



MINISTRY OF ECONOMY AND FINANCE OF ECUADOR

Creating a National Network through the "National System of Microfinance" (D.E No. 1126 -26-01-2006), that seeks:

- To constitute an axis of a Governmental Policy that supports the Microfinance Sector.
- To improve the conditions of access to credits.
- To promote the institutional strengthening of microfinance operators.
- To generate productive capacities.
- To reduce poverty.







MINISTRY OF FOREIGN TRADE, INDUSTRIALIZATION,
FISHING AND COMPETITIVENESS
UNDERSECRETARY OFFICE OF SMALL AND MEDIUM ENTERPRISE
Strengthening and Developing the Activities of Artisans and
Microenterprises

FROM THE PRESIDENT

Building Opportunity for the Majority

lmost a year ago, I had the honor and pleasure of opening the eighth Inter-American Forum on Microenterprise in Santa Cruz, Bolivia. That was one of my first public appearances as President of the Inter-American Development Bank (IDB), and I have come to believe that it was a suitable occasion to commence my tenure at the Bank.

The countries of our region face many challenges and difficulties, but none so critical as the struggle of millions of poor and marginalized citizens who enjoy very few options for creating and leading a dignified life. Although the Latin American and Caribbean region has experienced periods of economic growth and prosperity, there has been little or no improvement in poverty or inequality, resulting in social and economic exclusion for the majority of people.

During my first year with the IDB, I have tried to focus on strategies that may address these problems. In June 2006, the Bank organized a conference on *Building Opportunity for the Majority*, which brought together many bright minds to discuss the challenges to be met and to identify the best and most practical options for helping the many people at the base of the economic pyramid.

Among the areas discussed, microenterprise development was emphasized as a dynamic and flexible mechanism for providing opportunities and prospects for the majority. With the recognition that microenterprises can contribute considerably to economic development comes the obligation to support them in any way possible.

The Bank has long acknowledged

this obligation and has dedicated resources and funds for almost three decades to developing a vibrant and effective microenterprise sector in the region. Yet the supply of microfinance services is still inadequate relative to the potential market, particularly for rural households and agricultural producers.

Micro and small enterprises have a very high growth potential and their resourcefulness serves as a driving force for innovation. However, more firms need to generate higher-paying, better-quality jobs, and more workers need to be given the skills to access them. The firms themselves will find it difficult to grow in isolation, and increasingly will depend on linkages with other firms to fully take advantage of markets and new business opportunities.

The Bank has been committed to the microenterprise sector for a long time, but is now ready to take this commitment a step further and redefine its role in creating economic opportunities for all, accelerating and expanding the access of the majority to goods and services.

Many of the new activities that IDB is launching under its initiative *Building Opportunity for the Majority* will challenge more forcefully and effectively the historic lack of broad-based economic growth, which is needed to generate shared societal benefits in Latin America and the Caribbean.

To this end, IDB's initiatives will call for the establishment of a Network for Innovation and Opportunity throughout the region. To directly benefit the microenterprise sector, the Bank will undertake to leverage the volume of microfinance loans in the region from US\$5 billon to US\$15



LUIS ALBERTO MORENO
President of IDB

billion over the next five years, with private banks providing most or all of the money. It will also create a new US\$1 billion lending program for small and medium enterprises.

In order to meet the challenges of this new initiative, IDB's actions during the period 2007 to 2011 will focus initially on six priority areas, including: renewed focus on financial democracy, employment generation and entrepreneurship, basic infrastructure services, information and communication technology, housing, and basic identification documents. Each of these areas profoundly impacts quality of life for all at the base of the pyramid, and the quality and quantity of business for the millions of micro and small entrepreneurs in our region.

It is time to adopt a less macrobased approach and work to overcome obstacles that have prevented the majority from improving their quality of life.



Mission:

sustainable national network represents integrates specialized microfinance institutions, and contributes to transparency and market development, and promotes access to quality financial services."

Labor Components:

- Represent and influence in political matters in order to maintain the microfinancial market and its development.
- Transparency of information regarding microfinance institutions and clients' debts.
- Services and projects for the institutional development of our members.

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Quito - Ecuador



If banks want to be part of it, they should make sure that they first assimilate this knowledge and don't try to reinvent the wheel.

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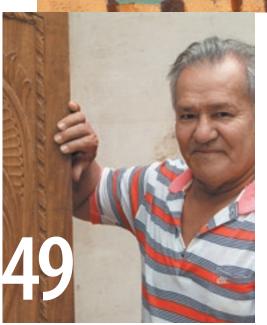
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COVER PHOTO BY WILLIE HEINZ, IDB



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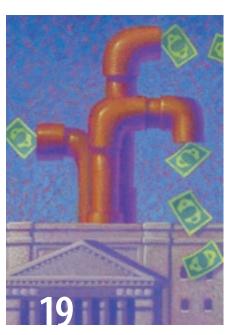
An alliance for the integral development and a future without poverty



America. Any new project and venture FUNDES implements are based

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Americas

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MicroEnterprise Americas

is published by the Inter-American Forum on Microenterprise, an annual event organized by the Inter-American Development Bank; Luis Alberto Moreno, President.

The Inter-American Development Bank is not responsible for the editorial content of *MicroEnterprise Americas*; the views expressed in the articles are those of the authors.

ISSN 1811-2013



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MicroEnterprise Americas

is available online at: www.iadb.org/sds/foromic/magazine

The Commitment to Reach Everybody

he microenterprise industry can boast almost 30 years of commitment to supporting micro and small enterprises throughout the world. But huge parts of the microenterprise population are not being assisted in any way. Increasingly, concerns are being voiced that the population at the base of the economic pyramid lacks access not only to economic opportunities but also to the most basic social services and infrastructure. In other words, there is a need to do more.

