

Evaluation of ProFund

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Introduction

In December 2001, Paul DiLeo and Mercedes Cuadra were contracted by several of the investors in ProFund to undertake an evaluation of the performance of the fund.¹ The objectives of the evaluation were as follows:

- (i) *Conduct an independent impact assessment of the Profund investment fund, attempting to define the state of Profund's market prior to its existence and post-Profund.*
- (ii) *Measure impacts to the targeted microfinance market at four levels:*
 - a. *The investor level*
 - b. *The MFI/investee level*
 - c. *The microentrepreneur level*
 - d. *The industry as a whole (LA, as well as beyond)*
- (iii) *Make recommendations, as appropriate, on modifications to the current structure.*
- (iv) *Make recommendations to the potential investor group from the existing shareholders on an appropriate follow-on vehicle, if any.*

The evaluation team undertook to develop information relevant to these objectives as follows: (1) interviews with founders, investors and staff of ProFund; (2) interviews with institutions in which ProFund has invested, co-investors and other collaborators; (3) interviews with financial institutions in which ProFund has not invested and with other observers and participants in the development finance industry in the region and globally; (4) examination of performance and impact data for both ProFund's investees and for other comparable institutions which did not receive ProFund investments.

There are two things the evaluation team does not attempt to do in this report. First, there is no attempt to provide an overview of the history and evolution of ProFund except as it relates to one of the four objectives above. Second, there is no attempt to evaluate the financial performance of ProFund itself. The report will generally refer to "ProFund" except in cases where the distinction between the investment fund and its management company is of significance.

This report begins with a summary of conclusions and a discussion of ProFund's main accomplishments and the lessons that can be drawn from it. The body of the report is then organized in two main sections. The first section articulates and assesses ProFund's approach and performance to date by looking at (1) its original business plan relative to performance; (2) the composition of its portfolio and the performance of its portfolio companies relative to peers; (3) the primary functions and roles ProFund has played with respect to its investors and investees.

¹ Paul DiLeo and Mercedes Cuadra, based in the U.S. and Nicaragua respectively, are directors of Scion Associates, which provides services to the development finance industry, including institutional assessments, cost and product analysis, and sector studies.

The second section of the report looks forward, first by articulating some brief observations on what the market for development finance in the region might look like in the coming years and then by looking at what the role of ProFund/Omtrix might be and providing some specific recommendations on how this might be accomplished.

Readers should bear in mind that the primary approach employed in this evaluation was conducting interviews. As interlocutors were assured that their comments would be treated as anonymous, ideas and observations are not attributed but it can nevertheless be assumed that very few if any of the insights in this report can be credited to the authors.

Executive Summary

Overall Accomplishments

1. ProFund has served as a focal point in the maturation of the Latin America microfinance sector by executing the unique role of an engaged and informed, regionally based, equity investor, with no other agendas or functions in the sector.
2. ProFund has creatively and flexibly developed a number of sophisticated approaches to creating and supporting MFIs in such areas as mergers, bank collaborations, special purpose initiatives, and liquidity support which provide a roadmap for the initiatives that will continue to be necessary in the future.
3. ProFund has demonstrated the key features required for a successful development finance investment fund with respect to such matters as the type of manager needed, constructive shareholder relations, breadth of responsibilities, relationship with TA funding and provision, costs, and the structure of the fund itself.

ProFund's Portfolio

4. As a general matter, ProFund has selected the larger, more mature Latin American institutions for its investments.
5. There is no evidence that ProFund's investees are establishing a dominant position in the industry and discouraging new entrants. New institutions of widely differing types continue to enter, and while ProFund's institutions have seen strong growth in both portfolios and clients, their shares of the industry totals have not significantly grown over the past 2-3 years.
6. As a group, ProFund institutions appear to have performed somewhat better than the industry as a whole in terms of efficiency and productivity.
7. ProFund investees have stayed closer to their target market, as crudely measured by average loan size, than other comparable MFIs.

Execution of the Business Plan

8. The original Business Plan for ProFund reveals how much has been learned during ProFund's life and due to its experience. While the plan provided a good platform for ProFund's launch, it was in retrospect overambitious or oversimplistic with respect to a number of key objectives. Nevertheless, ProFund did accomplish the core objective of the plan, which was to sharpen and consolidate the identity of the emerging industry.
9. Despite the initial commitment of management and investors, ProFund was unsuccessful in engaging dedicated SME institutions, and its experience suggests that the SME area poses special challenges requiring its own focused resources and expertise. The attempt to do both MFI and small business intermediary investments through a single initiative appears in retrospect to have been unworkable.
10. The anticipated response of private investors to the accomplishments of ProFund and of the microfinance sector more generally over the past 8-10 years has been

disappointing, due among other things to initially simplistic expectations, regional macroeconomic and financial sector developments, and the failure of ProFund's own portfolio to demonstrate yet the existence of clean exits and liquidity.

11. Due to the exit problem, the original structure of ProFund now looks excessively restrictive, although it undoubtedly has helped in defining ProFund as a disciplined, commercially oriented entity during its early and middle years.

Future Industry Needs and Role for ProFund/OMTRIX

12. The ultimate/end market for development finance in the region remains significantly underserved.
13. The number of institutions of different types and origins active in the market continues to grow.
14. The sector will continue to need agile equity and engaged and sophisticated governance and advisory support of the type ProFund and OMTRIX provide. Over at least the medium term – 2-3 years – ProFund/OMTRIX is best placed to provide these and should be restructured so as to do so.
15. The emergence of new types and providers of technical assistance to shareholder and transforming MFIs would help in their development as they grapple with technology challenges, as mainstream financial institutions explore and experiment, and as existing TA providers develop their own investment initiatives.

Review of Accomplishments and Key Strengths and Weaknesses

Accomplishments/Shortfalls

Key Findings

- *ProFund plays a unique role in integrating microfinance into the financial system.*
- *ProFund has spearheaded innovative institutional models for microfinance.*
- *Private investors will take longer than anticipated to play a leading role in microfinance, with significant implications for ProFund liquidity.*
- *ProFund has benefited from leanness and focus, but has sacrificed its own institutional depth and capabilities.*
- *While Latin American poverty cannot be discussed without major emphasis on Brazil and Mexico, microfinance in these countries is barely out of its infancy; ProFund has much to contribute to developing the industry in these markets.*

For many of the investors, collaborators and observers of ProFund it is difficult to step back from day-to-day engagement with the microfinance sector and appreciate how much the field has changed since the early 1980s. The problems being grappled with today in Latin America and increasingly in other regions include: what are the most likely ways for investors to get liquidity and exit?; what are appropriate returns to expect from MFI investments?; which of several viable institutional forms or institutional development paths is most appropriate for a particular market or environment?; how can incipient mainstream financial institution interest in the sector best be channeled and supported?

Such immediacy of these questions to our daily concerns today stands in stark contrast to the preoccupations of ten years ago, when we were more likely to be grappling with the existential question of whether “commercial microfinance” was an oxymoron.

This change was due to creative R & D backed by concessional funding, visionary successes and failures, and sustained commitment to building operational capabilities day by day, branch by branch, and country by country involving many different institutions and donors. As a general matter, it is next to impossible to ascribe clear responsibility for the steps forward to any institution or individual. However, it is the conclusion of this evaluation that ProFund, as an equity fund for commercial microfinance, was and continues to be unique. Its successes have been fundamentally dependent on the groundwork laid and continued collaboration of many other institutions, but because ProFund is unique, we nevertheless feel comfortable associating a number of key developments in the sector with ProFund.

