governance processes met or exceeded industry standards.

Their Growth and Profitability Allow Them to be Benchmarked as Banks. The institutions that have now listed and/ or gone through an IPO, are increasingly being measured or benchmarked in terms of performance against regulated financial institutions. They are all supervised by the respective banking regulation and supervisory authority in their country, and are increasingly being rated by international rating agencies such as Fitch and Moody. Also, market research on these institutions from investment banks and brokerage firms will rate them versus banks and not vis-à-vis other microfinance institutions.

Accounting and MIS

Each of the institutions was audited by internationally recognized accountants. Moreover, the audited financial statements going back several years, financial information disclosure, detailed footnotes to the financial statements, reconciliation of domestic standards to US GAAP or international accounting standards, and other information requirements for a prospectus, are extremely difficult to prepare and present for an institution whose accounting and MIS are not up to standard.

In general, these institutions that have listed and gone through and IPO, are excellent institutions, clearly amongst the best of the MFIs. As such they were able to list and issue their share to both domestic and international investors. The performance to date of their stock, post IPO, is a reflection of their long-term growth potential.. Even if we assume that their growth rate will slow by 50% by the end of 2011, collectively as a group their scale or outreach to the working poor is very significant—projected at some 11 million borrowers and some 41 million savers.[64]

[64] Projections were prepared by Bruce Campbell that take the historical growth rate of each of the institutions as to number of borrowers and then reduces their rate of growth stepwise over a five year period, between 2007-2011, so that by the end of 2011 the growth rate has been reduced by 50%. For savings, the projections simply focus on Equity Bank and BRI. However, Compartamos is beginning to seriously experiment with savings in several of its regions and BRAC Bank is mobilizing a large number and amount of savings in its SME focused bank. , Were both of these two institutions to succeed, as we expect they will, then these four institutions might well reach 45 million savers in the next five years.

THE CAPITAL MARKET LISTINGS/ OFFERINGS[65]

Given their profitability, strong management and social missions, it is not a surprise that all four companies were able to successfully list their stock, generally with great demand. It is also important to note that all four companies stocks have shown excellent to remarkable growth since going public.

Yet it is important to recognize that each of these institutions had different structures and purposes for their action. In fact, unlike the other three MFIs, Equity Bank did not actually have an IPO, but rather a listing of stock that was held by many of their clients and employees This section is intended to describe the individual nature and purpose for each IPO or listing. We will explain the reasons each of these companies believed there was an advantage to going public, as well as the performance to date of each company's stock.[66]

f) BRI OFFERING

On October 31st, 2003, BRI became the first bank with a predominant focus on microfinance to go public. By the time of its IPO, BRI had already passed its stage of dramatic growth, and was now a mature institution. The BRI IPO was part of a larger process where the government was slowly trying to divest its holding in the banking industry. In part this was a way to raise funds for the Indonesian Treasury.[67] It was also tied to the structural changes Indonesia had committed to the IMF to undertake, due to the East Asia crisis (1997-1999). BRI went public with two other banks, Bank Negara Indonesia and Bank Mandiri.

After the IPO BRI listed on the Jakarta Stock Exchange. At the same time, the Bank's shares were offered to international institutional investors, under US SEC Regulation 144A, which limited the international offering to institutional investors, without listing its securities on any of the U.S. or other major stock exchanges. Some 41% of BRI's capital stock was sold and therefore it was only a partial privatization, with the State retaining a majority interest in the bank. The IPO raised some $489 million of which 61% of the proceeds went to reimburse the Government of Indonesia, with the rest of the proceeds to be retained by BRI. According to the BRI Offering Circular, the money which was retained by the bank was intended to be used to "fund future growth [and] investment in technology."[68]

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[65] Unless otherwise noted, the information in this section of the paper comes from the offering memorandum or prospectus the MFI published before its IPO. See the Table 7 and 8.

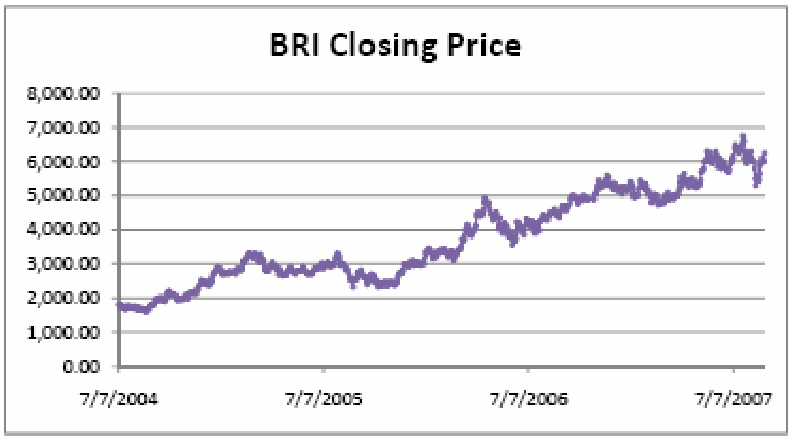
[66] All stock price data is as of September 10, 2007. All numbers are converted at the time of the transaction. For example, if BRI went public on November 10, 2003, we have converted November 10, 2003 Indonesian Rupiah to November 10, 2003 US Dollars. Currency exchange fluctuation will affect data.

[67] *Jakarta Puts Its Banks on the Block*, Business Week, October 31, 2005

[68] BRI, Offering Circular, 31 October 2003; also see Table 7 below

BRI's stock has performed exceptionally since the IPO, with a 561% increase on the original price in just three years. The lock-up period for the offering was twelve months and expired on November 10, 2004. From the time of the offering to the date the lock-up period expired the price increased 143%. From July 7, 2004, the monthly return has varied from -19.5% (August 2005) to 24.4% (November 2004) with an average monthly return of 4.12%. As of September 10, 2007, BRI's shares were trading at some 4.4 x times book value and at a price earnings multiple of 16.5 (see Table 7).

