Microfinance Funders Profiles

A Short Guide for Young and Small Institutions Still Looking for a Match[1]

Adrian Gonzalez, Lead Researcher, Microfinance Information Exchange, agonzalez@themix.org

Obtaining funding for growth can be an important challenge for many microfinance institutions (MFIs). The recent global liquidity crisis and economic slowdown has highlighted just one example of mismatches between funding sources and MFIs; recent evidence suggests that MFIs continued to seek funding while several microfinance funders were actually overly liquid but unable to find MFI matches that met their fund criteria. Obtaining additional funding is particularly difficult for small and young MFIs who are starting to navigate the ocean of funding alternatives and have little knowledge of where to go first. Without access to external sources of financing, the growth potential of these MFIs is constrained to their own resources.

The menu of funding sources has expanded over the last decade with the emergence of multiple microfinance investment funds. Still, many young and small MFIs struggle to find financing because of minimum requirements on size, age, profitability, portfolio quality, etc. As a result, MFI funding, particularly cross-border funding, often chases a limited pool of MFIs. This is demonstrated by the fact that in 2008, 76 percent of microfinance funding was concentrated in only 10 percent of MFIs in the sample.

This paper focuses on those MFIs that presumably have more difficulty getting funding; they can generally be described as younger, smaller, less profitable, and having lower portfolio quality than the typical institution. These are the MFIs in the lower quartile of each variable under analysis, or in the lower part of the distribution. Because of the focus on sub-prime MFIs, this article defines sub-prime funder profiles by identifying the main characteristics of lower-tier MFIs that have recently received funding (in the 2006-2008 period), and then categorizing funding for those lower-tier MFIs by type of funder. In particular, this paper identifies which funders are more likely to fund small, young, less profitable MFIs.

The creation and maintenance of funding relationships between MFIs and funders depend on both quantitative and qualitative factors. Since qualitative characteristics like quality of management or regulatory environment are not captured in MIX (Microfinance Information Exchange, Inc.) data, the focus of this paper is on MFI financial performance and other operational indicators that may impact the matching process between MFIs and funders.

By concentrating sub-prime MFIs (young, small, less profitable, etc.), this report seeks to answer questions like: Who lends to young MFIs? What types of lenders fund institutions with higher credit risk? Where are smaller MFIs sourcing their on-lending funds? This paper explores each of these questions individually and offers quantitative evidence on likely matches based on the most recent data available on MFI funding liabilities.[2]

Methodology and Data

MIX has been collecting data on MFI funding sources for the past two years in a confidential database, publishing results in aggregate form in global and regional analysis in 2009. By July 2010, these aggregate results will also be available to MIX Market users (www.mixmarket.org) along with tools to perform customized analysis. For this research, funders were classified into five major groups and 18 categories (see text box).[3]

For each funding transaction, MIX collects year-end balance amounts, currency of the debt, interest rate and type (fixed,

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1. The author wants to thank Elizabeth Larson, Sergio Navajas and Blaine Stephens for their valuable comments and suggestions. All errors and omissions remain my own responsibility.

2. In real life, the total probability of an MFI receiving funding from a particular funder depends on all factors at once, and lies beyond the scope of this paper.

3. The specific sample used on this paper was updated in January 2010.

floating), origination date, end date, and term. For 2008 MIX recorded 8,163 outstanding debt obligations for 1,154 MFIs to 1,052 lenders. After consolidation of transactions by lender and year of origination, the number of funding relationships between MFIs and funders was 5,773. The sample shows a rather concentrated pool of funds with 75 percent of debt owed by only 100 MFIs, and conversely, with the remaining 25 percent dispersed among more than 1,000 MFIs.

In order to focus on recent behavior of funders, only those transactions originating in the 2006-2008 period are considered.[4] Furthermore, in an attempt to understand the characteristics of the MFIs before they were funded, the analyzed benchmarks correspond to the year before the funding relationship was established. Only the most recent year is considered for those MFIs that received funding for more than one year from the same funder.

In the spirit of simplicity, this brief will not look at regional differences, although they should be addressed in future research on the subject. In addition, since certain funders are not open to new members, like holding companies and funds managed by parent NGO networks, they are mentioned only for the purpose of illustrating their relative ranking compared to other funders.

The following analysis focuses on the two extreme cases of the bottom quartile (or bottom part of the distribution of MFIs within each category (i.e. those that are the smallest, youngest, or have the lowest returns or highest portfolio risk): 1) those funders that have higher (stricter) thresholds for establishing funding relationships, versus 2) those funders that have lower (more relaxed) thresholds. In other words, who funds the smallest, the youngest, the least profitable or the riskiest MFIs? This paper will offer some initial evidence to suggest where such funding relationships do exist.