- (1) With the perspective of an investor rather than a partner, donor or technical assistance provider, ProFund confirmed that BancoSol and Bolivia were not aberrations. The transformation of NGOs into disciplined, performing private sector institutions can be accomplished in a wide range of situations.

- (2) Even as it has replicated the successful transformation of NGOs into regulated, shareholder institutions, ProFund's has also demonstrated that this need not be accompanied by "mission creep"; overall ProFund institutions have maintained their target population focus, as measured by average loan size.
- (3) While transforming NGOs were the initial focus, ProFund also encouraged and nurtured a proliferation of other MFI development models, including specialized "niche" banks or finance companies, mergers with mainstream financial institutions, and dedicated commercial bank subsidiaries.
- (4) Even as ProFund was encouraging the proliferation of promising models, it was realizing in a unique way common standards and a shared identity for the industry through well informed, engaged governance. Through this focused and sustained governance role, ProFund has helped to reduce industry fragmentation, at both the national and regional/global levels, even as the industry has become larger and more dynamic.
- (5) The visibility and credibility ProFund has brought to microfinance institutions as a commercially oriented investor has helped raise the stature of the industry within the broader financial landscape. While much work remains to be done in most countries to create a financial system architecture that constructively accommodates microfinance, ProFund's involvement as an equity investor has helped make the case that such institutions deserve to be accommodated.
- (6) ProFund has achieved excellent geographical diversification, and has invested in countries that other investors and even donors have had trouble penetrating, particularly the MDBs.
- (7) More generally, ProFund has shown itself to be truly additive, leading investments that in our view, few if any other investors would have precipitated and in a number of cases, effectively creating the investment opportunity.

There have also been a number of shortcomings relative to initial hopes or expectations:

- (8) To date, ProFund's experience supports the view that while microfinance investments can be remunerative, stand-alone microfinance intermediaries are not yet seen as commercially competitive equity investments.
- (9) After eight years of ProFund's operation, we are just beginning to learn how private investors of significant scale can be enticed into the sector, and it appears to be through more indirect avenues than ProFund's original closed end structure anticipated. This failure to achieve or map out clear exits is a fundamental shortfall from the overambitious or simplistic original goals for the fund.
- (10) ProFund's very success in operating so effectively at such low cost has established a standard for investment operations that other MFI funds, operating

perhaps in more challenging environments, should be held to but will be hard pressed to replicate. More immediately, ProFund itself has sacrificed its own staff depth and capabilities to its cost goals. However, it must be noted that relaxing the cost constraint would inevitably have entailed trade-offs with respect to its own focus and identity.

- (11) ProFund has not been especially successful at penetrating the largest markets and concentrations of poverty in the region, in Mexico and Brazil. It is hard to argue that its work is truly complete before it has contributed its unique capabilities to MFI institutional development in these countries.

What has been learned:

Key Findings:

- *SME and micro intermediaries are more different than similar, and probably can not/should not be addressed through one initiative.*
- *ProFund has demonstrated conclusively that NGO transformations are not the only source of new commercial MFIs and that going forward, special purpose “niche” institutions and commercial bank subsidiaries will be at least as important.*
- *ProFund’s ability to provide equity and function as an investor unencumbered by any other agenda has been key to its success and additionality, and should remain its core.*

As suggested by the summary above, ProFund’s experience and performance have demonstrated a number of fallacies or clarified key aspects of the environment facing development finance initiatives in the region and to some extent, globally.

SMEs: ProFund’s inability to engage opportunities in SME oriented institutions would appear to validate more general difficulties with development finance initiatives in this sector. Because of the resources required, it is difficult to participate meaningfully in the capital of banks that serve this sector, and inadvisable to attempt to focus them on this product line. It is not entirely clear why more specialized intermediaries like leasing or factoring were not forthcoming, and the matter clearly warrants more focus and specialized expertise. Given the challenges of this sector, we believe that the implicit decision of ProFund management and investors to narrow its original focus to concentrate on microfinance was correct.

This conclusion is not meant to deny that a number of ProFund’s investees (BancoSol, Solidario, BancaSol/Genesis) are moving to offer or do offer what could be considered small SME loans, just that much is still to be learned about how SME services can best impact the poor and what intermediaries are best suited to deliver them at appreciable scale.

Geography: While ProFund never had explicit goals with respect to specific countries in the region, it is noteworthy that its presence in several important markets has been limited

or non-existent. This experience suggests that the resources and capabilities represented by ProFund in and of themselves are inadequate for these markets. In several cases (Argentina, Chile), an argument can be made that due to income levels and the degree of formalization of the economy, that SME oriented institutions are more relevant, and the question reverts back to the SME issue noted above. In other cases (Mexico, Brazil), it would appear that specific features of the financial system or landscape have made it difficult to date for microfinance institutions suitable for ProFund investment to emerge, although this may now be changing. In this latter case, it would appear advisable for the development finance community to continue to press ahead to devise approaches that promise to create MFI investment opportunities in these countries, and that ProFund participate actively.

Private investors: A bedrock assumption of the development finance community in recent years has been that the failure of more private resources to flow into the sector represented a market failure, specifically that this business was perceived to be riskier and less profitable than it is, and that if a number of examples of profitable operation over a suitable period could be created, greater resources would begin to flow. It now appears that the curve should be both shifted out and flattened, which is to say that the private sector response will take longer and be smaller than anticipated. With respect to the timing, the projections were most likely overoptimistic, particularly in light of the volatility of the overall macroeconomic performance of most of the countries involved. More interesting is the possibility that the risk premium on development finance is *accurately* perceived to be higher, due to, for example, a perceived instability in the policy environment for development finance and/or its clients (i.e. social function, consumer protection, regularization of informal sector) or to the costs in terms of management time and infrastructure of implementing the existing models of development finance.

This being said, there are examples of several fully private initiatives in the sector which are pursuing various strategies (Credife's branch strategy; Solucion's technology) for reducing these implementation costs. What is interesting, however, is that these approaches while promising and ultimately fulfilling the goals of private sector involvement in the sector, do so in a more indirect way than ProFund contemplated. These initiatives represent a pattern of private investors *learning from* ProFund investments and *taking advantage* of the groundwork ProFund has laid, rather than moving to *buy* ProFund investments directly. While such imitation falls squarely within ProFund's core goals in encouraging more resources and expertise to enter the sector, it clearly does no good and perhaps some harm to ProFund's goals with respect to realizing value on its own investments.

A corollary of this mixed picture with respect to private investment is that the liquidity of ProFund's portfolio is not yet apparent. Expectations that private investors would emerge with an appetite for ProFund's shares in its portfolio companies have not been borne out. With the possible exception of private bank co-investors, the question of who will be the private investors who provide liquidity and exit to investors like ProFund

remains unanswered. To date, the most realistic exit in general for ProFund and similar investors is simply more investors of the same type.

This situation also raises a fundamental question of whether ProFund can be said to have been successful in the absence of successful exits? In a narrow sense the answer is clearly no. However, we believe that in terms of the goals of ProFund sponsors and investors with respect to defining and establishing a viable industry, the answer is clearly yes, as concretely demonstrated by such initiatives as Credife and Solucion and, in a different way, Vision and Solidario.

Pipeline: A key question for the sector is, what is the pipeline for new MFIs, both in countries where commercial MFIs already exist and in countries where they have yet to be introduced? For some time, the assumption was that as a few leading NGOs were transformed, others would shed their inhibitions and move forward along the same path, thus ensuring a steady stream of new entrants from the large pool of NGOs in existence and being created. Our conversations found many observers questioning whether this process would operate. There is widespread concern that the NGO pipeline for commercial MFIs may be drying up, not just in the region but worldwide, due variously to NGO sponsor/manager reluctance to cede control, lack of effective capacity building, lack of effective market development, and dearth of social entrepreneurs.