Chart 1



Source: Jakarta Stock Exchange

g) BRAC BANK OFFERING

Prior to the IPO of BRAC Bank, BRAC's microfinance NGO had approached the capital markets to securitize its microfinance portfolio . That allowed the NGO to raise BDT 12.6 BN (US $180 million equivalent) in July, 2006. The securitization was structured by RSA Capital, Citigroup, FMO and KFW.[69]

BRAC Bank went public through an IPO on the Dhaka and Chittagong Stock Exchanges on December 11, 2006. BRAC Bank raised some $13 million through the IPO, all of which will be utilized to expand the bank's operations throughout Bangladesh. The company sold 50% of its share capital to the public (this doubled the number of shares outstanding), and all proceeds were received as paid in capital by the bank. None of the existing shareholders sold at the time of offering; however, the IFC did receive an exemption from the lock-up period, allowing it to sell immediately if it chose to.[70]

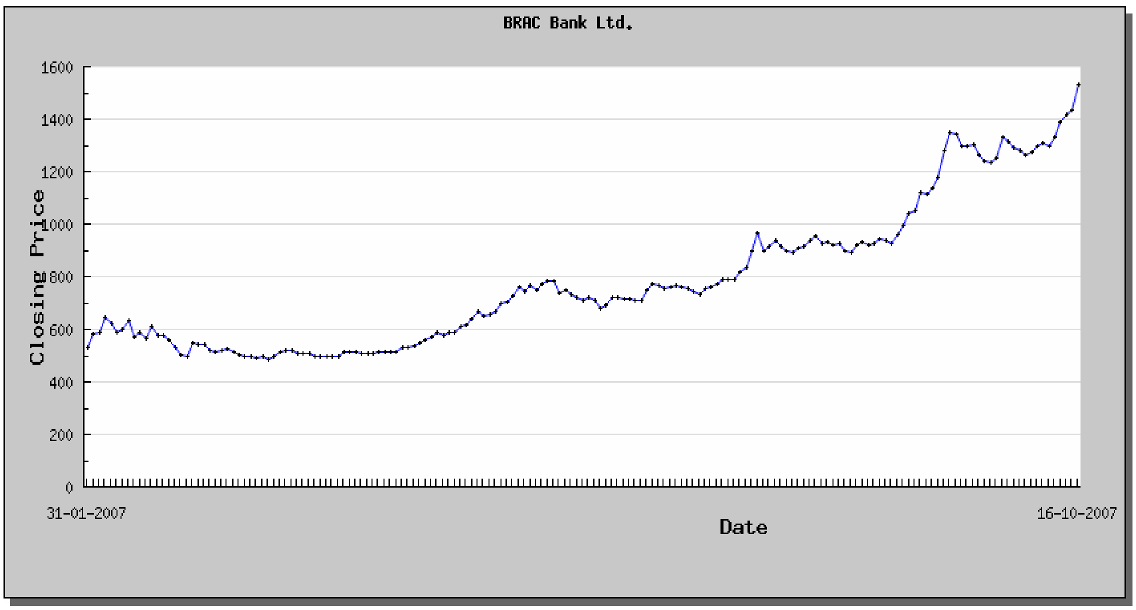
The distribution of the IPO allowed for one third of the company to be owned by the Bangladeshi public, with another 8% split between non-resident Bangladeshis and Mutual Funds. The lock-up for BRAC will last for three years, an exceptionally long holding period for inside investors from the usual 90 days to six months. BRAC's stock

[69] "Bangladesh: Citigroup Supports World's First AAA-Rated Microcredit Security," Citibank, July 2006, www.citigroup.com/citgroup/press/2006/060706b.htm and also see Rahman, R. and Mohammed, S.S., "BRAC Micro Credit Securitization Series I: Lessons from the World's First Micro-Credit Backed Security (MCBS)," Analytics Ltd, March 2007, Boston.
[70] Comments and discussion with BRAC Bank Director Paul Christensen.

has shown phenomenal growth in its first year with an increase of 619% over the initial price. As of September 10, 2007 BRAC Bank's shares traded at a multiple of 6.86x book value and at a price earnings ratio of 19.1x (see Table 7).

The BRAC IPO provided several benefits to the bank and shareholders. First, by raising funds, it allowed the bank to expand its operations into new markets. It will also allow institutional investors such as ShoreCap and the IFC to exit some of their investment, the former when the lock-up period is over. Investors gained greater liquidity and price discovery.