Part of the title for the 2005 Microenterprise Forum pledged a "commitment to reach everyone." The Forum's agenda emphasized not only improving services and products for existing micro and small enterprises, but also expanding access to these services and products to underserved and marginalized populations. This issue of *MicroEnterprise Americas* explores the various issues and challenges of extending economic opportunities to all.

In recent years, the sector has come to realize that microfinance institutions (MFIs) alone cannot aspire to reach the millions of clients and potential clients of the markets in Latin America and the Caribbean, and cannot achieve sufficiently broad-based coverage.

Already, numerous commercial banks have "downscaled" into the realm of microfinance, but many more have plans to, and one of the main features of this magazine will deal with the how's, when's and why's of downscaling.

As donor funding has become less readily available, MFIs are turning to other means of funding. The magazine discusses the various options, from deposits to issuance of stocks and bonds.

The magazine this year presents the first-time list of the TOP 100 MFIs in Latin America and the Caribbean and

also features an article on recent developments within the rating field and where this relatively new industry is headed.

Even though some financial products are successfully finding their way to poorer and marginalized parts of the population, knowledge of how to manage newly acquired loans, payments and interests is extremely important. Microfinance Opportunities has developed and implemented financial education programs in many parts of the world, and our article describes their experience in Bolivia and other countries.

The Special Section of the magazine focuses on access to markets, which most microenterprises characterize as the single most important challenge they face after access to finance. One article highlights value chains and linkages as a means of providing better market access; another article analyzes the pros and cons of offering a protected public procurement market for smaller enterprises; a third feature offers arguments in favor of developing associations and other partnerships when facing outside competition.

As in previous years, this issue also presents articles on a variety of other subjects, such as the use of technology to link microenterprises with potential investors through the Internet and setting up a special "disaster" fund to assist MFIs in affected areas.

Finally, the magazine portrays the accomplishments of the four winners of the Microenterprise Awards, and conveys the commitment and resourcefulness these winners display in their daily work that set them apart from numerous other institutions.

We hope you find all of the articles interesting and informative, and that you thoroughly enjoy this sixth issue of *MicroEnterprise Americas*.

—LENE MIKKELSEN

Banking

Championship League

The TOP 100 in Latin America and the Caribbean

As 2005 drew to a close, the leading microfinance institutions in Latin America and the Caribbean (LAC) continued their growth path. Fueled by an increasing injection of market funding, MFIs expanded their outreach by 33% over 2004. Commercial debt, including strong mobilization of public deposits, topped 90% of loan portfolio funding in 2005. Investors flocked to the 3% return on assets and nearly 18% return on equity, with commercial funding advancing 4 percentage points during the year. Combined with average loan balances under US\$1,000, MFIs in the sector also remain an undisputed magnet for socially motivated investors.

MicroEnterprise Americas brings readers this year's TOP 100 in Latin America and the Caribbean according to the Microfinance Information Exchange (MIX), an annual snapshot of the leading microfinance institutions across the region. Drawing on a survey of nearly 130 MFIs, the MIX uses the latest data reported by auditors, regulatory agencies and other sources at year-end 2005 in seven different areas. Taken as a group, these 100 institutions managed US\$6.6 billion in more than 6 million loans to microentrepreneurs and low-income clients in 15 countries across the region.

Scale

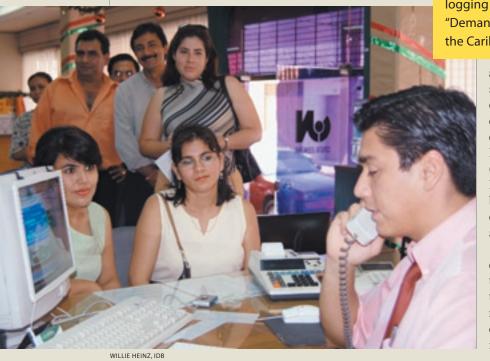
The year 2005 was a banner year for large-scale MFIs in Latin America and the Caribbean. Caja Popular Mexicana led the TOP 100 for the second year in a row with more than 550,000 loans outstanding. However, institutions from several different countries rapidly closed the gap

Want to see more?

This printed report contains only a small portion of the information available on the TOP 100 MFIs in LAC. More complete rankings can be found by logging on to www.mixmarket.org, clicking on "Demand" and searching for "Latin America and the Caribbean."

> and redefined the potential for achieving scale throughout the region. The number of MFIs with more than 200,000 loans doubled from three to six, and 15 now count more than 100,000 outstanding loans. Banco Caja Social in Colombia (BCSC) finished the year with a gross loan portfolio that shattered the US\$1 billion mark, leveraging its acquisition of the Colombian bank Colmena to rank among the largest microlenders globally.

Also of note this year, banks and credit unions swept up nine of the ten top spots. The success of these institutions, which are permitted by their respective governments to accept client deposits, demonstrates the power of mobilizing savings in building scale.







