

2007 Microfinance Investment Vehicle Survey

In recent years, microfinance institutions (MFIs) have turned to cross-border investments for their funding needs. Traditionally, international financial institutions (IFIs) were the primary source of foreign funding for MFIs, providing a variety of direct loans and donations. Now, international investment into microfinance is primarily done through a new innovative channel—microfinance investment vehicles (MIVs).

Fundamentally, MIVs are pooled investments that target the microfinance sector. IFIs and private investors provide MIVs with the majority of their funding. As for the recipients, they range anywhere from direct investment in individual MFIs to investments in other MIVs. In this role as intermediary investment vehicles, MIVs are growing rapidly in nearly every aspect including total assets, assets devoted strictly to microfinance, and regional funding.

While this dramatic growth is a welcome development for many MFIs, it has unearthed some causes for concern. Many MIVs are not yet transparent. It is often difficult for investors to obtain even the basic information that is taken for granted in more traditional industries. Without access to standardized, comprehensive data, investors find it nearly impossible to make informed decisions.

To determine the presence and role of MIVs as a funding channel for MFIs, MicroRate has conducted an annual, comprehensive survey of the MIV industry for the past four years. This overview will focus on the findings of the *2007 MIV Survey* by analyzing current trends, determining future implications and addressing any predicted obstacles.

What is an MIV?

Historically, MIVs consisted of a broad spectrum of vehicles which varied in legal

structure, investor-type and investment focus. To address this issue and remove any ambiguity from the results, MicroRate determined three fundamental criteria necessary in order to qualify as an MIV: (1) presence of an independent legal entity, (2) presence of and/or open to multiple investors, and (3) focus on microfinance investing. Of the 81 global MIVs initially contacted, 70 met this criteria and 69 of those responded to MicroRate's survey (99 percent response rate). MicroRate would like to thank all the MIVs that contributed to this survey.

It is important to note that the MIV definition excludes a number of prominent funds that were regarded as MIVs in the past. Criterion 2 - multiple investors- precludes leading exclusively-donor funded vehicles such as the Grameen Foundation, Omidyar-Tufts Microfinance Fund and two Deutsche Bank-sponsored funds. The most important exclusion however was ProCredit Holdings. As its name suggests, ProCredit Holdings mobilizes funding for its own companies. An MIV, in contrast, would be expected to channel funding to third parties. The distinction matters, because an MIV should be guided exclusively by the interests of its investors when it chooses how to invest its money. If included, both ProCredit Holdings and Omidyar-Tufts Microfinance Fund would be in the Top 10 MIVs in terms of microfinance assets.

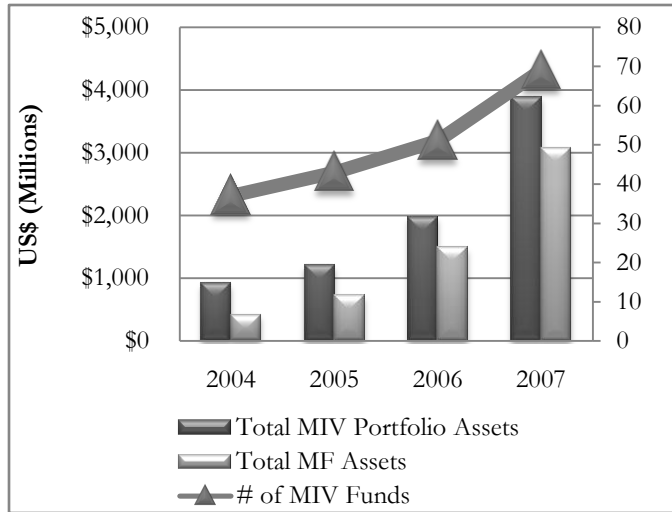
Survey Results

The MIV industry saw tremendous growth in almost every measurement over the past four years. Between 2004 and 2007, the number of MIVs nearly doubled from 37 to 70.¹ During that same time, total MIV assets grew from US \$908 million to US \$3.9 billion. Even more

¹ MicroRate *2007 MIV Survey*. The number of MIVs was taken from MicroRate's survey data and may not represent the entire universe of MIVs.

2007 Microfinance Investment Vehicle Survey

impressive was the growth of microfinance assets held by MIVs. These swelled from US \$415 million (2004) to nearly US \$3.1 billion (2007), a 634 percent growth rate. Microfinance assets of MIVs have nearly doubled each of the last 3 years.



In 2004, microfinance assets still accounted for less than half of their respective MIV portfolios. By 2007, nearly 80 percent of the MIV assets were earmarked specifically for microfinance. Because of this trend, MFIs benefit from both MIV asset growth and from the increased microfinance asset concentration.