Chart 2



Source: Dhaka Stock Exchange Website

Table 7: IPO Details: BRI and BRAC		
	BRAC	**BRI**
Name of Institution	Bangladesh Rural Advancement Committee (BRAC)	PT Bank Rakyat Indonesia (BRI)
Primary Information Source	Prospectus of Brac Bank Limited (20/9/06)	Offering Circular (31/10/03)
Date of Offering	12/11/2006	31/10/03
Total Shares Outstanding	12,000,000	11,764,703,700
Offering Number of Shares	5,000,000	488,782,226
Price at Offering	$2.52	$0.10
Total Value of Offering	$12,588,500	$488,782,226
Current Price (10 Sept. 07)	$18.12	$0.66
52 Week High	$20.06	$0.72
52 Week Low	$7.05	$0.47
Earnings Per Share	$0.95	$0.04
Price Earnings Ratio	19.1	16.5
Book Value Per Share	$2.64*	$0.15**
Book Value Per Share Multiple	6.86*	4.4**
Percentage Increase on Initial Price	619.0%	561.0%
Capital Sold	50%	41%
Type of Offering	Primary	Primary and Secondary
Underwriter or Advisor/Sponsoring Stockbroker	Southeast Bank Limited, Dhaka Bank Limited, The Trust Bank Limited, IDLC of Bangladesh Limited, LankaBangla Finance Limited, Prime Bank Limited, Bank Asia Limited, EXIM Bank of Bangladesh Limited, GSP Finance Company, Bangladesh General Insurance Co. Ltd.	PT Bahana Securities
Where Listed	Dhaka Stock Exchange Limited Chittagong Stock Exchange Limited	Jakarta Stock Exchange Surabaya Stock Exchange For Institutional Investors Internationally under rule 144A, US-SEC
Trading Symbol	BRAC- In Bangladesh	BBRI- In Indonesia BYR- In Germany BKRKF- In US
Proceeds	BRAC Bank received nearly 100% of the proceeds (There were some relatively small underwriting fees)	Government of Indonesia: 298 million BRI: 191 million (Approximate numbers)
Distribution	General Public: 33.33% (4,000,000 shares) Nonresident Bangladeshi: 4.17% (500,000 shares) Mutual Funds: 4.17% (500,000 shares)	Domestic and International Investors: $488.78 million (4,764,000 shares)
Auditors	KPMG	Ernst and Young Prasetio, Utomo and Co.
Rating Agency	Credit Rating Information and Services Ltd. (CRISL)	?
Lock-up	3 years	12 months
Use of Proceeds	"The proceeds will strengthen the capital base of the Bank and augment business expansion. The fund thus raised through this public issue would be generally used for investment and creation of assets."	To fund future growth, invest in technology, expand branch and unit network, and enhance regulatory capital, and for the Government to raise money through divestment.

Currency is not in constant dollars or adjusted for inflation
*This number is calculated using July 6, 2007 book value and the share price in this chart (September 10, 2007)
**This number is calculated using December 31, 2006 book value and the share price in this chart (September 10, 2007)

h) COMPARTAMOS' LISTING

Banco Compartamos went public on April 20, 2007 when it sold 29.9% of the shares outstanding.[71] In contrast to the other IPOs studied, in this case none of the shares sold were offered by the firm itself as all the shares offered were part of a secondary offering. This IPO received substantial press because of its huge success and the very substantial returns to its investors, for example, Accion had invested $1 million in Compartamos and earned some $143 million as a result of the IPO. The IPO was thirteen times oversubscribed.[72]

The proceeds of the sale went mainly to four groups: The Accion Gateway Fund ($147 million), Compartamos NGO ($93), the IFC ($42 million) and individual shareholders, who were primarily the management and directors of the bank ($136 million). Compartamos NGO plans to use their proceeds to continue to work on improving health and nutrition for poor Mexicans, while Accion and the IFC will use their proceeds towards furthering their development objectives.[73] Of the shares sold,
18 % percent of the shares were offered to the general public in Mexico and 82% percent were offered to international, Qualified Institutional Buyers. Some 158 institutional buyers purchased shares of which 58% were hedge funds and 42% more traditional financial institutions. The opening price of the stock was MXN 40.00 or $3.65. The offering opened at 12.8 times book value or at a market cap of $1.56 billion for Compartamos. As of August 13, 2007 the price was $5.4 which implies a premium of 48% over the issue price and a market valuation for Compartamos of $1.9 billion.[74] As of September 10, 2007 Compartamos' shares traded at 4.73 times book value and at a price earnings multiple of 11.85xearnings (see Table 8).
According to the detailed report on the Compartamos IPO done by Accion Insight, "The initial impetus behind the Compartamos IPO came from a normal process of ownership evolution. A sale of a portion of total shares held would allow the shareholders to redeploy capital that was otherwise tied up." The report goes on to explain that another advantage of an IPO would be that it would not cause the "major disruptions in governance, management, and strategic direction that abrupt ownership can bring."[75]

Why was the Compartamos IPO so successful, what were the factors leading to its success? According to Accion, the keys to success were the local financial market, past performance of Compartamos as a major MFI, the global economy, the performance of the underwriters, and macroeconomic stability.[76]

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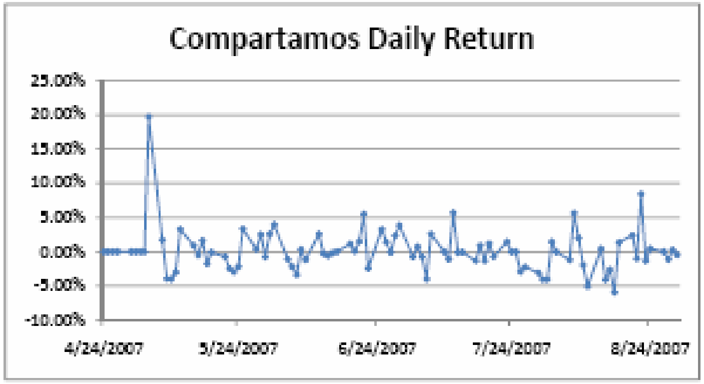
[71] Lauren Burnhill, "Bringing Microfinance to Scale, The Compartamos IPO," Accion, August 24, 2007 (presentation), slide 3, slide 4
[72] Richard Rosenberg, "CGAP Reflections on the Compartamos Initial Public Offering: A Case Study on Microfinance Interest Rates and Profits," No. 42, June 2007, pg. 1.
[73] Ibid, pg. 14-15.
[74] Burnhill, Accion, opus cited, slide 3
[75] "The Banco Compartamos Initial Public Offering," Accion Insight, No. 23, June 2007, pg. 4-5
[76] Lauren Burnhill, Accion, opus cited, slide 5.

