THE LATIN AMERICAN MICROFINANCE INDUSTRY

How Does It Measure Up?

Tor Jansson
Miguel Taborga

FOREWORD

Microfinance is growing up fast. More and more microfinance institutions (MFIs) are resorting to financial markets, private lenders and depositors for their financing. While non-profit organizations still outnumber full-fledged intermediaries by a wide margin, growth is clearly concentrated among those institutions that have managed to fund themselves in the markets. But markets can function only if they are able to assess risk. They thrive on transparency. Lenders and investors will not gamble their money on an industry about which they know very little.

Reasoning along these lines prompted the Inter-American Development Bank (IDB) and MicroRate, a private firm specialized in evaluating microfinance institutions, to undertake a project to establish performance benchmarks for the Latin American microfinance industry. Before the project was begun, it was virtually impossible to obtain objective information about microfinance institutions. To the extent that data were available at all, vastly different accounting practices made them difficult to compare. The project set out to change this. It set itself the goal of providing consistent, reliable information about microfinance institutions that donors as well as commercial creditors and investors could use to make funding decisions. As a secondary target, the project also aimed at microfinance institutions themselves. We hoped that providing them with the ability to compare themselves to their peers would influence how they develop; it would encourage the laggards to catch up with the industry leaders and it would affirm the course that successful institutions have been taking.

The project started in 1996 with a pilot phase, carried out by MicroRate and funded by the Swiss Development Corporation (SDC). At the IDB's initiative, in 1997 the effort was expanded from 3 to 18 and eventually 21 MFIs. Additional funding was also provided by the Argidius Foundation, the SDC, and USAID. This report presents results through 1998—but this is only the beginning. Since 1998, MicroRate has continued to evaluate many more microfinance institutions, often at the request of the institutions themselves. As a result, donors, creditors, and investors alike have available to them today a wide array of financial information about an ever larger number of microfinance institutions. We hope that this will eventually contribute to increasing the flow of commercial sources of funding to the microfinance industry.

Antonio Vives
Inter-American Development Bank

Damian von Stauffenberg
MicroRate

Contents

The authors would like to express their appreciation for the comments and suggestions received from numerous colleagues in the Inter-American Development Bank as well as from Richard Rosenberg of The World Bank, and Damian von Stauffenberg of MicroRate. The authors are especially grateful to Geoffrey Chalmers for his extensive work on the numerical analysis contained in the document.

The authors are respectively consultant and financial specialist working for the Microenterprise Unit of the Inter-American Development Bank. They can be reached at torj@iadb.org and miguelt@iadb.org. The views and opinions expressed herein are those of the authors and do not necessarily represent the official position of the Inter-American Development Bank. All errors and omissions are the sole responsibility of the authors.

© 2000 Inter-American Development Bank

ISBN: 1-886938-83-0

Cataloging-in-Publication data provided by the
Inter-American Development Bank
Felipe Herrera Library
Jansson, Tor.
The Latin American microfinance industry: how does it measure up?/Tor Jansson, Miguel Taborga
p.cm.
1. Financial services industry—Latin America—Investments—Evaluation. 2. Small business investment companies—Latin America—Evaluation. 3. Microfinance—Latin America. I. Taborga, Miguel. II. Inter-American Development Bank. III. Title.
332 J26—dc21

EXECUTIVE SUMMARY

This publication aims to help donors, creditors and investors evaluate the performance, condition and risk of individual microfinance institutions in Latin America and the Caribbean, in hopes of strengthening the microfinance industry and building the microenterprise sector. The document addresses an information gap about the microfinance industry. It provides concrete and reliable reference values for several benchmark indicators relevant to the industry. Specifically, it explores nineteen benchmark indicators in six major categories: profitability, capital, asset quality, liquidity, productivity, and growth. These indicators offer a relatively complete overview of an institution's financial and operational structure, performance and condition. Moreover, the report represents an attempt to assign reference values to these indicators for the microfinance industry in Latin America and the Caribbean.