Which funders lend to small MFIs?
In 2008, MFIs ranged in size from 40,000 USD to 2.9 billion USD in assets.[5] Yet even after years of 35 percent com-

pound growth in loan portfolio,[6] only 80 MFIs with more than 100 million USD in loan portfolio offer balance sizes large enough for sizeable debt transactions. Since over 95 percent of MFIs fall below this threshold and 50 percent carry less than 6 million USD in assets, who funds the vast majority of MFIs that have small balance sheets?

Funders of small scale MFIs lie outside the financial mainstream. They represent social or public interests, like Cooperatives, Governments, or Development Programs. They also include individuals and corporations, likely with close personal ties to the institutions. Like other small businesses, small and start-up MFIs leverage personal connections to raise initial funding before they can demonstrate the scale necessary for more mainstream actors to reach them.

MIX data show that funders with the lowest thresholds in terms of MFI size include: cooperatives, governments, NGO foundations, corporations/individuals, and development programs. Around 16 percent of all MFIs recently funded by any of these funders had total assets of 2 million USD or less, and around 25 percent had total assets of 3 million USD or less.

Figure 1 presents the percentage of MFIs being funded by type of lender and by size, as measured by total assets. Funders have been sorted by the category marked by a star (*), which usually corresponds to the 25th percentile of the variable under analysis, or a lower value depending on the case. The best way to understand the graphs is through a few examples. **Figure 1** shows that cooperatives are the funder most likely to lend to MFIs with less than 2 million USD in total assets (the 25th percentile), as measured by the second bar of each funder; they are followed by government, NGO foundations, and so on. In addition, the percentage of MFIs with at least 3 million USD in total assets funded by cooperatives is almost three times higher than the percentage of MFIs with only 1 million dollars or less in total assets being funded by cooperatives. Note that the percentages are cumulative and the bars add to more than 100 percent. This graph can be used to answer two different questions: 1) What type of funder has funded the largest percentage of MFIs with at least X million USD in total assets, and 2) How does the likelihood of being funded by a particular lender improve as the size of

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4. This represents 87 percent of all transactions for which it was possible to identify the origination year. However, we were able to identify origination year only for close to half of all recorded transactions.

5. Based on minimum and maximum from "2008 Benchmarks" available at http://www.themix.org/publications/2008-mfi-benchmarks.

6. "Microfinance at a Glance" (2008), available at http://www.themix.org/sites/default/files/Microfinance%20at%20a%20Glance%202009-12-31.pdf.

Classification of MFI Funders

DFI: Development Financial Institution - A financial institution owned by foreign government(s) that raises private capital to finance projects with development objectives. Examples include Asian Development Bank or IFC.

Government
- *Bi/Multilateral*: A bilateral or multilateral aid agency owned by foreign governments, like Agencia Española de Cooperación Internacional or International Fund for International Development.
- *Development Program*: A foreign government program or other public program with development objectives. Examples include FONDESIF – Bolivia, National Livelihood Support Fund – Philippines, or Social Security Corporation - Jordan.
- *Government*: A national administration, department, or agency of any sovereign nation. Most cases involve the local ministry of economy or finance.
- *Central Bank*: A domestic central bank.

Financial Institution
- *Commercial Bank*: A bank or other regulated financial institution where private entities are majority shareholders. Some examples of commercial banks considered include: ABN AMRO, AXIS Bank, Citibank, or HSBC.
- *Cooperative*: A financial institution owned by its members, not external shareholders.
- *Public Bank*: A bank or other regulated financial institution where the national government is a majority shareholder. Examples include the Republic of Srpska Investment-Development Bank and State Bank of Mauritius.

Fund
- *Blended Value*: A fund that offers below-market returns to socially-focused investors and provides a mix of debt and equity finance to MFIs. These funds are generally managed by non-profit organizations.
- *Commercial Fixed Income*: A fund that seeks a close to money market return from fixed income investments. Examples include Minlam Microfinance Fund and Deutsche Bank Start-up Fund.
- *Holding Company:* A company that provides mainly equity finance and technical assistance to start-up microfinance banks. It usually holds a predominant stake in its investees and is generally accessible by private invitation only. The most common holding in the sample was Pro-Credit Holding AG.
- *Mutual Fund*: A fund that seeks a close to money market return primarily from fixed income investments. Mutual funds publish their NAV on a monthly basis and are regulated by market authorities (undertakings for collective investment regulations). Examples include Dexia Microcredit Fund and responsAbility Global Microfinance Fund.
- *NGO/Foundation Fund*: A fund managed by a nonprofit or foundation that specifically targets MFI investments. Examples include Oikocredit Nederland Fonds and PlaNet Microfund.
- *Private Equity*: A fund that provides mainly equity finance and seeks a market return with a long time horizon. Most private equity funds are driven by commercial organizations with a strong development emphasis. For example: MicroVentures and Shorecap International Ltd.
- *Structured MF Vehicle*: A fund that offers microfinance investors a range of asset-backed securities with different risk and return profiles. These are generally classified as CDOs, and their assets are comprised only by a static pool of fixed income investments (pool of loans to MFIs). Examples include BlueOrchard Microfinance Securities I and Microfinance Securities XXEB.