Chart 3



Source: Bloomberg.com

i) Equity Bank's Listing

As previously mentioned, unlike the three other banks, Equity Bank did not execute an IPO. Instead the firm went from being traded over-the-counter (OTC) to being listed on the Kenyan Stock Exchange on August 7, 2006. The purpose of the listing was "to offer shareholders and the Bank the benefits of the stock market, liquidity, and price discovery" (information memorandum, see also boxes below). Prior to the listing , there was an agreement made that current shareholders would not divest of their shares for two years following the listing as a way of locking in large shareholders and aligning their interests with new owners.[77]

On April 23, 2007 after its initial listing, Equity Bank issued 181,129,100 new shares by allotting two ordinary shares to owners for every one ordinary share registered in their name. This allocation led to a large increase in the volume of trading.[78] Equity's stock has shown excellent growth with a 96% increase on the initial price. A recent publication of the African Alliance, an investment banking group located in Africa, described the excellent prospects for expansion for Equity. They write that by "providing banking services to the masses and generally expanding its distribution channels and services, Equity Bank Limited will be a star performer."[79]

On 14th November 2007, Equity Bank and Helios EB Investors, LP ("Helios") subscribed for 90.5 million new ordinary shares in the Bank at KES 122 (U.S.$1.94 per share (with 63 KES equal to $1) versus the original listing price at $0.96 per share) per new ordinary share. The purchase price equated to EBL's weighted trading average, as traded on the Nairobi Stock Exchange for the three months that ended 22 October 2007. The investment will substantially increase EBL's capital and Helios will become the largest shareholder in EBL at 24.99%. The transaction awaits regulatory approval from the

[77] Marguerite Robinson , "Note on Equity Bank," November, 2006 (memo)
[78] See Bloomberg.com
[79] "Kenya Banking Industry Review: Sector Report," African Alliance, April 2007

Kenyan Central Bank, the Capital Markets Authority; moreover, the Nairobi Stock Exchange will be asked to approve the listing of Helios' shares. The share sale is not only important for the liquidity it brings to Equity Bank, but because Helios is a prestigious investor making equity investments in Africa. [80]

[80] Equity Bank Limited, Press Release, 14 November 2007

Box 3:
Equity Bank's Objectives for Listing on the Nairobi Stock Exchange

The Board's objectives, as provided in Equity Bank Investor Briefing 2006, p. 2, are:

1. "To provide the shareholders with a market mechanism to realize the true value of their shares through the forces of demand and supply.
2. The need to consolidate and cement effective corporate governance, including amendments to the Articles and Memorandum of Association to outlaw insider trading and borrowing; and taking measures to enable Equity to subscribe to the stringent provisions of the Capital Markets and the rules and regulations of listed companies. These include higher standards of accounting, financial reporting and disclosure requirements.
3. For strategic reasons, including positioning Equity to access the Capital Markets in case of need for funds to take advantage of opportunities of rapid growth in a consolidating industry.
4. To provide an opportunity for Kenyans to own shares in the bank and, in particular, to enable Equity's customers to be owners of the successful bank that they have built."

Box 4: Excerpts on Equity Bank Listing from *International Business Times*, 19 July 2006

"Nairobi (IBTimes.com) - Kenyan investors will in two weeks time have a chance to acquire a stake in Equity Bank when its 90.5 million shares start trading at the Nairobi Stock Exchange…

The listing is a plus for Equity, as it will improve its access to structured financing. Given its capital base, the bank appears to see its immediate priority as growing its deposits to support new loans. "It is possible for us (Equity Bank) to boost our lending to well above Sh20 billion without the need for additional share capital," explained Mwangi [James Mwangi, Equity Bank Managing Director and CEO] on why Equity opted for private listing...

…The bank has developed a suite of products centered on small savers, previously ignored by the big banks. It is also among few banks that have developed products specifically for farmers and low to middle income earners. These include farm input, crop advance, commercial farm loans and salary advance loans. The bank has also invested heavily in top of the range ICT platform that has helped deliver its Autobranch ATM product. In the latest banking survey by Market Intelligence, Equity was ranked the third Best Bank in Kenya for the second year in a row and the Best Retail Bank in the country, getting citation for its solid capital base, good management and growing customer base. Early this year, the Global Credit Rating Company (GCR) quarterly rating put the bank among the leading companies in the Common Market for Eastern and Southern Africa. It scored an A-rating in the short-term credit and an A in the long-term ranking."

Source: International Business Times – World Business and Financial News. "Kenyans to Acquire Stake in Equity Bank" by Eddyson Lugangawa, 19 July 2006.

Table 8: IPO Details: Compartamos and Equity

	Compartamos	**Equity Bank**
Name of Institution	Banco Compartamos, S.A.	Equity Bank Limited
Primary Information Source	Offering Circular (4/19/07)	Information Memorandum (3/7/06)
Date of Offering	4/20/07	7/8/2006
Total Shares Outstanding	427,836,876	90,564,550
Offering Number of Shares	128,308,412	90,564,550
Price at Offering	Ps 40 ($3.70)	$0.96
Total Value of Offering	$473,899,952	$86,941,968
Current Price (10 Sept. 07)	$5.25	$1.88
52 Week High	$6.45	$2.24
52 Week Low	$3.70	$0.62
Earnings Per Share	$1.50 (as of 9/30/07	$0.12
Price Earnings Ratio	11.85x (as of 9/30/07)	15.67
Book Value Per Share		-
Book Value Per Share Multiple	4.73x (as of 9/30/07)	-
Percentage Increase on Initial Price	47.75 % (as of 9/30/07	95.8%
Capital Sold	29.99%	Listing (100% of shares listed on stock exchange)
Type of Offering	Secondary	Listing
Underwriter or Advisor/Sponsoring Stockbroker	Credit Suisse First Boston (CS) Banamex and Banorte for Mexican Tranche	Suntra Investment Bank and Dyer and Blair Investment Bank Limited
Where Listed	Mexican Stock Exchange For Institutional Investors Internationally under rule 144A, US-SEC	Nairobi Stock Exchange
Trading Symbol	COMPART- In Mexico	EQBNK- In Kenya
Proceeds	Compartamos A.C. (NGO)- 31.83% Accion Gateway Fund LLC- 9.03% International Finance Corporation- 7.93% Individual Shareholders 21.22%, Free Float 29.99%	No funds were raised
Distribution	Mexico General Public: 18%) International, Qualified Institutional Buyers: 82% (	Kenya Existing Investors: 100% (90,564,550)* On 23rd April 2007 Equity Bank issued 181,129,100 new fully paid ordinary shares by allotting two ordinary shares to owners for every one ordinary share registered in their name
Auditors	PricewaterhouseCoopers, S.C.	Ernst & Young since 2004 Mungai & Associated were the auditors 2003 and prior
Rating Agency	S&P (mxAA-, as of October 30, 2007 Fitch (A+Mex) as of march 2, 2007	Planet Rating
Lock-up	180 Days	2 years
Use of Proceeds	Major investors desired an IPO for liquidity and the ability to use proceeds for philanthropic activities and to take on riskier projects From IPO memorandum, "We will not receive any proceeds from the sale of Shares by the selling shareholders. The selling shareholders will receive all of the net proceeds from the sale of shares."	There were no proceeds because the stock went from OTC to the Nairobi Stock Exchange. No new stock was issued. The listing was done to "offer shareholders and the Bank the benefits of the stock market, liquidity and price discovery." "Opportunity to enhance corporate governance and disclosure standards"