The publication summarizes the results of a project conceived jointly by the Microenterprise Unit of the Inter-American Development Bank (IDB) and MicroRate, a private firm that specializes in evaluating microfinance institutions. In this project, a number of leading microfinance institutions (MFIs) in Latin America, representing a range of countries, sizes, and types of institutions, agreed to open their books and allow on-site visits for an independent evaluation by MicroRate. The evaluation methodology of MicroRate uses both quantitative and qualitative elements, and emphasizes portfolio quality, information systems and management. It further adjusts for differing accounting practices and backs out subsidies.

Key findings. Among the best-known microfinance institutions in Latin America, there are examples of efficiency, profitability, and sustainability that can serve as important benchmarks for other institutions striving to achieve similar goals. These "top-performers" in many cases compare favorably with the region's conventional commercial banks in such areas as loan delinquency rates, and perform even better in such areas as return on assets and return on equity. This is an important achievement, and provides a role model for those institutions that are still striving for a more competitive and efficient mode of operation.

In other areas, in particular the efficiency-related indicators, however, a different pattern emerges. A few of the best-performing institutions compare well with the banking sector, but the rest of the group lags well behind. This is not surprising, given the small size of microenterprise loans and the high personnel costs associated with microfinance credit methodology. The report makes clear that—with a few notable exceptions—microfinance institutions are quite distinct from commercial banks in terms of liquidity, capital, and asset and liability structure. These differences originate primarily from the fact that most MFIs do not accept deposits, and that some of them receive subsidized funding.

The report finds important patterns with regard to institutional form, size, and maturity. NGOs tended to have considerably lower debt-to-equity ratios, and relatively higher measures of solvency and liquidity. Regulated microfinance institutions, on the other hand, resemble commercial banks more closely, and are characterized by higher leverage, lower measures of solvency, and higher measures of efficiency. In other cases, there is little or no distinction between different institutional forms. For example, NGOs and regulated MFIs are characterized by similar performance in terms of asset quality. Size and maturity of the institution is an important factor in explaining the different rates of growth of microfinance institutions. As would be expected, the smaller and younger institutions (mostly NGOs) on the whole enjoyed higher rates of growth than the relatively larger, more mature institutions.

BENCHMARKING THE MICROFINANCE INDUSTRY

Reliable information on the performance and condition of individual microfinance institutions is in demand, but has so far proven difficult to obtain. Donors, creditors and investors alike need timely, objective and reliable information on actual and potential client institutions. This publication, takes a first step in addressing the information gap by providing concrete and reliable reference values for several benchmark indicators relevant to the microfinance industry.

Good information is all the more important because the microfinance industry is undergoing a gradual but fundamental transition toward mainstream finance. This transition holds the promise of increased access to commercial sources of financing that will allow the industry to continue its current expansion. However, the transition will also put new demands on the industry. In order to attract these new sources of funds, the microfinance institutions will have to provide a high degree of disclosure to potential creditors and investors.

Disclosure can pose a significant challenge to many microfinance institutions, whose historic reliance on donor financing and internally generated funds has not encouraged a general culture of transparency that includes standard accounting and financial practices. In the long run, however, as donor resources become ever scarcer, few institutions will have the luxury of not adopting such a culture.

The Value of Benchmark Indicators

In their quest to achieve and benefit from greater transparency, microfinance institutions confront a crucial problem: the lack of industry-wide benchmark indicators. Without such indicators, there are no meaningful reference values that can be used by donors, creditors and investors in evaluating the performance, condition and risk of individual institutions.

Standardized benchmark indicators can have several benefits for the microfinance industry:

- They help management of microfinance institutions identify and strive to improve relative weaknesses, and make more informed decisions.
- They enhance the information available to potential creditors and investors. This, in turn, serves to enhance the flow of risk capital and other forms of financing to the industry.
- They assist supervisory authorities in designing appropriate pruden-

tial norms for institutions involved in microfinance, which is key to ensuring the long-term viability of the industry.