It is our view that this concern overstates the problem in two respects. First, while there may be few new investment opportunities, a fund like ProFund doesn't need many. ProFund has made ten equity investments to date. Anticipating that five more NGOs can be nurtured to "investment grade" over the next few years does not seem overambitious, particularly given the previously mentioned gaps in Mexico and Brazil.

More fundamentally, however, ProFund has demonstrated conclusively that NGO transformations are not the only or even, going forward, likely to be the principal source of new commercial MFIs. Special purpose "niche" institutions and commercial bank subsidiaries have demonstrated their relevance to the sector, and can be expected to be as important or more important than NGOs in the future.

Finally, ProFund has also demonstrated the uselessness of static pipeline assessments and the reality that the task of a fund manager is to "create your own pipeline." Given the substantial unmet underlying demand for microfinance services, the existence of undiscovered niches this implies, and the technological turmoil facing the sector, this is likely to continue to be the most relevant approach for many years.

Equity focus: ProFund's sponsors began their initiative with a firmly held view that common equity was the gap facing the sector, and they imposed a very tight equity focus on ProFund. This continues to be largely valid. While other gaps exist – short term liquidity support comes to mind – they are subsidiary to the equity gap, meaning that equity helps create the bases for solving or addressing these other gaps. And on the other hand, more elaborate instruments or strategies like guarantees and securitization of portfolios have generally failed to deliver much if any results yet. Finally, as noted

above, the governance role played by ProFund has been key to its impact on its institutions and on the industry.

Strengths and Weaknesses: Strengths

Key Lessons:

- *A fund's objectives must be narrowly defined and assiduously adhered to, especially in the case of a pioneering initiative where translating a concept to implementation will inevitably be more complicated than anticipated.*
- *A fund's ability to lead investments is likely to diminish if it is identified with the interests of any sponsor or investor with other agendas in the target sector.*
- *It is critical that the fund develop a culture and approach distinct from that of its sponsors and investors if there is to be the additionality which justifies the costs.*
- *A fund should have a continuous presence and be firmly rooted in its target market to be proactive and effective.*
- *Substantial and ongoing TA is essential in nearly all investments, and it is critical that adequate funding and an array of providers be available, but the financing and provision of TA should be entirely independent of the investment fund.*
- *There is little to be gained and significant downside risk to the fund and the industry in undertaking a fund without capable and independent management.*
- *The qualities of the fund manager are the single most important ingredient for success.*

Many of ProFund's key strengths are mirror images of weaknesses and vice versa. In most cases, this suggests not that ProFund pursued a mistaken strategy or failed to take advantage of realistic opportunities, but rather that its task as originally defined was both overambitious and more complex in implementation than in concept. The strengths identified below comprise the attributes that have enabled ProFund to make a unique and critical contribution to the sector and play the leading and catalytic role that it has.

Focus: ProFund developed a sharp, clear focus on equity investing in MFIs, acting opportunistically and creatively in this niche and avoiding temptations to "mission creep". As a practical matter this sharp focus as an equity investor in commercially promising MFIs meant on the positive side that ProFund's agenda and role was clear, both to MFIs, coinvestors, regulatory authorities, shareholders, donors and others, helping to increase its influence and credibility and in some respects helping each of them to sharpen their own focus and objectives. On the negative side it translated into dropping efforts in the SME sector, failing to systematically collect and disseminate data and experiences, and failure to build the systems, capabilities and depth of OMTRIX.

Independence: ProFund achieved noteworthy success, the difficulty and importance of which cannot be overestimated, in establishing itself as independent of its shareholders and their agendas. This hard won independence both enhanced ProFund's credibility with MFIs and coinvestors as well as enabling it to act in a truly additional manner and to provide valuable objective criticism and guidance to its shareholders. This independence was largely a function of the substantive capabilities, communications skills, and

integrity of ProFund's management and of the broad vision of the key sponsors and investors. However, the importance of specific structural elements should also be noted, in particular, the division of labor between the Investment Committee, which operated with complete authority over individual transactions, and the Board, which restricted itself to broad strategic and performance guidelines and oversight.

Agile and opportunistic: Within its identified, narrow focus of activity, ProFund was able to act creatively and opportunistically and achieve true additionality by doing transactions that its investors either would not or could not do directly. ProFund could: react quickly to investment opportunities, moving from initial interest to a closed deal in matter of months; could respond immediately to liquidity problems; could access any and all sources of TA; and could conceptualize and lead complicated transactions. ProFund was also able to engage the regulatory authorities as an unambiguous advocate of the microfinance industry and its investees.

Local Presence and Connections: ProFund by virtue of the management and its location has become an integral part of the regional microfinance sector, in a way that staff and institutions based outside the region and drawing on extra-regional staff cannot. ProFund participates in the germination and nurture of opportunities on a continuous, real time basis, greatly enhancing its ability to create and shape the transactions to its objectives and more importantly, increasing the chances of a solid start. ProFund is universally appreciated as a very engaged Board member: well informed, in close contact with other Board members, management and other relevant parties, and willing and able to actively participate beyond formal Board meetings as necessary.

No technical assistance capabilities: The question of whether ProFund would have benefited from technical assistance capabilities – either resources for funding TA and/or in house capacity to deliver TA – is one of the more controversial issues considered, and strong arguments are made on both sides. On balance, we have concluded that ProFund would have and could still benefit from some funding for: (1) very limited internal capacity building of its own, such as data collection and dissemination; (2) more systematic advocacy on regulatory matters; and (3) resources to fund narrowly defined assessments or evaluations by third parties, for example of MIS needs or product development and costing. However, more generally we believe that ProFund has benefited from the clarity of agenda and identity provided by the lack of any significant TA function, either funding or delivery. Among the principle reasons is the more confused dynamic that characterizes the relationship when one party is both pressing for performance as an investor and at the same time responsible for articulating, financing and/or overseeing efforts to remediate performance problems. Most of ProFund's investments have required substantial TA, and ProFund was fortunate to be able to facilitate access to high quality TA, primarily from Accion and IPC. Its ability to maintain an arms length from the TA process has been of benefit both to its own investors, the MFIs and ultimately the TA providers themselves.

High quality management: It would be surprising if we were to identify mediocre management as a critical attribute, but we nevertheless thought it worth mentioning the

obvious to emphasize the importance of a diligent, disciplined search for high quality management for the fund. Those conducting the search, presumably key shareholders and sponsors, must be committed to finding a manager who is both highly capable and likely to operate with a high degree of independence. A very commonly stated opinion across all types of interlocutors is that ProFund was extremely fortunate in finding a manager of the caliber of Alex Silva – despite our best efforts it was difficult to elicit critical comment – and those participating in the search are to be commended for their diligence and clear commitment to the broader interests of the fund and the industry, including their willingness to craft a creative and attractive compensation package.

Among the critical attributes that ProFund’s manager brought to the table were:

- Strong and demonstrable commitment to and linkages with the region;
- The credibility and stature with respect to finance and business (not necessarily microfinance) to assert own judgements;
- Communications and diplomatic skills necessary to manage a diverse board and implement an independent course of action; and
- Ability to maintain a sharp focus and respond well to a concrete performance based structure.

Key ProFund weaknesses

Narrow focus/tight staffing: As noted above, the flip side of ProFund’s clear focus and tight cost control is that it has not done a number of things that might have further increased its impact. Specifically, its collection and dissemination of data and of its experience has been limited and ad hoc rather than systematic; its “cross-fertilization” efforts while not inconsequential, have also been sporadic and ad hoc; it has dropped items from its agenda that were perhaps too challenging or might require large up front investments of time in R & D such as greater penetration of Brazil and Mexico; the internal staff of OMTRIX has been stretched and unable to develop depth; and it has been unable to systematically engage regulatory constraints on the sector. We believe that these limitations had their greatest impact on ProFund’s secondary objectives of supporting the development of the industry and of other funds, while its tight focus and staffing has served it well with respect to its primary objective of assembling a good portfolio of investments and managing and supporting those investments actively and effectively.