Currency is not in constant dollars or adjusted for inflation
*Subsequent trading of shares will change ownership mix
** This number is calculated using December 31, 2006 book value and the share price in this chart (September 10, 2007)

j) SUMMARY AND CONCLUSIONS

The stock market offers all of these companies benefits and opportunities that they did not have prior to going public.. It also provides a means for equity investors to exit and that is critical in attracting private capital. We would expect to see some MFIs in the future use the fact that they have tradable shares for acquisitions and mergers. There are some concerns that going public may affect the ability of these companies to maintain their social purpose, but each of these companies has been diligent in maintaining an ownership structure that will not allow large changes in their mission.

One wonderful externality of these MFIs going public is the credence it gives to the profitability of serving the poor. Closer observation of the business operations of a company like Equity Bank or Compartamos is proof of the commercial viability of microfinance. An Accion publication declares, "The Banco Compartamos IPO is a powerful validation of the commercial model of microfinance…"[81]

It is certainly too early to come to any conclusions about the stock performance of these four banks, but it is difficult not to notice that all four have shown good to excellent growth. Although it is premature to call it a trend, it would be of value to continue following these stocks to see if there are some common factors driving their performance.

Some of the reasons we feel that the firms have performed so well include the following:

1) There may be an "irrational exuberance" for microfinance stocks. The double bottom lines/social appeal of these banks may cause this rise. Microfinance is part of the *zeitgeist* of socially responsible investment. In fact, there are relatively few choices for investors who want to take an equity stake in microfinance, the decision by these MFIs to list really enhances the appeal for those institutional investors interested in this niche market;
2) Some of these banks may have been under priced at the time of the IPO in order to ensure a highly successful offering. Since there was little comparable history in offering MFIs to the market, the tendency of the advisors would be to under price to demonstrate success.
3) There may be a brand premium for these MFIs. Each of these companies is well-known and generally well respected in their country, and investors may desire their stock for this reason rather than standard performance measures. Also, where the institution has competitive dominance over its market niche, there are expectations that they will continue to generate profits for some time into the future.
4) Finally, we may be experiencing a unique convergence of factors—(a) huge liquidity in international capital markets in part due to the very large U.S trade deficits and large Eurodollar holdings held abroad, surpluses in exporting powers such as China, and oil and gas exporting countries (the recent financial crisis over mortgage backed securities may in fact sap liquidity from the market for some time); (b) professional investors keenly interested in emerging market

[81] The Banco Compartamos Initial Public Offering," Accion Insight, No. 23, June 2007, pg. 15.

> opportunities. In this respect, perception of country risk would make it relatively easy to market the Compartamos, Mexico offering to international investors, while the offering of BRAC Bank in Bangladesh or Equity Bank in Kenya would have been correspondingly more difficult; (c) the dearth of good product offerings; and, (d) the rapid growth of emerging market stock exchanges all seeking good listings, perhaps has created the ideal scenario for a quality MFI to have an IPO, with an attractive valuation. How long this will last is anyone's best guess as markets continue to evolve and conditions in the international economy change.

This leads to an overall conclusion that there is an opportunity for a number of other MFIs to go public in the near future. Each institution will need to assess its own reasons for doing so, as the cost of an IPO is quite high, not only in professional fees and other expenses, but in management and staff time spent preparing the offering and participating in a "road show" for interested institutional investors.
In discussion with microfinance equity fund managers and investors in the microfinance industry, the views of the IPOs were mixed.[82] Many of the fund managers recognized that this would provide additional validation for microfinance as a subset of the formal financial sector and perhaps more importantly, a new investment opportunity in emerging markets. Fund managers indicated that the IPOs would make it easier to raise funds from private investors. But that also means more competition as larger financial groups already in the business—Citicorp, Credit Suisse, Deutsche Bank are seeking to expand their investments in the sector, while groups such as JP Morgan are said to be planning entry soon. Deep concern was expressed over the high price earnings and book value multiples at which the shares of the four institutions were trading. The concern is that this irrational exuberance might produce a microfinance "bubble" and it would be much more difficult for the fund managers to invest at "acceptable" or reasonable prices. However, it seems clear that these are amongst the best of the MFIs throughout the world and it is doubtful that the next-in-line MFIs would command such multiples.

4) OVERALL CONCLUSIONS

Four excellent MFIs decided for their own reasons to list/IPO on their domestic capital markets and in two cases to also raise funds from institutional investors. The industry has been moving in this direction for some Excellence in management, governance, in systems and technology , methodology and product line have allowed these institutions to achieve massive outreach to their poor clients and yet remain highly profitable at levels in terms of ROEs and ROAs that most banks would envy. As public institutions and regulated banks, these institutions are now being benchmarked to the banking sector in their respective countries. As good as they are rapid growth brings problems. Each of these institutions will need to face a series of issues to continue to be among the best. However, given the quality of their management, we expect they will address those concerns.