Pitfalls in Comparing Institutions

Comparing institutions must be done carefully, because no two institutions are perfectly alike in their circumstances and conditions, externally or internally. Unless the institutions operate in the same market they will be affected by different external factors, such as economic policy and regional conditions. This will quite naturally affect their financial and operational results. Moreover, internal strategic decisions, such as those regarding targets on average loan size, average loan terms, or urban versus rural focus, will also affect the ability of the institutions to minimize costs, increase efficiency and generate profits. Such decisions are generally based on the mission of the organization, which in the case of microfinance institutions often includes significant social objectives. Consequently, it is a highly subjective exercise to compare and judge microfinance institutions based on financial and operational indicators, because in certain cases their performance and characteristics may be the result of deliberate choices regarding social and financial objectives. However, from the point of view of a potential creditor or investor, a reference based on financial and operational indicators may be critical when making a decision.

IDB/MicroRate Project on Benchmarks for Microfinance

Objectives of the IDB/MicroRate Project

The objectives of the IDB/MicroRate project on performance indicators for microfinance include (1) establishing benchmark performance indicators to enable comparison between microfinance institutions, (2) raising the capacity of microfinance institutions to manage and use financial information, and (3) promoting the development of strategic plans to obtain commercial financing. This report is intended to publish the results relating to the first objective; however, it is expected that the use of the publication will have an important influence on the other two objectives.

Selection Criteria and Participating Institutions

Initially, the IDB and MicroRate conducted a preliminary screening of 42 MFIs in the region, using a set of criteria that included the following considerations:

- The institution's need for this type of collaboration.
- The institution's commitment to financial sustainability and transparency.
- The quality of the institution's information systems.
- Diversity of sample in terms of institutional type, credit methodology, and country.

Of the original 42 institutions pre-selected, a total of 18 institutions were contacted and agreed to participate in the project. The final selection of institutions consisted of a representative range of countries, sizes, and types of institutions, including village banks, non-profit foundations, non-bank financial intermediaries, and supervised commercial banks. The participating institutions represent a wide range of countries, legal forms, asset sizes and levels of management sophistication. In general, however, they are recognized as industry leaders in their countries.

The largest participating institution is BancoSol, a Bolivian commercial bank specializing in microfinance, which has 568 employees and a loan portfolio of nearly $75 million. The smallest loan portfolio ($935,000) belongs to FINCA in Nicaragua, which uses a village banking model. FAMA, in the same country, has the smallest portfolio in terms of number of outstanding loans (5,036). Average loan size ranged from a low of $68 for Compartamos in Mexico to a high of $1,774 for FUCAC in Uruguay. FUCAC, which represents a federation of cooperatives, has the fewest employees (30) in the group. Table 1 lists all of the principal descriptive characteristics of the participating institutions.[1]