Other
- *Corporation*: A registered legal entity. In the case of this survey, corporations do not include governments, non profits, funds or financial institutions.
- *Individual*: A person or persons.
- *NGO/Foundation*: A nonprofit corporation or other nonprofit entity. Common names in this category include ECLOF, Friends of WWB, and Grameen Foundation.

an MFI increases? Other graphs presented later in this paper follow this same pattern for other MFI characteristics.

One important lesson from this analysis is the multiplicative effect of MFI total assets on funding likelihood: an additional 1 million USD in total assets increases funding chances by almost 10 percentage points (pp) from these funders. Awareness of this pattern could be advantageous for international networks deciding on the minimum size of future start-ups. For instance, a network with 12 million USD for start-ups has

Figure 1
Percentage of MFIs by Total Assets and Funder Types
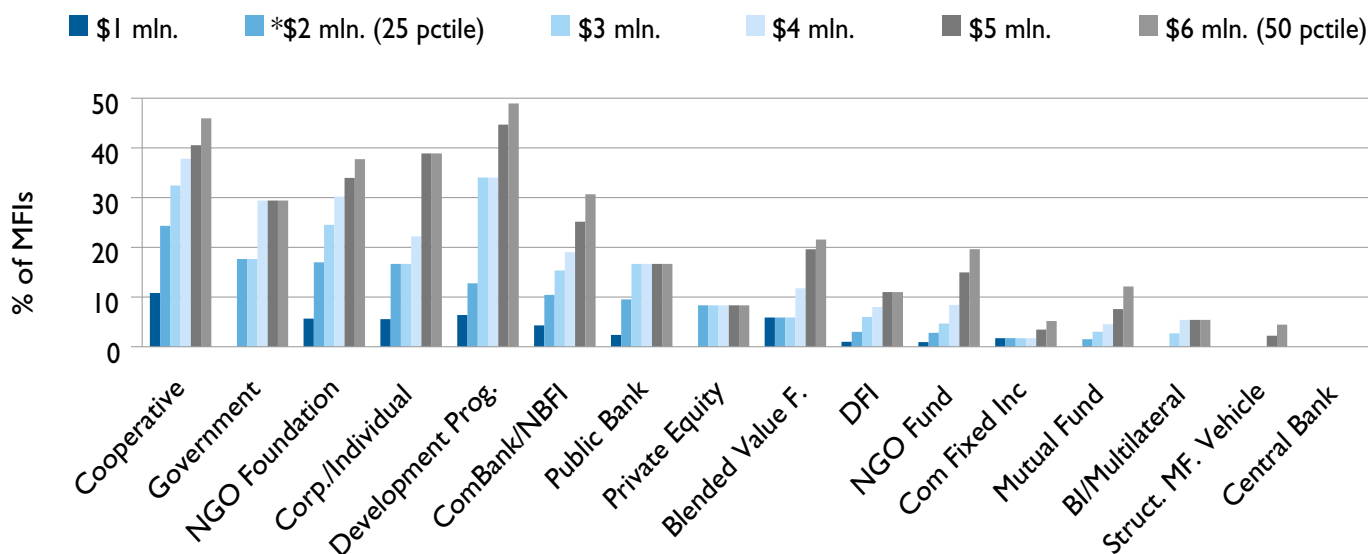
Legend: ■ $1 mln.   ■ *$2 mln. (25 pctile)   ■ $3 mln.   ■ $4 mln.   ■ $5 mln.   ■ $6 mln. (50 pctile)

*Funders sorted by the percentage associated with this category. Source: Microfinance Information Exchange, Inc, Funding Structure Database, 2008 data. Data represent percentage of MFIs being funded by type of lender.

a higher probability of obtaining external funding by setting up four MFIs with 3 million USD in assets each instead of six MFIs with 2 million USD in assets each. MFI start-ups might learn from this evidence and ensure that their seed capital is sufficient to improve the likelihood of attracting multiple lenders for their necessary growth funds for on-lending.