Conflict between nurture and return: There has been some concern expressed that ProFund has been handicapped by a built in contradiction between its goal of generating returns for investors and its commitment to nurturing its investees *as development finance institutions*. Examples cited have been an inadequate attention to exit at entry, in some cases a reluctance to push management hard reflecting a commitment to work with local management versus value maximization, and failure to exit at good opportunities (BancoSol) which reflects a general problem that an exit must not only be financially attractive but involve the “right” kind of investors as well. In this view, the long term benefits to the sector of pushing hard for value maximization regardless of its effect on an

individual institution will far outweigh the short term effects of mission drift or the disappearance of a leading institution.

Minority stakes: There has been some limited criticism of ProFund's strategy of taking minority stakes and depending on its influence with management and informal collaboration with other shareholders to achieve its goals and confront specific situations. While in theory larger stakes may have enabled ProFund to push its agenda through more directly and rapidly and operate more like a traditional venture capital investor, it would appear to have raised three problems in the absence of other changes in ProFund or the environment in which it operated. First, as noted above, ProFund did not really have the resources to lead a much more active and hands on role than it has. Second, it does not appear that there would have been many or any opportunities for ProFund to take majority positions, so such a requirement would have placed an enormous handicap on its ability to invest. The need for capital in the sector, while significant, is simply not that large, and alternative sources, while limited, do exist. Finally, given ProFund's size, majority stakes might well have implied an imprudent degree of concentration in the portfolio.

Specialization: There has also been some criticism that ProFund is excessively specialized – by region, by industry – and that this degree of specialization so reduces the universe of possible investees that ProFund is predestined to put together an underperforming portfolio. Proponents of this view note that ProFund invested in perhaps 12 of 40 opportunities, while a more typical venture capital fund might expect to invest in 1 out of 100 opportunities.

Assessment of Performance

The Business Plan

The original market assessment and business strategy for ProFund, as articulated in the MIF investment memorandum of 1994, elaborated a number of critical assumptions and targets for ProFund. This section summarizes the key assumptions and targets, and briefly comments on their accuracy or ProFund performance with respect to each.

Key Findings:

- *ProFund's performance with respect to the goals of the original business plan has been mixed, with high marks for playing a leading and complementary role with other investors and more limited credit for institution building and enabling environment support.*
- *The most significant divergence from the business plan is the response of private investors. While their interest in microfinance is emerging, it is much slower than anticipated and often in the form of new initiatives by mainstream financial institutions rather than purchase of ProFund shares in existing MFIs.*

Assumptions

The business plan included few explicit assumptions about the state of the market in which ProFund would operate. The business plan accurately suggested that the SME and microenterprise markets would likely be served by distinct intermediaries for the foreseeable future, but it inaccurately implied that the SME market would be more evident and attractive to commercial actors. This is consistent with one of the key divergences of ProFund's performance from that contemplated, in that it failed to find and exploit opportunities in the SME oriented sector.

It is noteworthy that there were no assumptions in the business plan with respect to geographical distribution of ProFund's portfolio². While the portfolio achieved admirable diversification, ProFund was unable to engage opportunities in some of the region's largest markets with the largest concentrations of potential end clients.

Both of these points suggest that much has been learned over the past eight years about the difficulty of inducing more services for SME end clients and the difficult conditions that face development finance intermediaries in a number of key markets.

Goals

The business plan articulates six key goals for ProFund's portfolio of investments in financial intermediaries:

² There were, however, investors such as CAF and CABEI that did have subregional investment requirements.

- Focus on SMEs and microentrepreneurs as end clients.
- Achieve improved capabilities of portfolio companies to serve end clients both qualitatively, in terms of range of services, and quantitatively in terms of scale;
- Increase private investment into the development finance sector.
- Encourage a more accommodating and supportive regulatory climate for development finance institutions;
- Encourage the integration of development finance institutions into the liquidity support system; and
- Work in a complementary fashion with other like-minded investors.

Overall, ProFund's achievements with respect to these goals has been mixed.

ProFund's lack of involvement in the SME sector has been discussed. At the other end of the spectrum, ProFund generally receives very high marks for working well, and in a leading role, with other investors, making unique and critical contributions to the success of such collaborative efforts.

On the other four measures, ProFund's results fall somewhere in-between. Its success in promoting an expansion in the scale and scope of services to end clients has not been dramatic: scale of operations has kept pace with that of the rest of the Latin American sector and the scope of services has increased in some cases due to ProFund's efforts to encourage "transfer of technology" among its investees, albeit slowly.

ProFund has engaged regulatory authorities on a number of occasions to advocate for changes supportive of its investments and the industry, and appears to have brought some additional credibility and stature to such interventions as an equity investor backed by respected institutions. But again, the impact has been marginal or evolutionary. And with respect to liquidity support, ProFund has confirmed and constructively responded to an important fact: given the systemic and macroeconomic challenges facing the region, domestic "liquidity support systems" are unlikely to provide a reliable source of support in times of stress, and external support from outside sources, most immediately investors such as ProFund, will be required.

Finally, as already noted, the level of interest of private equity investors in the microfinance sector during ProFund's life has been disappointing, if in retrospect understandable "Non-traditional" shareholders – non-traditional, that is, in terms of microfinance – have participated in a sporadic and ad hoc fashion, responding to specific circumstances rather than reflecting a more widespread and generalized appreciation of microfinance as a commercial investment.

Nevertheless, several cases of private investment, both in and outside of ProFund's portfolio, are suggestive of future trends and motivations. In ProFund's portfolio, there are two examples of mainstream commercial banks effectively piloting a microfinance initiative: BanGente and Sogesol. Outside the portfolio is the case of Banco Pichincha, the leading bank in Ecuador, which has created Credife. Banco de Credito in Peru falls in between: originally a minor investor in Mibanco, the bank sold its position in mid 2001 and has since initiated two microfinance pilot projects, one a stand-alone financiera and the other an in-house effort; the results are to be evaluated next year. Other examples have also emerged in the region over the past 2-3 years, such as a BanExpo pilot microcredit project in Honduras and a BanCentro microfinance department in Nicaragua. The picture is therefore not as bleak, in our view, as a review of the investor table might suggest, but private interest is expressing itself more indirectly than originally hoped and anticipated.

Market

The business plan accurately identified the types of institutions in which ProFund would invest: NGOs seeking to become formal financial institutions; new, specialized formal financial institutions dedicated to small or microenterprise finance; and established financial institutions seeking to enter the small business or microenterprise markets, or to enhance their activities in these markets.

Functions

The business plan said little explicitly about what functions ProFund would be expected to perform. In the event, ProFund has developed a range of interventions, both pre and post investment, which have been critical both to the realization of opportunities for ProFund and its coinvestors, and to the performance of institutions post investment. In addition to the basic functions one would expect from any investment fund, these interventions, which are detailed below, include conceptualizing and shaping an institution, assembling a group of like-minded collaborators, meeting with regulatory authorities, plugging management into networks of information and peer support, engaging very actively in the Board, and facilitating or directly providing liquidity support in difficult situations.

ProFund's activity, in light of the business plan's silence on the subject, is an indication of how much has been learned about what is required of an equity investor in this sector since ProFund was conceived.