TOP 100 MFIs IN LATIN AMERICA AND THE CARIBBEAN

	Pauling and the state of the st							
2005	nking 2004	MFI	Country	Number of Loans Outstanding	Gross Loan Portfolio (US\$)			
1	1	Caja Popular Mexicana †	Mexico	554,244	\$ 781,428,638			
2	2	Compartamos	Mexico	481,389	178,200,464			
3	4	Banco del Trabajo †	Peru	450,182	314,232,070			
4	3	Banco Caja Social * †	Colombia	386,678	1,226,183,478			
5	n/a	Caja Libertad * †	Mexico	246,602	342,220,902			
6	5	Crediamigo	Brazil	235,802	60,392,060			
7	12	BancoEstado †	Chile	181,638	397,594,368			
8	6	Banco Solidario †	Ecuador	176,401	207,033,940			
9	7	MiBanco †	Peru	154,541	206,729,446			
10	13	BanRural *	Guatemala	143,900	134,789,116			
11	10	WWB Cali	Colombia	129,382	100,489,474			
12	8	CMAC Arequipa	Peru	120,372	135,485,714			
13	9	CMAC Trujillo	Peru	116,618	133,436,455			
14	11	FMM Popayán	Colombia	110,148	45,522,513			
15	n/a	Financiera Familiar *	Paraguay	105,014	39,122,712			
16	14	BancoSol	Bolivia	85,000	129,458,739			
17	16	Banco Los Andes ProCredit	Bolivia	80,201	145,720,196			
18	19	FMM Bucaramanga	Colombia	76,346	36,655,970			
19	15	CMAC Sullana	Peru	74,836	76,285,028			
20	20	CRECER	Bolivia	74,819	15,862,891			
21	18	PRODEM FFP	Bolivia	68,792	108,402,258			
22	25	EDPYME Edyficar	Peru	68,260	54,788,953			
23	17	Banco ProCredit - El Salvador	El Salvador	66,617	102,455,400			
24	23	Pro Mujer - Bolivia	Bolivia	64,517	11,100,355			
25	22	Visión de Finanzas	Paraguay	61,119	40,187,243			
26	21	BanEfe *	Chile	58,140	117,160,604			
27	26	Banco ProCredit - Nicaragua	Nicaragua	58,117	64,465,884			
28	27	FIE FFP	Bolivia	56,446	73,482,290			
29	32	ADOPEM	Dominican Republic	56,108	15,069,628			
30	30	Génesis Empresarial	Guatemala	55,184	31,879,872			
31	28	CMAC Huancayo	Peru	54,212	67,488,406			
32	31	BanDesarrollo	Chile	53,935	61,797,709			
33	41	ACODEP	Nicaragua	52,650	15,156,329			
34	37	FDL	Nicaragua	50,969	32,633,518			
35	24	Interfisa	Paraguay	50,508	21,045,322			
36	34	Credife	Ecuador	50,142	79,702,109			
37	33	CMM Bogota	Colombia	48,875	22,254,872			
38	29	FINCA - Ecuador	Ecuador	43,140	17,784,886			
39	47	FINCA - Mexico	Mexico	41,142	9,804,931			
40	36	FAMA	Nicaragua	38,586	20,324,751			
41	n/a	CMAC Cusco	Peru	38,098	71,963,457			
42	38	Pro Mujer - Peru	Peru	35,372	3,415,965			
43	35	Fundación Mario Santo Domingo	Colombia	35,284	11,473,563			
44	43	FinComún	Mexico	34,300	21,125,325			
45	n/a	ASODENIC *	Nicaragua	33,971	5,082,040			
46	42	Banco Ademi	Dominican Republic	33,145	76,720,662			
47	39	CMAC Maynas	Peru	31,221	26,063,914			
48	51	Banco ProCredit - Ecuador	Ecuador	30,974	73,318,307			
49	45	Financiera El Comercio	Paraguay	29,896	13,349,320			
50	61	BanGente	Venezuela	29,818	25,956,053			
51	46	FINDESA	Nicaragua	29,561	55,483,695			
52	40	CMAC Tacna	Peru	27,805	41,530,673			
53	44	Finamérica	Colombia	26,723	37,724,495			
				.,	, = ,,			

	Ranl	_	MFI Country		Number of	Gross Loan
	2005	2004			Loans Outstanding	Portfolio (US\$)
	54	48	CMM Medellín	Colombia	26,284	\$ 16,326,801
	55	54	EDPYME Confianza	Peru	26,256	22,063,091
	56	n/a	CMAC Ica	Peru	25,444	34,371,607
	57	n/a	Caritas	Peru	23,522	6,665,731
	58	56	Caja Nor Peru	Peru	23,340	29,739,359
	59	49	CMAC Del Santa	Peru	23,305	21,544,606
	60	62	EDPYME Crear Arequipa	Peru	22,259	16,473,012
	61	n/a	CMAC Paita	Peru	21,073	22,636,399
	62	52	Apoyo Integral	El Salvador	20,989	16,682,295
	63	n/a	Sèvis Finansye Fonkoze *	Haiti	20,825	2,837,190
	64	59	Bancafé Mipyme	Guatemala	20,746	48,632,574
	65	n/a	Actuar Famiempresas	Colombia	20,745	17,516,359
	66	50	FADES	Bolivia	20,728	18,752,649
	67	n/a	COAC Mushuc Runa	Ecuador	19,886	25,617,206
	68	58	Fundación José Nieborowski	Nicaragua	19,790	14,953,714
	69	n/a	CODESARROLLO	Ecuador	19,387	22,136,134
	70	53	COAC Jardín Azuayo	Ecuador	18,906	36,546,333
	71	55	Fundación Covelo *	Honduras	18,238	20,821,536
	72	57	Financiera Solidaria	Honduras	17,213	15,946,277
	73	n/a	World Relief - Honduras	Honduras	15,799	5,973,678
	74	n/a	EDPYME Efectiva	Peru	15,451	3,695,028
	75	n/a	ENLACE	El Salvador	15,357	2,894,769
	76	n/a	PRISMA	Peru	15,222	4,051,786
	77	67	Ecofuturo FFP	Bolivia	15,064	18,970,153
	78	n/a	Asociación Raiz	Guatemala	14,970	22,146,807
	79	n/a	FINCA - Honduras	Honduras	14,581	3,338,121
	80	64	EDPYME Proempresa	Peru	14,536	11,648,147
	81	n/a	FINCA - Guatemala	Guatemala	14,129	2,062,281
	82	68	CEAPE Maranhão	Brazil	14,018	3,853,800
	83	66	Fundación Espoir	Ecuador	13,886	4,921,468
	84	63	ODEF	Honduras	13,826	7,890,047
	85	60	Pro Mujer - Nicaragua	Nicaragua	13,815	2,542,609
	86	n/a	FINCA - Haiti	Haiti	13,719	1,102,791
	87	n/a	Familia y Medio Ambiente	Honduras	13,681	3,323,886
	88	n/a	FUNDENUSE	Nicaragua	13,433	7,158,881
	89	69	PRODESA	Nicaragua	12,929	10,499,903
	90	n/a	ADMIC	Mexico	12,652	4,761,666
	91	65	FUNED	Honduras	11,657	3,852,066
	92	71	D-MIRO	Ecuador	10,842	5,891,778
	93	n/a	FUNDAHMICRO	Honduras	10,693	2,764,859
	94	n/a	Movimiento Manuela Ramos	Peru	10,410	1,816,269
	95	n/a	FED FED	Ecuador	10,335	7,030,948
	96	n/a	CEPRODEL	Nicaragua	10,289	5,608,750
	97	n/a	Fonkoze	Haiti	10,265	2,469,382
	98	73	Hermandad de Honduras	Honduras	10,084	4,786,321
	99	n/a	AYNLA	Guatemala	9,677	3,761,325
	100	72	ADRA - Peru	Peru	9,584	1,688,162
			TOTALS		6,027,656	6,620,018,324