Interestingly, three of the MFIs that have gone public have had strategic equity investors and several have had extensive external technical assistance to reach their present level of

[82] Council of Microfinance Equity Funds, Meeting October 10-11, Amsterdam

excellence. Equity Bank has recently concluded a deal, subject to regulatory approval, to sell a 25% interest in the bank to a private equity firm, post its listing, at a price reflecting its recent trading price, considerably in excess of the listing price. The best situation seems to be the combination of the two—strategic investors and then a listing/IPO. One thing is clear, the strategic international investor gives the market an added measure of confidence and that is important for an IPO in a sector that up to now has little comparable experience for the institutional investors in the market to analyze.

Each institution's shares have performed well in their respective capital markets. We could perhaps call it a bit of "irrational exuberance"; however, it is still early and we will see how the shares perform over time. Companies that have a social mission and are profitable have a certain cachet, so does the microfinance sector for the moment and we would expect that trend to perhaps strengthen in time. The initial success of the IPOs has opened the door for the industry. There are a number of MFIs or groups that could go public over the next few years, some that are already deep into their preparation and one in Mexico formally announced. They should learn from the early experience of these four institutions

Finally, it is clear that these institutions are also poised to achieve massive outreach to their potential client base—the working poor without formal access to finance. BRAC is an interesting case as it has now become a multi-national NGO in microfinance in Asia and Africa. It is possible that BRAC and Equity Bank will either be collaborating or competing throughout East Africa within the next five or so years. Joining them in seeking expansion in Africa is AfriCap Microfinance Investment Company Limited, a Mauritius based microfinance equity investor, which was recently re-capitalized at $50 million.[83] AfriCap was the first strategic investor in Equity Bank, it could collaborate in the future expansion of Equity Bank in Africa, with BRAC or all three could compete. Any of these alternatives, should give a boost to the growth of microfinance in Africa.

We have projected conservatively that if these four institutions that listed/ IPO, continue to grow, but at a declining rate over the next five years (2007-2011), on a combined basis they could reach some 16 million borrowers and have some 41 million savings accounts. Interestingly, with the exception of Compartamos, they are also reaching a large number of small enterprises. Perhaps even more important is the quality of their products and services; we expect them to become more diverse and fully meet the financial needs of their clients in the future.

[83] AfriCap closed its re-capitalization on October 25, 2007. Ira Lieberman led an advisory team that assisted in this effort.

Annex 1: Poverty Data for Locations of the Four MFIs

	Bangladesh		***Indonesia***		***Kenya***		***Mexico***	
Year	2000	2005	2000	2005	2000	2005	2000	2005
Population	128.9 million	141.8 million	206.3 million	220.6 million	30.7 million	34.3 million	98.0 million	103.1 million
Population Growth % (Annual)	2	1.9	1.3	1.4	2.2	2.3	1.4	1
Life expectancy at birth, total (years)	61.5	63.9	65.8	67.8	48.4	49	74	75.4
Fertility rate, total (births per woman)	3.2	3	2.4	2.3	5	5	2.4	2.1
Mortality rate, infant (per 1,000 live births)	66	54	36	28	77	79	25	22
GNI per capita* (current US$)	390	470	590	1280	430	540	5110	7310
Adult literacy rate (% ages 15 and older)	34.2	na	79.5	90.4	70.8	73.6	87.3	91
GINI Coefficient**	33.42	[2000]	34.3	[2002]	42.5	[1997]	46.05	[2004]
UN Human Development Rank***	137 (medium development)		108 (medium development)		152 (low development)		53 (medium development)	

All data except the UN HDR rank and GINI is from WDI database: http://publications.worldbank.org/WDI/
* Atlas Method
703-438-7001703-438-7001703-438-7001
*** Among 177 Countries

Annex 2: Summary of Financial Results for BRAC Bank, Equity Bank, Compartamos, and BRI						
		BRAC Bank	Equity Bank	Compartamos	BRI	
		Financial Reports	Financial Reports	Financial Reports	Financial Reports	MIX Data
Revenue	**2006**	**$31,140,676**	**$48,717,077**	**$188,766,600**	**$2,347,309,400**	**$1,213,618,123**
	2005	$17,728,865	$24,895,839	$129,483,840	$1,756,457,200	$904,026,735
	2004	$11,672,951	$13,413,053	$73,051,213	$1,669,582,500	$863,808,574
	2003	$4,092,137	$7,394,300	$48,374,255	$1,782,662,700	$955,886,838
	2002		$4,771,600	$30,109,627	$1,505,502,600	$835,492,941
Operating Expenses	**2006**	**$15,395,030**	**$32,780,562**	**$102,036,000**	**$853,992,400**	
	2005	$8,960,230	$17,983,492	$76,276,400	$783,860,000	
	2004	$6,161,092	$10,586,690	$43,161,634	$654,567,500	
	2003	$3,100,102	$5,520,700	$26,214,736	$664,372,800	
	2002		$3,331,300	$17,047,472	$437,305,200	
Earnings	**2006**	**$5,010,557**	**$10,886,139**	**$58,624,320**	**$474,341,200**	**$378,284,769**
(after tax)	2005	$2,911,395	$4,758,898	$35,347,600	$387,756,200	$277,988,221
	2004	$1,705,974	$1,762,948	$19,352,297	$390,547,500	$258,106,002
	2003	$531,123	$1,278,100	$13,626,879	$305,095,700	$213,449,531
	2002		$963,300	$7,940,712	$170,647,500	$209,625,179
Total Assets	**2006**	**$449,877,182**	**$289,353,794**	**$297,388,560**	**$17,236,365,000**	**$5,498,325,137**
	2005	$254,996,511	$158,214,859	$220,085,320	$12,498,596,800	$4,483,680,975
	2004	$172,073,849	$86,861,091	$125,194,342	$11,506,800,000	$4,169,725,401
	2003	$79,667,439	$51,833,799	$91,458,761	$11,204,193,000	$3,866,839,331
	2002		$33,507,423	$54,685,345	$9,662,005,500	$3,185,793,000
Total Liabilities	**2006**	**$418,140,384**	**$257,549,445**	**$171,327,720**	**$15,356,044,400**	**$5,229,646,177**
	2005	$243,166,397	$136,201,816	$137,204,500	$11,139,261,400	$4,224,262,207
	2004	$161,934,023	$70,398,341	$76,027,324	$10,168,425,000	$3,929,690,018
	2003	$72,722,931	$45,521,498	$59,162,891	$10,204,085,800	$3,662,157,736
	2002		$29,173,308	$36,343,223	$9,013,656,900	$2,990,364,574