Instruments

Again, the business plan said little on the subject of the instruments ProFund could utilize, basically because there was a clear understanding that ProFund was to be an equity fund. ProFund has been notably successful in this regard, with nearly all its investments involving common equity. While it could be argued that ProFund could have been and would be served by utilizing on a more routine rather than exceptional

basis a wider range of instruments, including structured debt and preferred shares, the assumption of ProFund's originators that equity would be too challenging to be just one of several instruments appears to have been valid. By and large other investors in Latin America eschew equity, except in the cases of the networks. ProFund has clearly filled a gap and performed a critical function by specializing in equity.

End Client Services

Setting aside the fund's initial ambitions with respect to the small business sector, it would appear that the range of services that it was hoped ProFund investees would offer is gradually being realized. All investees offer short and in many cases medium term credit for working capital or for investment, a number offer some type of credit card, and several offer housing related financing, which was not explicitly cited in the business plan. Many institutions are moving to offer savings and transactions services. On the other hand, leasing has not materialized and, perhaps as another reflection of the SME challenge, the larger transactions contemplated are only slowly emerging. ProFund serves as an effective if sporadic conduit of information about these and other products among its investees and between its investees and several outside networks and other information sources. Overall, we believe that ProFund's role in product proliferation and in "cross-fertilization" among its investees has been limited and largely reactive, reflecting both its limited resources and the generally slow evolution of the industry at large with respect to product development.

Targets

The targets included in the business plan cover a variety of measures: number of clients, portfolio composition, investment period, and an "adequate" return to investors. Portfolio composition appears to have diverged largely because of the SME issue already discussed. The investment period was somewhat overambitious. ProFund vastly exceeded the net new client targets, only in part due to the SME issue. We are unable to judge if the expected return to investors is likely to be adequate.

The Portfolio

Key Findings:

- *ProFund has focused on the upper tier of MFIs, in terms of size and institutional sophistication.*
- *ProFund's investees have achieved better performance in many respects than their peers, while more closely maintaining their focus on their original client population.*
- *While ProFund's investees have registered strong growth, it is commensurate with growth of the industry overall, and there is no sign of industry consolidation to date.*
- *There are several private investment – equity and debt – funds active in Latin America, but ProFund plays a unique role, providing equity and engaged governance by local, well connected management.*

We have attempted to place the ProFund portfolio in broader context by contrasting it in three ways:

- with other microfinance institutions;
- comparing the performance of ProFund institutions with the performance of peer groups over a roughly similar period;
- comparison with other funds.

Portfolio Composition and Performance

The portfolio of ProFund consists of 11 institutions, of which seven originated as NGOs which transformed into formal financial institutions, one was a new financial institution, and three were initiatives of mainstream financial institutions which decided to enter the microfinance market.

Types of Institutions

Type of institution	No.	Names
NGO – formal financial institutions.	7	1.Bancosol, Bolivia; 2.Caja Los Andes, Bolivia; 3.Compartamos, Mexico; 4.Confia, Nicaragua; 5.Finamerica, Colombia; 6.MiBanco, Perú; 7.BancaSol/Genesis ¹ , Guatemala;
New institutions	1	1.Bco.Solidario, Ecuador.
Established financial institutions entering the micro and small.	3	1.Bangente, Venezuela; 2.Sogesol, Haiti; 3.Visión, Paraguay.
Total	11	

Mergers	3	1.BancaSol/Genesis. 2.Confia (Chispa/Servicredit/Interfin) 3. Bangente (Bco. del Caribe/3 NGOs)
<i>1. To date, data of BancaSol/Genesis is not included in the financial reports of ProFund.</i>		

Three of ProFund's investees were created through mergers between different types of institutions, including NGOs, and private commercial banks or finance companies.

This section [presents conclusions](#) based on comparative performance and outreach data for ProFund's portfolio institutions, using data from the MicroBanking Bulletin (MBB) to construct a peer or comparison group. Data was drawn from the MBB Issue 7 of November 2001, which includes data for 59 Latin American MFIs, mostly for end 2000, and the MBB Issue 4 of February 2000, with information on 51 Latin American MFIs, mostly for end 1998. Information for ProFund companies was for October 2001, the most recent available at the time the comparison was undertaken, and December 1998.

For the most part, comparisons are between the MBB's "Latin America – Large" category and the ProFund portfolio, excluding BanGente and Sogesol, which would fall into other MBB categories. It should be noted that the MBB Latin America -- Large category includes a significant number of ProFund institutions: five of eleven in the 2001 report and four of eleven in Feb 2000 report. Thus, the comparisons will tend to understate the difference between the ProFund institutions and the non-ProFund institutions. It should also be noted that the period covered for the ProFund institutions is longer than for the MBB group, with the most recent data for ProFund October 2001 and for MBB December 2000.

As a general matter, the data must be used with caution. Many of the trends and contrasts apparent in the data may be as much a function of the different stages of maturity of the institutions as of any more fundamental differences in management or overall performance. This is particularly true as the data combine entities which are not only in different stages in terms of maturity in one institutional form, but are in fact changing forms. In addition, while the MBB is making great strides, the data are of mixed quality and the sample itself may be less than representative of the sector or subsectors that would provide the best comparison with the ProFund portfolio. Finally, it is of course difficult to ascribe causality to any trend or performance divergences that are observed: did ProFund simply pick the best institutions or did it pick those with high potential and then help them to perform better?

With all these caveats in mind, we nevertheless are prepared to draw a number of conclusions from the data.

- **Selection:** As a general matter, ProFund has clearly chosen the larger, more mature institutions or partners for its investments. ProFund's portfolio is concentrated among institutions classified by the MBB as "Large" and their size, in terms of portfolio or clients, tends to be at or above the average for the Large group as a whole.
- **Industry:** There is no evidence that ProFund's investees, or any small group of institutions for that matter, are coming to dominate the industry and by virtue of their maturity, market share, or other advantages, are discouraging new entrants. New institutions of widely differing types continue to enter, and while ProFund's institutions have seen strong growth in both portfolios and clients, their shares of the industry total as represented by the MBB have not

significantly grown over the past 2-3 years. Needless to say, the industry as a whole continues to serve a fraction of what many observers assume to be the underlying demand for microfinance services.

- Performance: As a general matter, ProFund institutions appear to have performed somewhat better than the industry as a whole, although not dramatically so.
- Target Population: There is no evidence that ProFund investees have moved away from the target market, as crudely measured by average loan size, and in fact, ProFund institutions appear to have hewn more closely than the rest of the industry to their client populations over the period observed.

ProFund's Portfolio compared with Other Investment Funds

Comparing ProFund's activities to that of other private investment funds active in the Latin American microfinance industry reinforces a number of the points gleaned from the MBB data. In particular, ProFund's investees tend to be the more mature and institutionally developed in their markets, both by selection and by virtue of ProFund's efforts. While we were unable to gather specific information on all the investees, it appears that most other investors are much more active in pre-transformation or non-shareholder institutions, a result that one would expect given ProFund's equity focus.³

In addition, this comparison suggests a number of other observations about ProFund's place and role in the industry. First, while there are numerous sources of financing – and bear in mind that the table excludes official investors – sources of equity financing are limited. This is particularly the case for institutions which are unaffiliated with the major networks, which for shareholder institutions currently are Accion and IPC. The only other non-network private equity fund active in the region is the Triodos-Doen fund. While the role of Triodos-Doen is critical, both to the industry and to several of ProFund's investments, its role as a foreign based, global institution differs from that of ProFund. As a general matter, we would suggest that ProFund brings a unique capacity to originate and lead investments and to devise innovative structures and approaches in which it then enlists other investors, including Triodos. Similarly, ProFund's location and focus tend to enable it to be a more active and engaged investor, again to the benefit of other investors.