Overall, these figures pose an important question for Bi/Multilaterals that have development goals, since their minimum thresholds with respect to size are as high as those of private investors (like Structured Microfinance Vehicles and Mutual Funds), compared with the lower minimum thresholds of Governments, Development Programs, and DFIs. Note that since these data are based on recent transactions, this finding suggests that in recent years, Bi/Multilaterals prefer to fund large MFIs.

The funders with the highest minimum thresholds on MFI size (as measured by total assets, loan portfolio, and equity) are Central Banks, Structured Microfinance Vehicles, Bi/Multilaterals, Mutual Funds, and Commercial Fixed Income Funds. Only 5 percent or less of all MFIs that received funding from these sources in recent years had assets of 6 million USD or less (median assets for all MFIs in 2008). This means that more than half of the MFIs currently reporting

to MIX have a very small chance of ever establishing a financing relationship with any of these funders.

Deposit mobilization is sought by only a few types of funders
Based on the 2008 Benchmarks, close to 50 percent of all MFIs do not engage in any deposit mobilization. This is consistent with the fact that deposit mobilization is not a choice for many MFIs after their initial set-up and with the fact that only a small percentage of MFIs have transformed into new legal statuses allowing them to mobilize deposits. However, the following evidence suggests that deposit mobilization has important implications in terms of potential MFI funders. This could be disappointing for MFIs that are currently operating under a particular legal status that prevents them from mobilizing deposits. Therefore, those groups designing new MFIs may reconsider their business model and include deposit mobilization as an alternative, in order to benefit from access to different funding sources.

In the case of deposit mobilization, it is very hard to differentiate among the lenders for which deposit mobilization matters the least, so it is better to focus on the ones for which it matters the most and define the rest as the difference. From all funder types under analysis, deposit mo-

Figure 2
Percentage of MFIs by Amount of Deposits and Funder Type
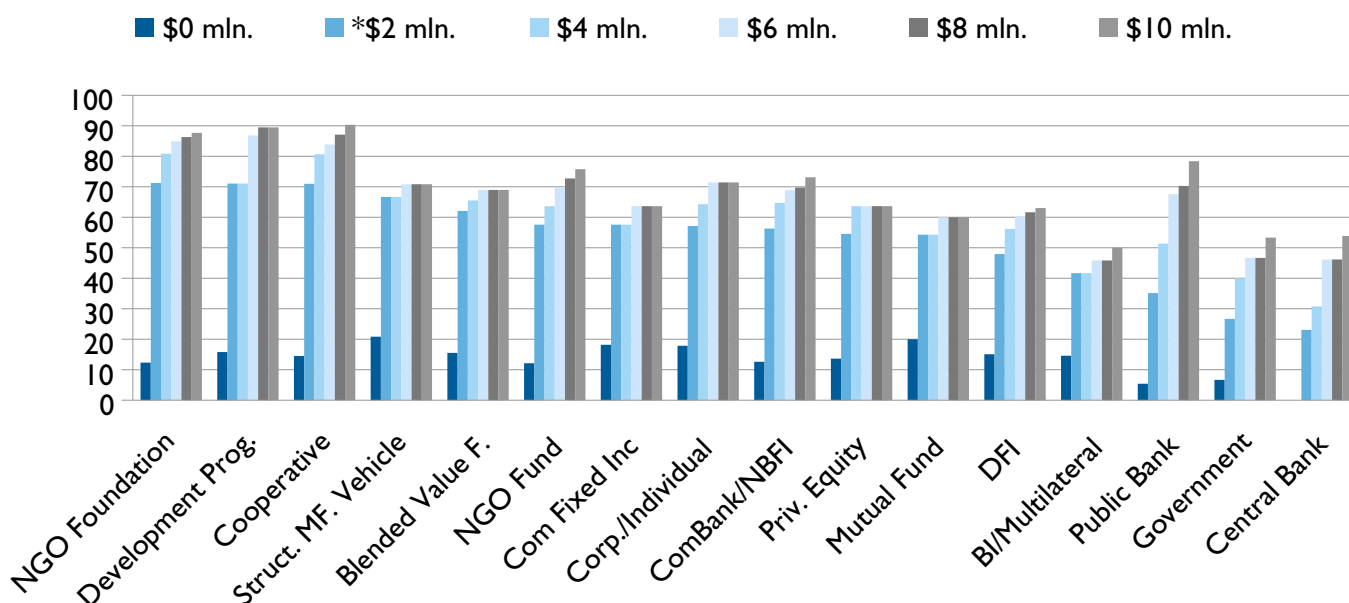
Legend: ■ $0 mln. ■ *$2 mln. ■ $4 mln. ■ $6 mln. ■ $8 mln. ■ $10 mln.