 $^{{\}rm *Of\,the\,top\,100\,institutions, some\,only\,provided\,data\,on\,the\,volume\,of\,active\,loans\,and\,outstanding\,portfolio.}$

 $[\]texttt{†Of the top 10 MFIs, some provide more than microenterprise credits, including low balance consumer loans, } \\$ and the data presented here may include such accounts.



TOP 20 MFIs WITH GREATEST GROWTH								
MFI	Country	Adjusted % Change in Loans	Adjusted Absolute Change in Loans	Adjusted Absolute Change in Gross Loan Portfolio (USD)				
EDPYME Efectiva	Peru	337%	11,855	\$ 2,545,655				
EDPYME Alternativa	Peru	110%	3,084	1,136,776				
BanGente	Venezuela	110%	15,607	13,352,120				
Fonkoze	Haiti	94%	4,968	1,441,507				
BanRural	Guatemala	87%	66,792	17,168,432				
FINCA - Mexico	Mexico	83%	18,524	4,435,693				
FINCA - Guatemala	Guatemala	82%	6,380	869,845				
AYNLA	Guatemala	78%	4,243	902,160				
MCN	Haiti	69%	2,962	484,801				
ACODEP	Nicaragua	68%	21,336	4,979,149				
FUNDENUSE	Nicaragua	66%	5,362	1,916,033				
EDPYME Crear Arequipa	Peru	62%	8,452	5,848,004				
FDL	Nicaragua	62%	19,357	13,260,102				
CEPRODEL	Nicaragua	57%	3,710	1,454,140				
Friendship Bridge - Guatemala	Guatemala	56%	2,575	465,278				
PRESTANIC	Nicaragua	53%	2,076	2,386,591				
EDPYME Confianza	Peru	53%	9,018	8,217,940				
Banco ProCredit - Ecuador	Ecuador	52%	10,613	\$29,678,770				
Caja Nor Peru	Peru	51%	7,874	7,224,734				
EDPYME Edyficar	Peru	49%	21,999	12,907,403				

Growth

The LAC microfinance market quickly expanded in 2005 with almost 20 institutions in the TOP 100 increasing their number of loans provided by 50% or more. The institutions with the largest relative increases tended to be smaller in scale. However, some larger MFIs also reported strong relative growth numbers. ACODEP, one of the biggest MFIs in Nicaragua, increased its number of loans by 68% and nearly doubled its gross loan portfolio.

As expected, larger institutions dominated absolute growth measures. Of the 10 leading MFIs in account acquisition for 2005, eight began the year with at least 50,000 outstanding loans. Although not included in the list of relative growth, Compartamos outshined the pack by adding more than 150,000 accounts at almost 50% relative growth, an impressive feat for an institution of its size.

One of the most notable stories of 2005 was BanRural in Guatemala. It crossed the 140,000 loan mark, nearly



doubling in size, and ranked fifth in relative growth and second in absolute terms, surpassing several larger institutions.

Depth of Outreach

For the third year in a row, MFIs deploying the village banking model provided the smallest loans in the

region. As with last year, Pro Mujer Peru, with its US\$97 average loan balance, vied with FINCA's Mexican affiliate for the top of the list. Both institutions effectively reached the lowest income sectors, keeping their ratio of average loan balance to gross national income (GNI) per capita at 4.1% or lower.

TOP 20 MFIs WITH GREATEST DEPTH						
MFI	Country	Adjusted Average Loan Balance / GNI per Capita	Adjusted Average Loan Balance (USD)			
FINCA - Mexico	Mexico	3.5%	\$239			
Pro Mujer - Peru	Peru	4.1%	97			
ASEI	El Salvador	5.4%	127			
Compartamos	Mexico	5.5%	370			
ADMIC	Mexico	5.6%	376			
FINCA - Peru	Peru	6.3%	148			
Friendship Bridge - Guatemala	Guatemala	6.3%	134			
FINCA - Guatemala	Guatemala	6.9%	146			
EDAPROSPO	Peru	7.1%	168			
Movimiento Manuela Ramos	Peru	7.4%	175			
ADRA - Peru	Peru	7.5%	176			
ENLACE	El Salvador	8.0%	189			
Crediamigo	Brazil	8.3%	256			
CEAPE Maranhão	Brazil	8.9%	275			
FinComún	Mexico	9.1%	616			
EDPYME Efectiva	Peru	10.1%	239			
PRISMA	Peru	11.6%	273			
Caritas	Peru	12.1%	285			
ADOPEM	Dominican Republic	13.1%	272			
Fundación Mario Santo Domingo	Colombia	16.2%	323			

Also of note, the top MFIs in this category showed significant improvement over 2004 in reaching the low end of the market. Not only did FINCA Mexico push the relative average loan balance to a new low, but 15 of this year's top finishers kept the ratio under 10%, compared with only eight last year.