Equity	**2006**	**$31,736,798**	**$31,804,349**	**$126,060,840**	**$1,880,320,600**	**$268,678,960**
	2005	$11,830,114	$22,013,043	$82,880,820	$1,359,335,400	$259,418,768
	2004	$10,139,826	$16,462,750	$49,167,018	$1,338,375,000	$240,035,383
	2003	$6,944,508	$6,312,301	$32,295,870	$1,000,108,200	$204,681,595
	2002		$4,334,115	$18,342,122	$648,348,600	$195,428,426
Gross Portfolio Size	**2006**	**$292,930,698**	**$157,932,446**	**$264,922,560**	**$10,057,526,200**	**$3,035,685,400**
	2005	$178,133,580	$76,291,412	$180,365,780	$7,689,259,400	$2,321,540,457
	2004	$99,975,273	$37,214,287	$97,953,204	$6,704,560,000	$2,044,532,205
	2003	$50,341,686	$22,061,112	$65,136,024	$5,630,961,700	$1,720,072,773
	2002		$15,108,463	$40,842,276	$4,405,838,700	$1,344,006,170
Number of Borrowers	**2006**	**61,526**	**252,147**	**616,528**	**3,455,894**	
	2005	37,584	110,112	453,131	3,313,532	
	2004		59,306	309,637	3,210,678	
	2003		65,145	215,267	3,100,358	
	2002		41,024	144,991	3,056,103	
Total Savings Balance	**2006**	**$344,798,781**	**$236,065,734**	**$0**	**$13,865,735,200**	**$4,869,688,137**
	2005	$202,610,141	$124,949,635	$0	$9,879,282,800	$3,748,591,984
	2004	$140,343,076	$65,804,853	$0	$8,858,000,000	$3,503,488,748
	2003	$61,342,642	$44,465,624	$0	$9,028,182,800	$3,244,874,360
	2002		$27,869,589	$0	$7,791,261,300	$2,627,456,201
Number of Depositors	**2006**	**258,601**	**1,014,474**	**0**	**30,907,566**	
	2005	124,289	556,000	0	32,252,741	
	2004		413,095	0	31,271,523	
	2003		252,186	0	29,869,197	
	2002		155,883	0	28,262,073	
Employees	**2006**	**3,047**	**1,394**	**3,203**	**38,545**	
	2005	1,650	884	2,295	37,545	
	2004	1,216	530	1,561	36,458	
	2003		354	1,012	27,766	
	2002		210	745	21,271	

Earnings Per Share	**2006**	**$0.95**	**$0.12**		**$0.04**	
	2005	$0.58	$0.05		$0.03	
	2004	$0.40			$0.03	
	2003	$0.21			$0.03	
	2002				$0.01	
Exchange Rates	2006	$0.01499	$0.01445	$0.09276	$0.0001114	
US$ per local unit on 12/31	2005	$0.01511	$0.01381	$0.09302	$0.0001018	
	2004	$0.01718	$0.01295	$0.08965	$0.0001075	
	2003	$0.01754	$0.01320	$0.08911	$0.0001183	
	2002	$0.01487	$0.01301	$0.09590	$0.0001119	

Annex 3: Basic Ratio Analysis for BRAC Bank, Equity Bank, Compartamos, and BRI

		BRAC	Equity Bank	Compartamos	BRI	
		Financial Reports	**Financial Reports**	**Financial Reports**	**Financial Reports**	**MIX Data**
Debt/Equity	**2006**	**13.18**	**8.10**	**1.36**	**8.17**	**19.46**
	2005	20.55	6.19	1.66	8.19	16.28
	2004	15.97	4.28	1.55	7.60	16.37
	2003	10.47	7.21	1.83	10.20	17.89
	2002	-	6.73	1.98	13.90	15.30
Debt/Assets	**2006**	**92.95%**	**89.01%**	**57.61%**	**89.09%**	**95.11%**
	2005	95.36%	86.09%	62.34%	89.12%	94.21%
	2004	94.11%	81.05%	60.73%	88.37%	94.24%
	2003	91.28%	87.82%	64.69%	91.07%	94.71%
	2002	-	87.07%	66.46%	93.29%	93.87%
Capital/Assets	**2006**	**7.05%**	**10.99%**	**42.39%**	**10.91%**	**4.89%**
	2005	4.64%	13.91%	37.66%	10.88%	5.79%
	2004	5.89%	18.95%	39.27%	11.63%	5.76%
	2003	8.72%	12.18%	35.31%	8.93%	5.29%
	2002	-	12.93%	33.54%	6.71%	6.13%
ROE	**2006**	**23.00%**	**40.46%**	**56.12%**	**29.28%**	**143.26%**
	2005	26.50%	24.74%	53.54%	28.75%	111.32%
	2004	19.97%	15.48%	47.51%	33.40%	116.08%
	2003	-	24.01%	53.82%	37.02%	106.70%
	2002	-	-	-	-	
ROA	**2006**	**1.42%**	**4.86%**	**22.66%**	**3.19%**	**7.58%**
	2005	1.36%	3.88%	20.47%	3.23%	6.42%
	2004	1.36%	2.54%	17.86%	3.44%	6.42%
	2003	-	3.00%	18.65%	2.92%	6.05%
	2002	-	-	-	-	