*Funders sorted by the percentage associated with this category. Source: Microfinance Information Exchange, Inc, Funding Structure Database, 2008 data. Data represent percentage of MFIs being funded by type of lender.

bilization matters the most (in descending order) to Central Banks, Governments, Public Banks, Bi/Multilaterals, and DFIs. Around 90 percent of all MFIs that received funding from these sources reported some deposit mobilization in their balance sheets. This could be an important exclusion factor, considering that around 50 percent of all MFIs in the sample do not mobilize any type of deposits (voluntary or compulsory). That this same group of funders is dominated by institutions with a development goal suggests a higher priority on supporting deposit mobilization. There are a few additional factors that make deposit mobilization a positive trait in the eyes of funders. First, it implies stricter regulation and closer supervision by local regulatory authorities, which makes the due diligence analysis easier. Additionally, MFIs that mobilize deposits tend to be larger. Lastly and most importantly, deposit mobilizing MFIs are more likely to have financial backing from public authorities in the event of acute liquidity problems, in which case deposit mobilization can function as an implicit insurance for funders.
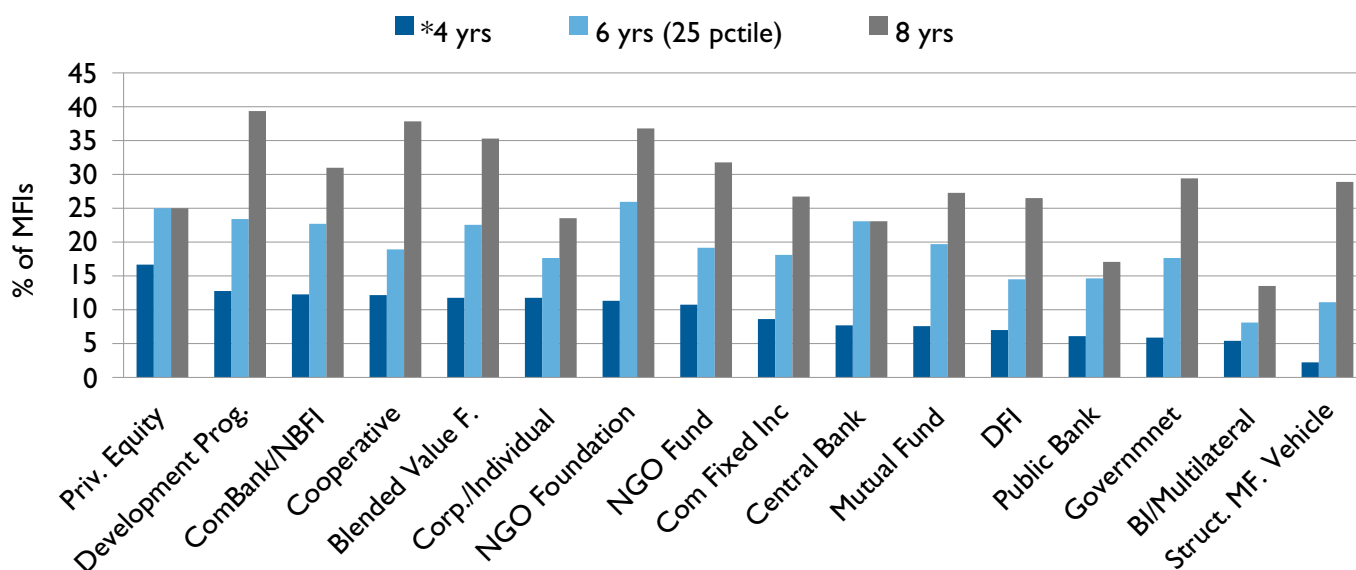
When are you old enough to borrow?
Previous research has demonstrated the importance of age in determining other elements of an MFI's perfor-

mance or operations, in particular the levels of efficiency or portfolio quality.[7] An MFI's track record, including its business longevity, also seems to influence the type of funders willing to lend to an institution. Yet, age is a factor outside an MFI's control. Where can young MFIs turn for funding? Note that by 2008, 25 percent of MFIs benchmarked had been operating for less than six years, while another 25 percent had more than 16 years of experience in microfinance. Any minimum age threshold by funders at six years of experience automatically excludes one quarter of the MFIs in the sample.