Savings

One of the biggest developments in LAC microfinance in 2005 was the growth of the burgeoning market for microsavings products. LAC institutions on the list managed over US\$ 3 billion in client deposits in 2005, a 30% increase from the previous year.

Each of the 10 largest institutions on this year's list takes deposits to finance growth. The 2005 leader Caja Popular Mexicana captured almost US\$ 1 billion in savings, more than enough to finance its entire loan portfolio. As more MFIs become regulated, mobilizing deposits will grow in importance in increasingly competitive LAC markets.

Efficiency

Not surprisingly, the top 10 most efficient MFIs all carried higher-end average loan balances over US\$500. They showed strong improvement in 2005, with eight institutions spending less than 10% of their gross loan portfolio on operating expenses, compared to three in 2004. Peru's CMACs put in an especially good performance, with many improving efficiency by one percentage point or more as they achieved scale.

Of the small balance lenders, only two institutions—Pro Mujer Bolivia and Interfisa—decreased their cost of lending, while the majority dealt with increased operating costs, pushing some out of the top spots. Generally, the most productive institutions measured by average number of loans per staff member were also the most efficient. The formidable Women's World Banking affiliate in Popoyán, Colombia, outperformed the other smaller-balance institutions due to its extremely productive staff.

Asset Quality

A surprising and encouraging result of this year's TOP 100 ranking is that low-risk portfolios were achieved in almost every country surveyed. Institutions from all corners of the region are represented among the top 20 in asset quality. While external economic and political conditions can always affect MFI performance, good lending practices are still a key driver of portfolio risk in any country.

MFIs incorporating the village banking model continue to prove adept at minimizing risk in their portfolios. Two Peruvian MFIs, Pro Mujer and ADRA, led the pack, showing no delinquency at year end. However, some institutions focusing on individual products and solidarity groups also proved savvy lenders. D-Miro and Credife in Ecuador both cleaned up their portfolios to improve dramatically from 2004, reporting less than 1% delinquency in 2005.

Profitability

The most profitable institutions on this year's list saw strong increases in adjusted return on assets (AROA) over 2004. Two of the top three improved returns by over three percentage points. Mexico's Compartamos set itself apart from the rest, achieving a record 19.6% AROA and 51.2% adjusted return on equity (AROE). Peru's ADRA and Pro Mujer affili-



ate leveraged their zero-risk portfolios into top performing spots. The Women's World Banking affiliate in Popoyán, Colombia, translated its high operational efficiency into a strong bottom line.

Even more compelling is the high AROE of 18% in the region.

LAC institutions have become more leveraged as a result of growing commercialization in the sector. As more investors turn to microfinance as a viable investment option, strong return onequity will take on increasing importance for MFIs.

Conclusion

Looking to 2006, the LAC microfinance industry is poised to continue on its current track of strong growth and profitability while improving access to financial services for all in the region. But there are several

TOP 20 MFIs IN SAVINGS	S PORTFOLIO			
MFI	Country	Voluntary Savings (USD)	Average Savings Account Balance (USD)	Deposits to Gross Loan Portfolio
Caja Popular Mexicana	Mexico	\$945,118,774	\$ 464	123%
Banco del Trabajo	Peru	227,239,067	477	73%
Banco Solidario	Ecuador	197,587,178	1,705	97%
BancoEstado	Chile	191,804,905	2,137	48%
MiBanco	Peru	147,150,729	2,315	72%
CMAC Arequipa	Peru	112,692,420	682	84%
BancoSol	Bolivia	96,411,478	1,125	75%
CMAC Trujillo	Peru	84,010,795	902	63%
Banco Los Andes ProCredit	Bolivia	78,811,525	1,864	54%
PRODEM FFP	Bolivia	74,157,733	415	69%
CMAC Cusco	Peru	68,082,274	1,074	96%
Banco ProCredit - El Salvador	El Salvador	64,462,200	765	63%
Banco Ademi	Dominican Republic	60,950,448	982	79%
CMAC Sullana	Peru	52,875,759	640	70%
CMAC Huancayo	Peru	50,176,169	648	74%
Visión de Finanzas	Paraguay	43,555,361	1,238	110%
Bancafé Mipyme	Guatemala	38,843,196	3,712	80%
COAC Jardín Azuayo	Ecuador	34,082,372	764	96%
FIE FFP	Bolivia	32,535,179	419	44%
CMAC Tacna	Peru	30,502,927	1,104	74%

Beyond the Numbers

The year 2005 demonstrated the increasing importance of banks in providing microfinance services. In no country has the presence of large, traditional financial institutions been more visible than in Brazil. Unibanco launched its Microinvest products in Fininvest branches throughout the country under the slogan "For small businesses with big dreams." Banco Real, a subsidiary of the Dutch ABN Amro, partnered with ACCIÓN International to continue scaling up its Real Microcrédito effort in the states of São Paulo and Rio de Janeiro.

Brazil is not the only country where large, established banks have entered the microfinance market. In Chile,

Banefe, the microbanking arm of the Spanish bank Santander, has won numerous awards for its growing portfolio of financial products targeted at low-end consumer and microenterprise needs. Peru's Banco del Trabajo made a strong move down market with its Crédito Multicombo Microempresario, offering microentrepreneurs a comprehensive package of financial products that include lines of credit, savings, credit cards and insurance. As more traditional financial institutions consider microfinance, it remains to be seen whether the best strategy for entry in LAC is through acquisition or internal product development.