Profit Margin	**2006**	**16.09%**	**22.35%**	**31.06%**	**20.21%**	
	2005	16.42%	19.12%	27.30%	22.08%	
	2004	14.61%	13.14%	26.49%	23.39%	
	2003	12.98%	-	28.17%	17.11%	
	2002	-	-	26.37%	11.33%	
Deposits/Loans	**2006**	**117.71%**	**149.47%**	**0.00%**	**137.86%**	**160.41%**
	2005	113.74%	163.78%	0.00%	128.48%	161.47%
	2004	140.38%	176.83%	0.00%	132.12%	171.36%
	2003	121.85%	201.56%	0.00%	160.33%	188.65%
	2002	-	184.46%	0.00%	176.84%	195.49%
Deposits/Assets	**2006**	**76.64%**	**81.58%**	**0.00%**	**80.44%**	**88.57%**
	2005	79.46%	78.97%	0.00%	79.04%	83.61%
	2004	81.56%	75.76%	0.00%	76.98%	84.02%
	2003	77.00%	85.78%	0.00%	80.58%	83.92%
	2002	-	83.17%	0.00%	80.64%	82.47%
Loans/Assets	**2006**	**65.11%**	**54.58%**	**89.08%**	**58.35%**	**55.21%**
	2005	69.86%	48.22%	81.95%	61.52%	51.78%
	2004	58.10%	42.84%	78.24%	58.27%	49.03%
	2003	63.19%	42.56%	71.22%	50.26%	44.48%
	2002	-	45.09%	74.69%	45.60%	42.19%
Borrowers/Employee	**2006**	**20.2**	**180.9**	**192.5**	**89.7**	
	2005	22.8	124.6	197.4	88.3	
	2004	-	111.9	198.4	88.1	
	2003	-	184.0	212.7	111.7	
	2002	-	195.4	194.6	143.7	
Depositors/Employee	**2006**	**84.9**	**727.7**	**0.0**	**801.9**	
	2005	75.3	629.0	0.0	859.0	
	2004	-	779.4	0.0	857.7	
	2003	-	712.4	0.0	1,075.7	
	2002	-	742.3	0.0	1,328.7	

Cost per Borrower	**2006**	**$310.67**	**$180.98**	**$190.78**	**$252.31**	
	2005	-	$212.30	$200.00	$240.29	
	2004	-	$170.13	$164.46	$207.44	
	2003	-	$104.00	$145.53	$215.83	
	2002	-	-	-	-	
Operating Expense/Loan Portfolio	**2006**	**6.54%**	**27.99%**	**45.83%**	**9.62%**	**31.88%**
	2005	6.44%	31.69%	54.81%	10.89%	35.91%
	2004	8.20%	35.72%	52.93%	10.61%	34.77%
	2003	-	-	49.47%	13.24%	43.37%
	2002	-	-	-	-	
Capital Adequacy Ratio	**2006**	**7.05%**	**10.99%**	**42.39%**	**10.91%**	**4.89%**
as calculated (capital/assets)	2005	4.64%	13.91%	37.66%	10.88%	5.79%
	2004	5.89%	18.95%	39.27%	11.63%	5.76%
	2003	8.72%	12.18%	35.31%	8.93%	5.29%
	2002	-	12.93%	33.54%	6.71%	6.13%
Savers/Borrower	**2006**	**4.20**	**4.02**	**0.00**	**8.94**	
	2005	3.31	5.05	0.00	9.73	
	2004	-	6.97	0.00	9.74	
	2003	-	3.87	0.00	9.63	
	2002	-	3.80	0.00	9.25	
Average Deposit Size	**2006**	**$1,333.32**	**$232.70**	**-**	**$448.62**	**$157.56**
	2005	$1,630.15	$224.73	-	$306.31	$116.23
	2004	-	$159.30	-	$283.26	$112.03
	2003	-	$176.32	-	$302.26	$108.64
	2002	-	$178.79	-	$275.68	$92.97
Average Loan Balance	**2006**	**$4,761.09**	**$626.35**	**$429.70**	**$2,910.25**	**$878.41**
	2005	$4,739.61	$692.85	$398.04	$2,320.56	$700.62
	2004	-	$627.50	$316.35	$2,088.21	$636.79
	2003	-	$338.65	$302.58	$1,816.23	$554.80
	2002	-	$368.28	$281.69	$1,441.65	$439.78

Portfolio at Risk >30 days	**2006**	**3.76%**	**12.19%**	**1.13%**	**5.07%**	
as reported by The MIX	2005	5.92%	51.54%	1.24%	4.76%	
	2004	8.33%	22.21%	0.56%	4.78%	
	2003	5.98%	28.76%	0.70%	6.04%	
	2002	5.97%	8.29%	1.11%	4.37%	
Loan Write-off Ratio	**2006**	**0.63%**		**0.57%**	**0.83%**	
as reported by The MIX	2005	1.69%	1.92%	0.51%	1.43%	
	2004	2.78%	0.40%	0.24%	1.59%	
	2003	2.59%	1.87%	0.31%	0.79%	
	2002		3.35%	0.18%	2.61%	
Capital Adequacy Ratio	**2006**	**13.53%**			**18.82%**	
as reported in financial statements	2005	9.39%			15.29%	
	2004	10.15%			16.19%	
	2003	14.29%			19.64%	
	2002	23.27%			12.62%	
Pct. Of GNI	Loan	1013.00%	118.18%	5.88%	227.36%	68.63%
	Savings	283.69%	43.91%	-	35.05%	12.31%

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