MIVs continue to hold an overwhelming majority of debt instruments in their portfolios, with a small portion of equity securities and a negligible number of guarantees. In 2005, 87 percent of microfinance assets were debt, while equity accounted for 11 percent and guarantees for only 1 percent. In 2007, the MF asset composition was 82% debt, 16% equity and 2% guarantees. While equity investments grew 149% between 2006 and 2007, they continue to represent a relatively small percentage of the portfolio.

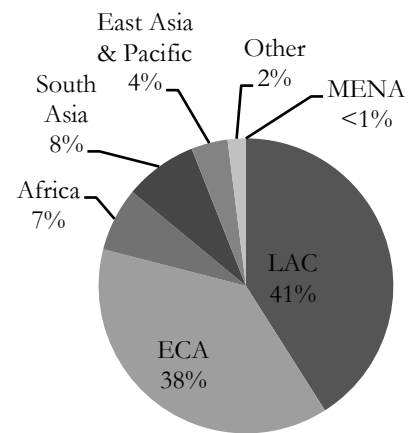
Encouraged by favorable economic and regulatory environments, more MFIs are transforming from unregulated NGOs into

regulated, for-profit institutions that are capable of securing equity financing through shareholder offerings. The case of the Mexican MFI Compartamos is a well-known example. Compartamos transformed itself from an NGO into a for-profit corporation back in 2000. In 2007, it became a bank, capable of accepting saving deposits.

Concentration

The top 10 MIVs, based on size of microfinance assets, show some interesting trends. Eleven new MIVs appeared in 2007. Two of these immediately joined the top 10. Nine of the top 10 funds had microfinance assets over US \$100 million, compared to just one in 2005. All of the top 10 had over 55 percent of their portfolios invested in microfinance and the average investment in microfinance was a surprisingly high 87 percent of total assets.

There are other signs that assets are heavily concentrated in a few MIVs. Over 40 percent of total MIV assets are controlled by the five largest MIVs, whereas the MIVs with assets under US \$20 million account for less than 20 percent of the market.



Geographically, microfinance assets remain highly concentrated within Latin America and the Caribbean (LAC) and Europe and Central

2007 Microfinance Investment Vehicle Survey

Asia (ECA), Africa, South Asia, and East Asia and Pacific, in addition to LAC and ECA, all nearly doubled in size from 2006 to 2007. The Middle East and North Africa (MENA) region, however, lost almost half of their microfinance assets over this same period. Concerns over information disclosure appear to be the major contributor to this surprising outflow.

Future Implications

What does the future hold for MIVs? Based on the results of the *Survey*, spectacular growth continues within the MIV universe. But some caution is warranted on behalf of both MIV investors and MIV managers.

For investments to continue to flow into MIVs, transparency must be improved. Without accountable, third-party reporting and information dissemination, investors will soon find that they lack the data they need to make well-informed decisions.

While the heightened attention surrounding microfinance is partially responsible for the tremendous growth in MIVs, there is concern that there may have been too much growth too soon. As MIVs compete with each other and with International Development Agencies, margins have come under pressure. In many instances, rates charged by MIVs seem to ignore country risk. MicroRate has observed with some concern, that in the short run, MIVs may be straining the absorptive capacity of microfinance institutions.

Microfinance institutions themselves are entering more uncertain times as clouds gather over financial markets and unprecedented increases in food prices affect the repayment capacity of microentrepreneurs. Should economic cycles return to the high inflation and low liquidity that long characterized developing economies, many MFIs would face serious difficulties. Even without a dramatic

deterioration in the economic environment, it is likely, in MicroRate's opinion, that microfinance will see a correction as competition among MFIs increases and borrowers carry ever-increasing burdens of debt.

MIVs continue to grow and to reach larger numbers of investors. So far, much of this growth has been fueled by a certain amount of euphoria about microfinance. It is not exaggerated to say that if an investment bore the stamp of "microfinance," investors were prepared to buy it, often based on a minimum of scrutiny. The Compartamos share sale of April 2007 was perhaps the most dramatic instance of this euphoria. Investors – most of them international institutional investors – oversubscribed the offer 13 times. The resulting share price was nearly 14 times book value. While Compartamos is a highly successful Mexican microfinance bank, not a MIV, some of the sentiment that surrounded the Compartamos sale could be felt by MIVs.

Given the ever present possibility of a correction, it is essential that investors should base their decisions less on sentiment and more on impartial analysis. It is equally important that MIVs should be transparent enough to make such an analysis possible. If they are not, market sentiment could shift dramatically when investors discover that it is possible to lose money in microfinance.