Second, ProFund has the largest and most diverse equity portfolio of the equity funds. Only Accion has more than half as many equity investments as ProFund and a number of those can be credited to ProFund's efforts (just as ProFund's portfolio has benefited in other ways from Accion's efforts). We believe that this illustrates the body of experience which places ProFund at the head of both the regional and the global microfinance investment industries.

³ Data on specific institutions for Oikocredit and Dexia were not available.

Finally, the population of microfinance intermediaries which are receiving largely commercial financing is large and varied, and in our view presents ample terrain for a dynamic ProFund to continue to operate in building the capabilities of the sector.

Private Equity and Debt Funds for Latin American MFIs

		<i>Primarily Equity</i>				<i>Primarily Debt</i>					<i>Guarantee</i>	
		ProFund	Triodos-Doen	IMI	Accion Gateway	OikoCredit	Dexia	Triodos-Hivos	LACIF	Alterfin	Accion Bridge	OTHER FUNDS
				Network	Network						Network	
Country/MFI	Form					N.A.	N.A.					
BOLIVIA												
BancoSol	<i>Comm Bank</i>	Equity	Debt		Equity							SIDI: Equity
Caja Los Andes	<i>NBFI</i>	Sub Debt		Equity				Debt	Debt			
FIE	<i>Micro NBFI</i>		Debt						Debt			
Prodem	<i>MFI</i>		Debt									
San Luis	<i>Financial Coop</i>											Sarona: Equity
APT										Debt		
FADES										Debt		
FONDECO										Debt		
CHILE												
Credicoop	<i>Coop</i>		Debt									
Propesa												Deutsche: Guarantee
COLOMBIA												
Finamerica	<i>NBFI</i>	Equity	Equity		Equity						Guarantee	
WWB Affiliates	<i>NGO</i>											Deutsche: Guarantee
Bco de la Mujer			Debt									
DOMINCAN REP												
ADOPEM			Debt						Debt			

		ProFund	Triodos-Doen	IMI	Accion Gateway	OikoCredit	Dexia	Triodos-Hivos	LACIF	Alterfin	Accion Bridge	OTHER FUNDS
ECUADOR												
Ecuatorial	<i>NBFI</i>			Equity								Doen: Equity
Maquita										Debt		
Fideicajas	<i>Coop Federation</i>							Debt				
Solidario	<i>Comm Bank</i>	Equity	Debt		Equity	Equity		Debt	Debt		Guarantee	SIDI: Equity
EL SALVADOR												
Calpia	<i>NBFI</i>		Debt Equity	Equity								Doen: Equity
GUATEMALA												
BcaSol/Genesis	<i>Comm Bank</i>	Equity	Equity		Equity							
HAITI												
SOGESOL	<i>NBFI</i>	Equity			Equity							
Micro Credit National	<i>NBFI</i>			Equity								
SHEC	<i>Credit Union</i>											Sarona: Equity
HONDURAS												
Fucach	<i>Coop Federation</i>		Debt					Debt				
MEXICO												
CAME	<i>NGO</i>									Debt		
Compartamos	<i>NBFI</i>	Equity			Equity							
FinComun												Deutsche: Guarantee

		ProFund	Triodos-Doen	IMI	Accion Gateway	OikoCredit	Dexia	Triodos-Hivos	LACIF	Alterfin	Accion Bridge	OTHER FUNDS
NICARAGUA												
CONFIA	<i>NBFI</i>	Equity	Equity	Equity								Sarona: Equity
FINDE									Debt			
BancoSur	<i>Coop Bank</i>		Equity									
FDL - Nitlapan	<i>NGO</i>									Debt		
Niebrowski	<i>NGO</i>									Debt		
Prestanic	<i>NGO</i>									Debt		
PARAGUAY												
Vision	<i>NBFI</i>	Preferred Equity										
PERU												
MiBanco	<i>Comm Bank</i>	Equity			Equity			Debt	Debt		Guarantee	
Rural San Martin								Debt				
Caja Credinca								Debt				
Rondas Campesinas										Debt		
Yanapay										Debt		
Fondesurco										Debt		
IFOCC										Debt		
Confianza									Debt	Debt		
Proempresa	<i>MFI</i>		Debt Equity						Debt			
Cajas Municipales: Arequipa Tacna								Debt	Debt			
VENEZUELA												
BanGente	<i>Comm Bank</i>	Equity			Equity							

Other funds include Doen, SIDI and Sarona. Information was unavailable from Dexia and Oikocredit.

Where did PF not invest

Finally, in addition to looking at where ProFund did invest and how those investments performed relative to peer groups of other institutions or other investors, we also compiled a list of some of the occasions where ProFund took a decision not to invest in a specific opportunity, and the primary reason given by ProFund, the investee and/or a related party for that decision.

- SME very difficult, too big (Balcarce Argentina, Indes Chile)
- Focus on market leaders (BPE Dominican Republic)
- Consumer lending (Ban Tech, Financiera Trisan Costa Rica)
- Second story funds looking for concessional funds (CFN Ecuador)
- Government interference (Jamaica Workers' Bank)
- Existing shareholders exercise option (Improsa Costa Rica)
- Management flux (Calpia El Salvador)
- Too late in ProFund lifecycle (FUSAI El Salvador)
- Ambivalent, unready NGOs (FINCA various)
- Country portfolio limit (FIE Bolivia)
- Risky business model, such as rural concentration (Agrocapital)

Key Roles and Functions

Key Findings:

- *ProFund has flexibly and creatively developed specialties in its quest to identify and execute successful transactions, filling critical gaps for both the industry and individual MFIs.*
- *Among these, ProFund has shown strong leadership in the critical areas one might expect of an investment fund, such as structuring transactions, assembling like-minded shareholders, and helping arrange TA.*
- *ProFund has also identified and responded to needs in other, less obvious but still critical areas as well, including conceptualizing and creating the institutions themselves, directly providing short term liquidity support, and providing sustained and informed board level oversight of operating costs.*

ProFund has taken a variety of approaches to sourcing, structuring and then managing its investments, and has developed a range of functions and roles, some contemplated in the original Business Plan and some not. The table below summarizes the main functions and where they were applied.

Pre-Investment

Vision: In many cases, a critical role for ProFund has been articulating and selling a “vision” for the institution which coherently combines both development and financial objectives and doing so with credibility in the eyes of both commercially oriented investors (and key third parties, like regulators) and developmentally oriented investors, such as NGO sponsors. In many cases, ProFund has found that the major obstacles to transactions moving forward are such “cultural” disconnects, for example, NGO fears of losing control which may reflect a fear of mission creep, rather than more technical issues such as serious deficiencies in operational capabilities. ProFund’s ability to play this role appears to have been critically dependent on three factors: the financial credibility arising from its clear, sole agenda as an investor; the development credibility gained by its backing by entities known and respected for their commitment to development; and the credibility and capabilities of its manager.

Structure and Shareholders: ProFund’s due diligence focuses strong emphasis on managerial capabilities and the objectives of sponsors and major (prospective) shareholders, and ProFund considers the local investors to be the linchpin of any transaction. If these factors are promising, ProFund then focuses on financing needs and as necessary, attempts to assemble a shareholder group to provide fresh capital. ProFund has played a central role in this process of bringing together a shareholder group in a number of transactions and in several cases has gone well beyond this, to conceptualize and articulate a business concept and structure and sell it a core group of sponsors.