TOP	TOP 20 MOST EFFICIENT MFIs WITH AVERAGE LOAN BALANCE > US\$ 500						
Ran 2005	king 2004	MFI	Country	Adjusted Average Loan Balance (USD)	Operating Expense / Average Gross Loan Portfolio	Adjusted Loans per Staff Member	
1	n/a	Bancafé Mipyme	Guatemala	\$2,342	3.9%	110	
2	1	COAC Jardín Azuayo	Ecuador	1,933	4.9%	191	
3	2	PRODESA	Nicaragua	814	6.5%	263	
4	n/a	CODESARROLLO	Ecuador	1,125	7.3%	323	
5	3	COAC San José	Ecuador	1,476	8.2%	158	
6	15	BancoEstado	Chile	2,206	8.8%	278	
7	n/a	CMAC Cusco	Peru	1,944	8.8%	136	
8	6	CMAC Arequipa	Peru	1,119	9.8%	294	
9	8	CMAC Huancayo	Peru	1,251	10.4%	158	
10	n/a	COAC Mushuc Runa	Ecuador	1,282	10.4%	306	
11	4	WWB Cali	Colombia	777	10.6%	286	
12	19	COOPAC Santo Cristo	Peru	916	10.8%	192	
13	9	CMAC Tacna	Peru	1,524	11.1%	135	
14	n/a	ACCOVI	El Salvador	3,247	11.3%	61	
15	10	CMAC Trujillo	Peru	1,144	11.5%	237	
16	12	BancoSol	Bolivia	1,511	11.9%	115	
17	16	Credife	Ecuador	1,589	11.9%	188	
18	7	FIE FFP	Bolivia	1,311	12.0%	94	
19	11	BanDesarrollo	Chile	1,146	12.1%	194	
20	n/a	Banco Los Andes ProCredit	Bolivia	1,815	12.4%	98	

ТОР	TOP 20 MOST EFFICIENT MFIs WITH AVERAGE LOAN BALANCE < US\$ 500						
Ran	king 2004	MFI	Country	Adjusted Average Loan Balance (USD)	Operating Expense / Average Gross Loan Portfolio	Adjusted Loans per Staff Member	
1	1	FMM Popayán	Colombia	\$413	11.8%	326	
2	n/a	FONCRESOL	Bolivia	316	13.1%	228	
3	5	Interfisa	Paraguay	413	16.7%	176	
4	n/a	FODEMI	Ecuador	405	17.9%	215	
5	n/a	Crysol	Guatemala	351	19.0%	290	
6	4	CMM Bogota	Colombia	455	19.2%	220	
7	3	FMM Bucaramanga	Colombia	480	19.3%	296	
8	8	Pro Mujer - Bolivia	Bolivia	172	20.6%	178	
9	n/a	AYNLA	Guatemala	383	21.0%	323	
10	20	Financiera El Comercio	Paraguay	446	21.4%	139	
11	n/a	Crediamigo	Brazil	256	22.1%	240	
12	n/a	Fundación Mario Santo Domingo	Colombia	323	22.1%	292	
13	7	FINCA - Ecuador	Ecuador	412	23.7%	284	
14	n/a	EDPYME Efectiva	Peru	239	24.1%	342	
15	10	Hermandad de Honduras	Honduras	482	24.8%	97	
16	9	ADOPEM	Dominican Republic	272	25.5%	240	
17	n/a	FAFIDES	Guatemala	474	26.0%	97	
18	12	Pro Mujer - Peru	Peru	97	26.5%	393	
19	11	ACODEP	Nicaragua	288	26.9%	333	
20	16	Pro Mujer - Nicaragua	Nicaragua	184	27.3%	219	



TOP 20 MOST PROFITABLE MFIs					
MFI	Country	Adjusted Return on Assets	Adjusted Return on Equity		
Compartamos	Mexico	19.6%	51.2%		
ADRA - Peru	Peru	13.9%	20.1%		
FMM Popayán	Colombia	12.7%	24.3%		
Pro Mujer - Peru	Peru	12.3%	21.6%		
EDPYME Efectiva	Peru	11.9%	41.3%		
FINCA - Mexico	Mexico	11.9%	30.2%		
ADOPEM	Dominican Rep.	11.7%	22.3%		
FINCA - Peru	Peru	11.0%	11.4%		
Crediamigo	Brazil	10.8%	59.5%		
FUNDENUSE	Nicaragua	9.3%	21.6%		
FINCA - Ecuador	Ecuador	9.1%	29.5%		
CRECER	Bolivia	8.9%	20.9%		
FONCRESOL	Bolivia	8.0%	9.9%		
PRODESA	Nicaragua	7.7%	22.4%		
Financiera El Comercio	Paraguay	7.5%	35.1%		
CMAC Cusco	Peru	7.4%	42.3%		
ACODEP	Nicaragua	6.9%	26.3%		
CMAC Arequipa	Peru	6.9%	37.6%		
Pro Mujer - Nicaragua	Nicaragua	6.9%	9.7%		
BanDesarrollo	Chile	6.7%	n/a		

TOP MFIS WITH LEAST RISK							
MFI	Country	Adjusted Portfolio at Risk > 30 Days	Adjusted Write-off Ratio				
ADRA - Peru	Peru	0.0%	0.0%				
Pro Mujer - Peru	Peru	0.0%	0.0%				
Crysol	Guatemala	0.2%	0.3%				
Pro Mujer - Nicaragua	Nicaragua	0.3%	0.4%				
FINCA - Peru	Peru	0.4%	0.9%				
Bancafé Mipyme	Guatemala	0.5%	0.7%				
Pro Mujer - Bolivia	Bolivia	0.5%	0.0%				
FMM Bucaramanga	Colombia	0.6%	0.2%				
Credife	Ecuador	0.7%	1.2%				
D-MIRO	Ecuador	0.7%	0.2%				
FMM Popayán	Colombia	0.8%	0.4%				
FONCRESOL	Bolivia	0.8%	8.9%				
FDL	Nicaragua	0.9%	0.5%				
CEAPE Maranhão	Brazil	1.0%	1.9%				
Banco ProCredit - Ecuador	Ecuador	1.0%	0.8%				
WWB Cali	Colombia	1.0%	0.7%				
FIE FFP	Bolivia	1.1%	1.2%				
FODEMI	Ecuador	1.1%	1.1%				
FUNDENUSE	Nicaragua	1.1%	0.1%				
Caja Nor Peru	Peru	1.2%	1.3%				
Compartamos	Mexico	1.2%	0.6%				
Ecofuturo FFP	Bolivia	1.2%	1.5%				
Finamérica	Colombia	1.2%	4.1%				
FINCA - Guatemala	Guatemala	1.2%	0.0%				
Fundación Espoir	Ecuador	1.2%	0.3%				
Banco Los Andes ProCredit	Bolivia	1.2%	2.0%				

storms on the horizon that MFIs may have to face. Many will be anxiously watching the political arena as governments in several South American countries consider rolling out state-sponsored microfinance initiatives. MFIs may also have to deal with the consequences of a global rising interest rate environment and client over-indebtedness in some portions of their portfolios. Watch this space for next year's TOP 100 in Latin America and the Caribbean to find out how the industry faces the challenges ahead and which institutions end up on top.