Many of today's start-up MFIs are members of microfinance groups that have equity stakes in the start-up branches. It is no surprise that private equity funds are one of the most likely sources of financing for young MFIs, accounting for

7. "Resilience of Microfinance to National Macroeconomic Events: A look at MFI assets Quality" (2007), The MicroBanking Bulleting, No. 14, pp. 36-38, May, available at http://www.themix.org/sites/default/files/Discussion%20Paper%201.pdf, and "Efficiency Drivers of Microfinance Institutions (MFIs): The Case of Operating Costs" (2007), The Micro-Banking Bulletin, No. 15, pp. 37-42, September, available at http://www.themix.org/sites/default/files/MBB%2015%20-%20Efficiency%20Drivers%20of%20MFIs.pdf

Figure 3
Percentage of MFIs by Age and Funder Types

*Funders sorted by the percentage associated with this category. Source: Microfinance Information Exchange, Inc, Funding Structure Database, 2008 data. Data represent percentage of MFIs being funded by type of lender.

more than 15 percent of recent transactions with MFIs younger than four years of age. Outside this restrictive pool, options remain somewhat scarce. Socially motivated funders, such as development programs and cooperatives, provide the next largest block of funding at 12 percent and 11 percent respectively. The young MFIs funded by commercial banks/NBFIs correspond to a select group of institutions originally established as banks or NBFIs, suggesting that they are not the typical small, young NGOs, but rather young and large regulated MFIs.

The funders who are more likely to lend to the youngest of the young MFIs are Private Equity Funds, Development Programs, Commercial Banks/NBFIs, and Cooperatives. For example, more than 15 percent of recent transactions with Private Equity Funds were with MFIs less than four years old, compared with only 2 percent of transactions with Structured Microfinance Vehicles. The funders less likely to lend to the youngest of the young are Structured Microfinance Vehicles, Bi/Multilaterals, Governments, Public Banks, and DFIs. With the exception of Private Equity Funds, the other funders that favor young MFIs tend to be local and closer to the MFIs that they fund. This suggests that local funders find it easier to evaluate and determine the reputation of young MFIs that

may not be well known yet in the international community, in comparison with foreign funders, for which acquiring information on less-known MFIs is a more complicated process. This is similar to the problem faced by MFIs when evaluating borrowers that are farther away in distance.

As shown in **Figure 3**, age is an important discriminating factor affecting the probability of being funded by different sources. However, by 10 years of age (half of the MFIs reporting to MIX are currently older than this) age becomes less crucial. A 10 year old MFI has a 50 percent likelihood of funding from most types of funders.

Profitability thresholds
In 2008, 25 percent of the benchmarked MFIs recorded losses of at least 2.1 percent as measured by return on assets (ROA), and 50 percent of them made a profit of at most 1 percent of average assets. This means that having very high thresholds on the profitability of MFIs could exclude most of the institutions trying to obtain funding. However, **Figure 4** confirms that many funders have financed MFIs even though they were not profitable the year before the funding transaction originated. It also shows that by improving profitability by just 1 percent-

Figure 4
Percentage of MFIs by ROA and Funder Type
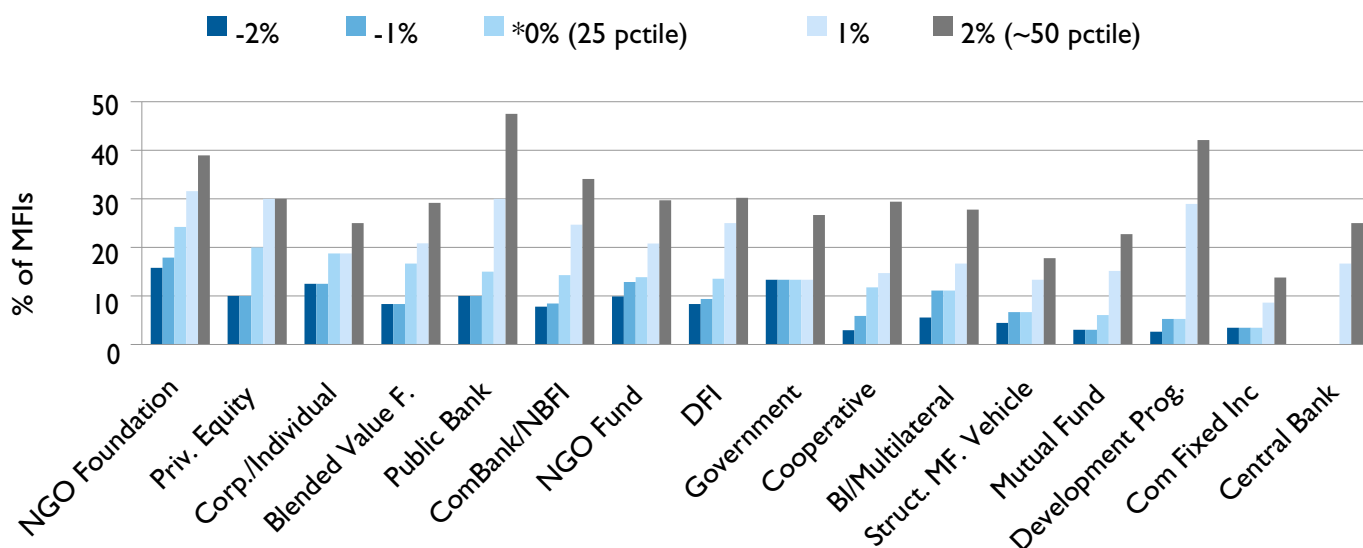
*Funders sorted by the percentage associated with this category. Source: Microfinance Information Exchange, Inc, Funding Structure Database, 2008 data. Data represent percentage of MFIs being funded by type of lender.