Key ProFund Functions by Transaction

	BancoSol	Solidario	BanGente	Los Andes	Compartamos	CONFIA	Finamerica	BcaSol/Genesis	MiBanco	Sogesol	Vision
Conception/structure			X			X		X	X	X	
Assemble shareholders	X	X				X		X			
Credibility					X	X			X	X	X
Facilitate TA	X	X	X							X	
Institutional focus	X	X	X		X				X		
Strategy			X								X
Management oversight	X	X	X			X	X		X		X
TA oversight			X							X	
Cost control	X	X							X		X
MFI networking	X				X					X	
New investors/financing				X	X	X	X		X		X
Liquidity support	X	X		X	X	X					
Regulatory advocacy		X					X		X		

Credibility: In a number of cases, ProFund has been able, due to the credibility and stature it wields as an equity investment fund with strong international backing by reputable institutions, to legitimize an institution/initiative in the eyes of private investors or of local regulatory authorities or government officials.

Facilitate TA: ProFund has identified TA needs of institutions and in some cases, convinced sponsors and/or TA providers that the effort will be worthwhile and then helped to shape and oversee the TA provided. A summary of the TA relationships associated with ProFund’s investments suggests both how critical subsidized TA continues to be even to these relatively mature institutions and how limited the pool of providers is.

Technical Assistance Providers

	Current
BancoSol	Accion
Bco Solidario	Accion
BanGente	Accion
Caja Los Andes	IPC
Compartamos	Accion
CONFIA	IPC
Finamerica	Accion
BancaSol/Genesis	Accion
Mibanco	Accion
SogeSol	Accion
Vision	IPC

In addition to these pre-investment roles, ProFund has often taken a lead role in the negotiations themselves and has shared documentation developed in other transactions. In most cases, ProFund will take the lead in the due diligence process, although it has not infrequently coordinated with others (SCDF with Solidario, CAF and MIF with BanGente, Accion with Sogesol). ProFund has been very successful at devising effective, low cost documentation. The primary investment document is the Shareholders’ Agreement, which serves the function of a Subscription Agreement and any Options Agreement as well. Legal costs are kept to a minimum, estimated at \$3,000-10,000 for an equity investment, helping keep total costs well below the estimate of up to \$50,000 cited by other participants in the industry.⁴

⁴ See Tor Jansson, “Microfinance: From Village to Wall Street”, IDB Micro, Small and Medium Enterprise Division, November 2001 citing Robert Pouliot.

Governance Initiatives

Institutional Focus: In a number of cases, ProFund has served as the stabilizing element on the Board, helping the Board and management continue to strike an appropriate balance between financial and development objectives.

Strategy: ProFund has been active in two cases in precipitating or shaping deliberations on fundamental business strategy, for example, reconfirming the commercial nature of the institution or exploring what new form an institution might take as it matures.

Management Oversight: In two cases, Boards were required to take significant steps to change management or to prevent ownership changes that they felt would not be in their or the institution's interest. ProFund was an active participant in these efforts. In other cases ProFund was actively involved in providing guidance to management.

TA Oversight: ProFund has been able, because of its independence, to serve as a constructive critic of third party TA efforts, supplementing and reinforcing management's own observations.

Cost Control: If there is one operational issue on which ProFund appears to have developed a particular emphasis and specialization, it would appear to be cost control and operating efficiency.

In working at the board level, ProFund does not rely upon special supermajority voting requirements, relying instead on active and engaged participation to help shape Board consensus. As noted above, ProFund derives much of its influence on the Board from two characteristics: its ability to "bridge the culture gap" between commercially minded and socially minded investors, being seen by both camps as able to understand and respect their objectives and considerations, and secondly the clarity and transparency that derives from wearing only one hat.

Supplemental Functions

MFI Networking: In a number of cases, ProFund has taken concrete steps to connect investees to peers or other sources of information that is relevant to a specific issue that they are confronting, or else has been explicitly credited by the investee for providing them with a window on the broader microfinance industry.

New Financing: ProFund sees one of its primary functions as serving as an entry point to a network of potential sources of financing, both as part of the initial investment and subsequent to ProFund's investment.

Extraordinary Functions

Liquidity Support: ProFund has been surprisingly active in providing short term liquidity support to its investees; five of the eleven institutions have turned to ProFund as a "lender

of last resort”, highlighting the deficiencies of the environments in which they operate and suggesting that resources for such support must be factored in to the structure of such a fund.

Regulatory Issues: ProFund has had an impact in regulatory areas in two ways: first, through direct intervention with the authorities to advocate for specific policies (Finamerica, Mibanco, Solidario); second, by providing credibility and stature to its investees thereby helping to secure regulatory approval (CONFIA). As a general matter, however, ProFund has not had the resources to involve itself more deeply in general regulatory structure issues.

Part 2: Looking Forward

Development Finance: Regional and Global

Key Observations:

- *Questions of whether microfinance is commercially viable and has a role to play in financial systems have given way how best to integrate microfinance into financial systems and more rapidly increase scale and scope.*
- *Efforts focus on four key areas: the institutional forms microfinance might take, and how these relate to increased private investment; how new or expanded investment funds can help relax the capital and governance constraint; how to proliferate sources of technical assistance, especially locally based and with IT capabilities; and engendering more hospitable enabling environments.*

As noted at the outset, the microfinance industry that exists today is markedly different from that which existed when ProFund was conceived and began operating, and we would argue that that transformation has been, at least in part, due to ProFund's own efforts. Given this transformation, however, the question naturally arises of whether ProFund has served its purpose and the industry is now sufficiently mature to proceed without such targeted interventions. This question will be addressed in two parts: first, in this section, a brief look at where the industry is along four key dimensions and what support it continues to require, and second, in the next section, a look at what resources and assets ProFund has that might be relevant to any continuing needs.

ProFund, in concert with other industry supporters, has achieved an important objective over the last ten years: conclusively demonstrating the commercial viability of microfinance. What has not been demonstrated is that the activity offers sufficiently competitive returns to attract a level of capital adequate to support a substantial expansion in scale. Nor have the institutional forms that the industry will take been definitively articulated, although we know much more about the range of options and their respective strengths and weaknesses.⁵ Finally, the industry continues to move up a relatively steep stretch of the technology learning curve, and is still exploring and testing how IT and communications technologies might yet transform the cost structure and infrastructure of the industry.

As noted above, a key consequence of this mix of accomplishments and residual uncertainties is that the flow of private capital into the industry is lagging well behind where it was hoped to be at this point, and well below the needs of the industry. Specifically, while there are gaps in terms of access to debt, and particularly as ProFund's experience has demonstrated, short term liquidity support, the critical shortfall exists with respect to equity capital.

⁵ Another process still under way is the differentiation of microfinance between its more commercially oriented and more developmentally oriented currents. However, since ProFund's emphasis is clearly in the commercial sector, this will not be discussed here.

Microfinance Institutions

Even if this capital constraint could be relaxed, however -- and there are observers, such as CGAP, who would argue that the constraint either doesn't now exist or soon won't -- a question remains of which institutional vehicles, and in the short term specifically which institutions, would effectively absorb it? In this regard we believe that ProFund's experience points to four, not mutually exclusive, options:

First, there now exist, in part through ProFund's efforts, a cadre of leading microfinance institutions in many of the markets in Latin America, and a number of them could potentially expand into some of the unserved markets as well. One approach, then, is to focus on these leaders, ensuring that they have the additional capital and other forms of support necessary to complete their move into the mainstream of the financial sector and consolidate more of the microfinance resources under their umbrellas.

Second, there exists some opportunity to continue to create such leaders by working with other NGOs that are not as far along in the process of transformation but show good potential. A very wide range of industry observers have noted that the pipeline of promising NGOs is running dry. However, bearing in mind that ProFund's entire portfolio consists of ten equity investments, we do not consider it far-fetched to expect that five or so additional opportunities might emerge in the next few years, especially given the lack of activity to date in Mexico and Brazil. This approach does pose potential challenges to ProFund's role and identity that should be dealt with: When does remedial work with a broader group of lower tier NGOs begin to change the nature of ProFund's work? How to refill the pipeline while preserving performance standards?