MIX and *MicroEnterprise Americas* would like to thank all participating institutions for sharing their financial and outreach information and advancing transparency in microfinance.

Methodological Note: All data are presented in USD for the year ending December 31, 2005. Financial data must be provided along with third-party documents verifying the accounts. All data are reclassified to industry standard financial statement presentation and then adjusted using MIX standard MicroBanking Bulletin methodology. Only loan and portfolio information from the "scale" list remains unadjusted. Microfinance programs and departments within larger entities must also provide reliable allocations of income statement items to be eligible for the subsidiary top 10 lists. Otherwise, MFIs that cannot be completely analyzed are only eligible for the lists based on volume and are listed with an asterisk (*).

Following the methodology of MIX, the analysis uses a definition of microfinance based on the average size of a financial product relative to average individual income levels (GNI per capita), with a ceiling for average balances equivalent to US\$3,000. This classification does not generally distinguish between the destination or the use of the loan, due to the fungible nature of money and the impossibility of rigorously singling out microenterprise credit for all institutions. Institutions among the 10 largest that may offer a broader array of credit

products are marked with a cross (†).

In some cases there are differences between the results reported here and in the report from 2004. These are due to revisions made by the MFIs. Notable exceptions from this list have likely been excluded because they could not or would not provide or substantiate information within the allotted time frame. Some institutions could not appear in the scale list because of size but did appear in other categories due to performance.

For more information on the definitions and methods used, go to www.iadb.org/msm and www.mixmbb.org.

Acknowledgments: The authors would like to thank analysts Anne-Lucie Lafourcade (MIX) and Gerardo Talavera (REDCAMIF) for their contributions to significantly expanding this year's MFI coverage. Many thanks to the following organizations that provided valuable assistance in facilitating the collection of data for this article: COPEME, REDCAMIF, RFR, ACCIÓN, ProMujer, FINCA International, and ProCredit Holdings.

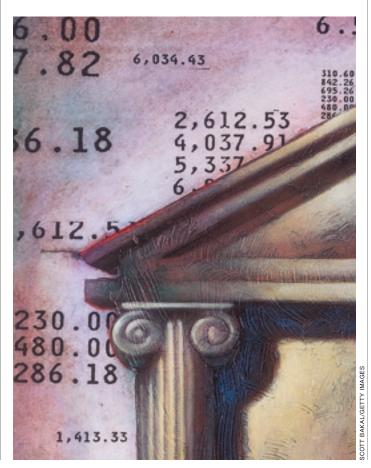
—MATTHEW GEHRKE, RENSO MARTÍNEZ AND BLAINE STEPHENS, MICROFINANCE INFORMATION EXCHANGE, INC. (MIX)

Banking

Microfinance Rating Agencies:

An Industry on the Rise

Risk rating is no longer an unfamiliar concept to microfinance. Investors, donors and regulators now take into account risk ratings when forming an opinion about a particular microfinance institution. Ratings are becoming acceptable "business cards" in microfinance, mirroring a widespread practice in developed capital and financial markets. As happens with commercial banks,



microfinance institutions (MFIs) are commonly viewed through the analytical lenses of conventional and specialized rating agencies. Recent estimates indicate that each year at least 281 MFI ratings are conducted worldwide; about 144 of these take place in Latin America and the Caribbean.

In the last few years, the microfinance rating market has undergone important changes. Previously, ratings were nothing more than assessments fitted to serve donors' needs. Now, private investors and regulators are prime users of microfinance ratings and have sparked renewed interest in the subindustry by traditional players in financial markets, including traditional credit rating

Each year, at least 281 MFI ratings are conducted worldwide; about 144 of these take place in Latin America and the Caribbean.

agencies. As a result, questions such as the following are being raised: How large is the microfinance rating market? How extended is risk rating in microfinance? And, most important, do microfinance investors utilize microfinance risk ratings in their investment processes? The answers to these questions were central discussion topics of the

second Workshop on Microfinance Ratings, entitled "Toward a Sustainable Market," held in Santa Cruz, Bolivia, October 4–5, 2005. The workshop was sponsored by the Consultative Group to Assist the Poor (CGAP), the Inter-American Development Bank (IDB) and the European Commission (EC), and preceded the eighth Inter-American Forum on Microenterprise. Participants included representatives from 11 rating agencies and select international and domestic investors and donors.

What Is Risk Rating in Microfinance?

In financial and capital markets, credit risk rating has been around for a while, with Moody's first recorded bond rating in the early 1900s. Since then the business of rating has evolved and diversified. Today, it includes a variety of products seeking to satisfy different users and needs, allowing investors to demand risk ratings to compare risk within a country as well as globally.

Microfinance ratings emerged in the late 1990s and have evolved on their own. Probably the first tool specifically designed to assess MFIs' financial health and overall performance was the CAMEL (Capital adequacy, Asset quality, Management, Earnings and Liquidity) method of ACCION International. The original CAMEL was developed in 1978 by the U.S. Federal Reserve to evaluate the solvency of U.S. banks. In 1993, ACCION International adapted the CAMEL to microfinance. This diagnostic tool has been mostly used within the member institutions of the ACCION network.