age point, unprofitable MFIs can see a 6 percentage point increase in their likelihood of being funded by the lenders with the most relaxed thresholds. Funders do lend to MFIs that experience negative returns. Indeed, many of these lenders are the same ones who fund small institutions (Corporations / Individuals) and start-up MFIs (Private Equity Funds) or generally attribute a social or development purpose to their lending (NGO/Foundations and Public Banks). These funders may have a higher tolerance for the variability in MFI profitability in difficult markets or during set-up phases.

In particular, the funders with lower profitability thresholds are NGO/Foundations, Private Equity Funds, Corporations/Individuals, Blended Value Funds, and Public Banks. On the other extreme, the funders with lower tolerance for losses are Central Banks, Commercial Fixed Income Funds, Development Programs, and Mutual Funds.

Portfolio quality
The historically low default record of microcredit has been affected by 2008-2009 events. As MFIs in markets as diverse as Cambodia, Bosnia and Herzegovina, Morocco, and Nicaragua face higher portfolio arrears, what can they learn

from the experience of others who have dealt with low portfolio quality and still found funding? Only 25 percent of the MFIs reporting to MIX had a write-off ratio over 3 percent in 2008. For this level, the funders with more relaxed standards in terms of portfolio quality are Bi/Multilaterals, Cooperatives, Corporations/Individuals, Commercial Banks/NBFIs and DFIs. This group is composed of funders of all types, from private individuals to development program groups, and it would be hard to argue that none of them care about the portfolio quality of their fundees.

Indeed, by using a threshold write-off ratio of only 3 percent, these funders are taking just a little more risk than the rest. It is likely that in most of these cases, these are funders that are either willing to fund MFIs with a strong commitment to improving their portfolio quality, or are a little bit less risk averse than the other funders (and thus expecting a larger return in compensation for their additional risk). For these funders, between 20 percent and 30 percent of their recent borrower MFIs have write-off ratios exceeding 2 percent. The funders with the toughest standards in terms of portfolio quality are Private Equity Funds, Central Banks, Commercial Fixed Income Funds, Mutual Funds, and NGO Funds, with 0-14 percent of their fundees' write-offs exceeding 2 percent.