Third, ProFund has also demonstrated, both directly with a number of its own investments and indirectly in several cases that may well have been inspired by its accomplishments, that mainstream financial institutions are increasingly willing to seriously -- committing capital, staff and other resources -- explore how microfinance fits into their business strategy. In many respects, banks are best positioned to provide microfinance services, typically enjoying substantial advantages in, for example, cost of funds, established branch networks, back office infrastructure, and complementary products. ProFund has experience with the types of considerations that banks face in making such a decision and has experience with a variety of approaches to meeting their needs. ProFund is also well aware of some of the things that might make banks more willing to move into the industry and is well placed to work with others to develop some of these features.

Finally, there is an argument to be made that despite all the advantages that commercial banks have, there is ample evidence that they are all trumped by the cultural mismatch between commercial banking and microfinance, and that however much sense the combination may make on paper, it is rarely successful

in practice. This line of thinking leads to the special purpose bank or NBFIs which sees microfinance as its strategic niche. Here, too, ProFund has developed experience with at least two distinct models (Ecuador and Paraguay) and is well placed to further develop this avenue.

In conclusion, we believe that while the traditional NGO pipeline may or may not be running dry, the overall pipeline of potential commercial microfinance institutions is probably richer and more dynamic than ever, and requires a sophisticated and experienced support and guidance.

Investment Funds

A second dimension is the channels through which equity might reach the industry. In principle, ProFund has smoothed the way for new funds, providing benchmarks and “best practices” from which to design and implement new funds. However, it is noteworthy that there are no new funds in preparation that follow the ProFund model with respect to focus and independence. This may be largely a cost issue, but may also reflect different diagnoses of what the industry requires. Whatever the reason, it is difficult to review the role that ProFund plays in the Latin American industry and conclude that it is not a critical, ongoing requirement for the industry in all regions.

Another aspect of the fund issue that warrants more intensive exploration is whether there are opportunities to expand the pool of patient capital by reaching out to socially responsible investment communities more systematically, and perhaps devising structures whereby such funds could help provide liquidity to less patient investors.

Technical Assistance

We have already noted both the good quality of the technical assistance available in the region and the desirability of expanding the pool of providers, particularly as existing providers expand their own equity investment roles. A further issue is the trend towards increasing the technological content of TA, and the question of how to ensure that the microfinance industry is getting access to sufficiently sophisticated IT resources.

Enabling Environment

Finally, despite efforts in a number of countries to craft more accommodating environments for microfinance, enabling environments remain difficult; governments, at the end of the day, just don’t appear to care very much. This will continue to pose a major impediment to private sector commitment, as a fear of policy volatility increases the perception of risk.

Role of ProFund / OMTRIX

Key Findings:

- *ProFund/OMTRIX capabilities intersect in several key areas with the industry needs outlined above, and strong efforts are warranted to preserve and disseminate these capabilities for the benefit of the regional and global industries.*
- *ProFund has accumulated unique experience in working with private institutions exploring and piloting initiatives in microfinance.*
- *ProFund represents a standard and a benchmark against which new funds should be designed, not necessarily to replicate ProFund in every respect in every situation, but to provide a deliberate, disciplined framework for designing new funds.*
- *An active and engaged ProFund plays a unique role in the Latin American industry which no other actual or prospective participant can replace for the foreseeable future.*

In looking for the possible relevance of ProFund in the context sketched out in the preceding section we have relied primarily on the demonstrated value that it has provided in its transactions to date, drawing on the previous discussion of ProFund's key roles and functions. We would highlight three as being areas where either OMTRIX has unique experience which should be preserved and made available to the industry or where ProFund is playing a role which the industry continues to need and consequently where ProFund should continue and build on its engagement.

Private Sector Involvement: OMTRIX appears to have accumulated substantial and unique experience in conceptualizing and navigating the more indirect and creative paths that will be required to engage the private sector in large scale involvement in the microfinance industry. ProFund has to this point gained direct experience with a number of models, including commercial bank subsidiaries and virtual banks, and has closely observed the process by which a bank takes the decision to make an independent commitment to the sector.

Fund Management: OMTRIX has accumulated invaluable experience in the management of microfinance investment funds. Issues such as proper staffing, working with NGOs, establishing and maintaining credibility, and sourcing and screening deals in a cost effective manner are all areas where any new funds should have access to OMTRIX's experience.

Independent, Engaged Governance: ProFund has a solid reputation in the region for independent and high value, engaged governance. This carefully accumulated capital is well worth preserving, particularly as there are no immediate prospects of similarly focused, independent funds emerging for the foreseeable future. The withdrawal of ProFund from the scene would, in our view, leave a critical gap which would have negative consequences for the regional industry.

As a more general matter, ProFund / OMTRIX should be supported in facilitating the emergence of similarly focused and independent capabilities in regions where it will not itself operate, along the lines suggested above.

Conclusion

We believe that in the ten years since it was first conceived ProFund has had a major positive impact on global commercial microfinance, both in defining the industry, supporting individual MFIs, and identifying effective approaches and models for investors and investment funds. In all three areas, we believe that ProFund, contributing in unique ways to the complementary efforts of many institutions, can point to real breakthroughs and accomplishments. Most concretely of all, of course, is the impact of ProFund investees on their 350,000 borrowers, the many others in their families and communities, and still others through imitators and collaborators.

ProFund's ability to impact these lives depends on two assets: the relationships and portfolio of ProFund, and the expertise and insights of its management. Both of these are valuable to the industry and should be preserved and enhanced. ProFund's work in Latin America should continue, and its management given the resources to disseminate its approaches and experience more widely.

Finding the best ways to accomplish these tasks is the next challenge for ProFund investors and management. These are the next steps in the process of realizing the hopes and ambitions that motivated the visionary project that became ProFund.

Appendix : Acronyms

BPE	Banco de la Pequena Empresa
BG	BanGente
CABEI	Central American Bank for Economic Integration
CAF	Corporacion Andina de Fomento
CD	certificate of deposit
CDC	Commonwealth Development Corporation
CGAP	The Consultative Group to Assist the Poorest
DAI	Development Alternatives, Internatioonal
DFI	development finance institution
EBRD	European Bank for Reconstruction and Development
FI	financial institution
FINCA	Foundation for International Community Assistance
FUSAI	Fundacion Salvadorena de Apoyo Integral
IDB/BID	Inter-American Development Bank
IFC	International Finance Corporation
IPC/IMI	Internationale Project Consult/Internationale Micro Investitionen
IT	information technology
LA	Latin America
LACIF	Latin American Challenge Investment Fund
MBB	MicroBanking Bulletin
MDB	multilateral development bank
MEDA	Mennonite Economic Development Association
MF	microfinance
MFI	microfinance institution
MIF/FOMIN	Multilateral Investment Facility (IDB)
MIS	management information system(s)
MSE	micro and small enterprises
MT	medium term
NBFI	non-bank financial institution
NGO	non-governmental organization
OSS	operational self sufficiency
PAR	portfolio at risk
PF	ProFund
PF2	ProFund 2 (follow on initiative)
R&D	research and development
SBFI	small business financial institution
SCDF	Seed Capital Development Fund
SG	Sogesol
SIDI	Societe d'Invest et de Developpment International
SME	small and medium enterprise
SPV	special purpose vehicle
SRI	socially responsible investment
TA	technical assistance
USAID	US Agency for International Development