Table 1. Characteristics of Participating Institutions, 1998

Institution	Country	Super-vised?	Assets (US$ '000)	Gross Portfolio (US$ '000)	Equity (US$ '000)	Number of loans outstanding	Average Loan Size
BancoSol S.A.	Bolivia	Yes	$90,714	$74,948	$13,359	81,555	$919
CMAC Arequipa	Peru	Yes	$34,408	$24,682	$3,482	37,280	$662
Caja Los Andes S.A.	Bolivia	Yes	$31,730	$27,392	$3,683	34,838	$786
FUCAC	Uruguay	Yes	$26,312	$23,189	$3,861	13,074	$1,774
Financiera Calpia	El Salvador	Yes	$23,854	$22,714	$5,506	29,101	$781
Vision S.A.	Paraguay	Yes	$23,788	$17,694	$4,457	14,640	$1,209
Mibanco S.A.	Peru	Yes	$19,894	$11,285	$6,495	33,849	$333
FinAmerica S.A.	Colombia	Yes	$17,324	$13,994	$4,020	9,563	$1,463
FIE S.A.	Bolivia	Yes	$16,338	$14,215	$2,190	20,848	$682
Génesis	Guatemala	No	$12,403	$11,910	$3,824	22,413	$531
WWB Cali	Colombia	No	$10,341	$8,640	$4,190	18,812	$459
FED	Ecuador	No	$7,546	$3,481	$4,110	11,596	$300
FUNADEH	Honduras	No	$5,684	$4,354	$5,200	10,268	$424
FAMA	Nicaragua	No	$4,357	$2,646	$2,679	5,036	$705
Compartamos	Mexico	No	$3,785	$2,930	$3,419	43,401	$68
CHISPA	Nicaragua	No	$2,073	$1,869	$1,180	6,610	$283
FINCA	Nicaragua	No	$1,421	$935	$764	11,864	$79
Median			**$16,338**	**$11,910**	**$3,861**	**18,812**	**$662**
Mean			**$19,528**	**$15,699**	**$4,260**	**23,809**	**$674**

[1] Two of the institutions initially selected—Banco Solidario in Ecuador, and Fundación Emprender in Argentina—had to be dropped from the study. Fundación Emprender is still in a period of consolidation and Banco Solidario proved impossible to analyze as a purely microfinance entity because their internal accounting does not separate the costs associated with microlending from those related to their normal banking activities. These institutions were replaced by Caja los Andes (Private Financial Fund, Bolivia), which brought the total number of institutions analyzed to seventeen.

Methodology of Analysis

Although the project was launched with a defined evaluation methodology, it continued to evolve over the course of the evaluations. MicroRate began to give greater weight to measuring qualitative factors and identifying critical risks. The lesson here was that measuring qualitative factors is not necessarily a subjective exercise: whether management has banking experience, the motivations and training of loan officers, and the composition of the board can all be objectively described, analyzed and measured.

On the quantitative side, one of the principal objectives of the project was comparison among disparate institutions operating in different countries. In order to make an objective comparison, material differences among the institutions and their environments were taken into account by adjusting the audited financial and portfolio information of each. MicroRate applied four adjustments: (1) non-monetary assets and liabilities were adjusted to reflect the effect of inflation; (2) accrued interest and fee income was recognized only on a cash basis; (3) loan loss reserves were recalculated on a common scheme[2]; (4) funds with below-market costs were assigned a market rate.[3] The adjusted financial and portfolio information, converted to dollars, was used to calculate comparable financial indicators. This publication presents both adjusted and unadjusted numbers when applicable.

Local Commercial Banks as a Benchmark

Wherever possible, the report has also provided averages from the Latin American and Caribbean banking sector, to be used as a further benchmark for comparison. These averages were compiled using data from 756 commercial banks throughout Latin America and the Caribbean. The principal source was Bankstat, a reporting service of Thomson Bankwatch. In some instances, the reporting methods used by the commercial banking sector differed too widely from those used by the microfinance institutions. In these cases, an accurate comparison could not be made. In other instances, such as the ratio of loans per credit officer, the indicators used are simply not relevant for any non-micro banking sector. Because the majority of the institutions analyzed in this report have ambitions of transforming themselves into some sort of regulated financial institution or commercial bank (many in fact have already done so), these comparisons represent the true benchmark for their performance in many ways. They represent the levels of profitability, performance and efficiency that can and should be achieved in a competitive, regulated and completely self-sufficient environment.

---

[2] For provisions, the following uniform schedule was applied: 1–30 days, 10 percent; 31–60 days, 30 percent; 61–90 days, 60 percent; >90 days, 100 percent. Loans more than 360 days past due are considered written off.

[3] In terms of subsidies, a financial expense (based on the bank lending rate for short and medium term loans in each country, as indicated by the International Monetary Fund) has been assigned to funds granted or provided to the institution below market rates.