Figure 5
Percentage of MFIs by Write-off Ratio and Funder Type
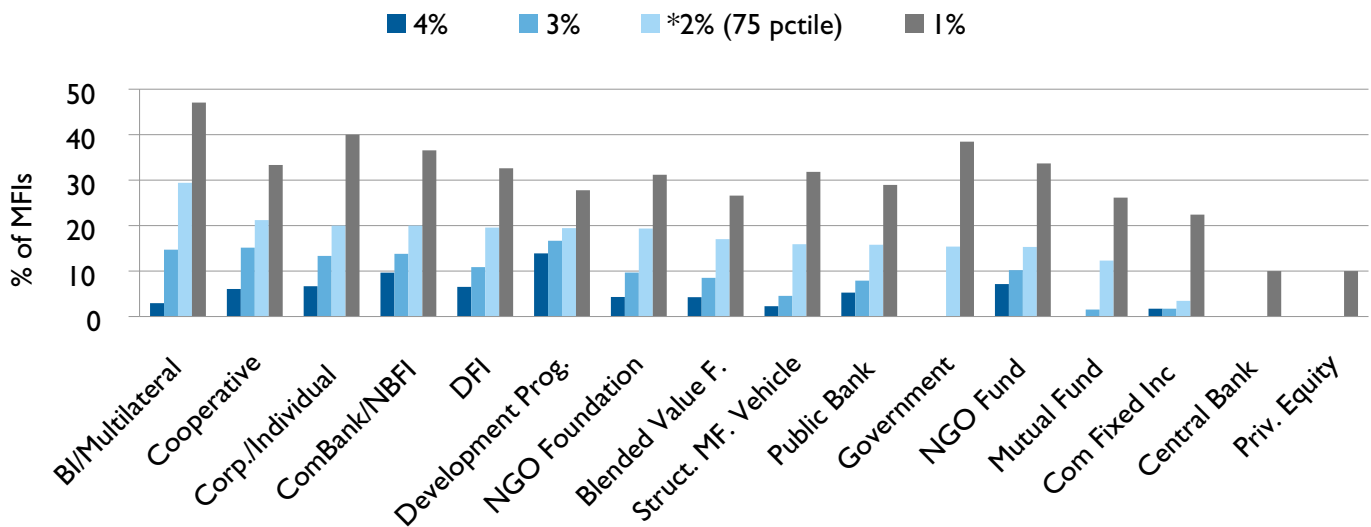
*Funders sorted by the percentage associated with this category. Source: Microfinance Information Exchange, Inc, Funding Structure Database, 2008 data. Data represent percentage of MFIs being funded by type of lender.

Figure 6
Mapping of Most Likely Funder Match According to MFI Characteristics

Assets	Deposit Mobilization	Age	Profitability	Portfolio Quality	Funders
Small	No	New	Med.	Low	Cooperatives
			High	Med.	Development Program
		Med.	Low	Low	Corporation/Individual
				Med.	NGO Foundation
	Yes	Mature	Med.	Med.	Government
Me-dium	No	New	Low	Best	Private Equity
			Med.	Low	ComBanks/NBFIs
		Med.	Low.	Med.	Blended Value Funds
			Med.	Best	NGO Funds
	Yes	Mature	Low	Med.	Public Banks
			Med.		DFIs
Large	No	Med.	High	Best	Commercial Fixed Income
					Mutual Funds
		Mature		Med.	Structure MF Vehicles
	Yes	Med.	High	Best	Central Banks
		Mature	Med.	Low	Bi/Multilaterals

The total probability of being funded by a particular type of funder depends on an in-depth historical analysis of the MFI, its environment, its management, and its strategic plans. Figure 6 summarizes the preceding analysis and results in a single table. Readers should review the table from top to bottom to move from the smallest, youngest, least profitable and riskiest MFIs to those that are larger, holder, more profitable and with the least credit risk. MFIs in the lower quartiles of the distributions have a larger probability of being funded by funders at the top of the list and a lower probability of being funded by funders at the bottom of the list.

Conclusion

Lending relationships are based on contracts and promises of repayment. In order to determine which MFIs to fund as well as the terms and conditions of that lending, funders carry out significant due diligence all the while dealing with imperfect and asymmetric information. The main conclusion from the previous table is that the funders who are most likely to fund MFIs from the lower quartile are generally **local funders**, who are closer to the MFIs than any other type of funder and thus have better knowledge about them. At the opposite end of the spectrum, the funders least likely to finance MFIs from the lower quartile are **foreign or more mainstream financial players**, for whom fixed costs are too high to evaluate small local actors. This can be explained by the comparative advantage (both in terms of cost and local knowledge about the sector) that local funders have in MFI evaluation, especially for small, new, and not very well-known MFIs. At the heart of this lie

two problems: inefficient information signaling from MFIs to funders, and high fixed costs for foreign funders to obtain this information.

The literature has identified a similar issue in the matching process between individual borrowers and lenders, with informal sources like friends and family being more local for the borrowers, non-microfinance commercial banks being farther away, and NGOs and MFIs covering the area between the two extremes.

Another important finding is an apparent decreasing marginal discriminatory effect for most variables under analysis, as the shares of MFIs around the medians of the distributions start approaching similar values for all funders. In other words, **small improvements in size, age, or profitability quickly increase the pool of potential funds**. The general message for MFIs that are new to the funders' waters is to target local funders first, and move up the spectrum with the hope of finding a better deal in terms of rate, term, foreign risk exposure, and all other conditions.

The preferences and thresholds of funders are not constant, and the recent liquidity crisis and economic slowdown may have changed the way that funders select their fundees. Since the results summarized in this paper are only what the data show for 2008, this question must be revisited as funder roles and appetites change. MIX's funding structure database is a resource for the community to use to address this question in the years to come.