In 1996 the idea of a diagnostic tool for external users (such as investors) by a fully specialized micro-

mational. The original eveloped in 1978 by all Reserve to evaluate yof U.S. banks. In International adapted microfinance. This has been mostly used aber institutions of the The pioneer agency was MicroRate, which offered a new rating product more commonly known as performance assessments or global risk assessments. These ratings seek to evaluate the overall capacity of MFIs to meet their goals.

Compared to traditional credit risk

Compared to traditional credit risk ratings, performance assessments put more weight on operational elements such as appropriateness of lending methodologies and governance issues and allow comparability mainly to other MFIs. This emphasis seems to reflect the fact that performance assessments were originally designed to satisfy the needs of donors. The table summarizes the characteristics of ratings currently offered to MFIs by conventional and specialized rating agencies in Latin America and the Caribbean.

finance rating agency was realized.

MAIN DIFFERENCES BETWEEN SELECT CONVENTIONAL AND SPECIALIZED RATERS

Conventional Raters

- Emphasis on credit risk and solvency
- Benchmarking against the banking sector
- Main areas covered: capital adequacy; profitability; operational efficiency; liquidity risk; foreign exchange risk; credit management, organizational management and ownership; market position; projected cash flows
- Qualitative vs. Quantitative information: S&P 50–50; Fitch Ratings 50–50*
- Main clients: Regulated MFIs

Specialized Raters

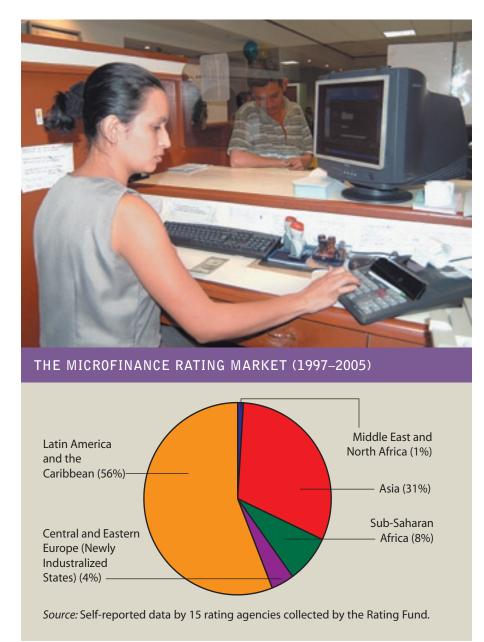
- Emphasis on portfolio structure and quality and operational risk and efficiency
- Benchmarking against other MFIs
- MicroRate analyzes five areas of MFI performance and risk: microfinance operations; portfolio quality; management and organization; governance and strategic positioning; and financial performance** Qualitative vs. Quantitative information: 70–30*
- PLANET Rating methodology looks at: governance and decision making (20%); information and system (12%), risk management (12%); activities and services (25%); funding and liquidity (7%); and efficiency and profitability (24%) Qualitative vs. Quantitative information: 60–40*
- MicrofinanzaRating covers: external environment and institution positioning; governance and operational structure; financial products; assets structure and quality; financial structure and ALM; operating and financial results; business planning and financial needs; details of the risk factors
- Qualitative vs. Quantitative information: 50-50*
- Main clients: Non-regulated MFIs
- * As self-reported to the Rating Fund (www.ratingfund.org).
- ** MicroRate takes into account operating, financial and market risks in microfinance companies, and uses these functional areas as an organizing framework.

Source: Adapted from Todd Farrington. "The Evolution of Specialized Rating for MFIs." Microenterprise Development Review. June 2005, Vol. 8, No. 1.

The Microfinance Rating Market

Since its beginnings, use of microfinance ratings has grown steadily worldwide. Naturally, this growth has been more intense in those regions where microfinance itself is more developed. Latin America and the Caribbean (LAC) and Asia represent almost 90% of the total number of microfinance ratings undertaken worldwide since the late 1990s (see graph on right).

In Latin America and the Caribbean alone, 710 ratings have been undertaken since 1997, and already 275 MFIs have been rated at least once. Half of those MFIs are located in three of the countries with more mature microfinance markets (Peru, Bolivia and Colombia). Another factor influencing the number of ratings is regulation. In some countries (such as Ecuador), the microfinance market is dominated by formal MFIs that are required—by local regulations—to obtain a risk rating. Less mature microfinance markets, such as those in the Caribbean have the fewest ratings.



In 2005, 144 ratings were undertaken in LAC. Of this total, 99 were of MFIs that had already been rated at some earlier point. These numbers show that the microfinance rating industry is not only reaching an increasing number of new MFIs every year, but also that risk ratings are becoming an established practice among MFIs, confirming that the microfinance industry finds ratings useful.

Carmen Velasco, manager of Pro Mujer-Bolivia, shared with us Pro

Mujer's experience with ratings, and elaborated on why Pro Mujer finds risk ratings a credible instrument to certify institutional quality and accomplishments for regulators and social and for-profit investors. Pro Mujer, a non-regulated MFI, is not required by Bolivian regulatory authorities to obtain a rating. "However, as a nonregulated MFI, it is important to align with best practices from the regulated institutions in order to show that nonregulated MFIs may also be successful and trustworthy," Velasco explains.

In 2002, Pro Mujer contracted a specialized microfinance rater to undertake its first rating exercise, and Pro Mujer obtained the highest rating. In 2004, the MFI received its second rating from the same rater with similar results. When asked about what results Pro Mujer had reaped from the rating exercises, Velasco says: "While the benefits of a credit rating in terms of additional financing from social investors may take some time to materialize, institutional assessment allows an MFI to gain more prestige in the eyes of 'financial' investors. Investors such as Blue Orchard, INCOFIN, OikoCredit and Global PartnerShip value the analysis from a well-known rating agency."

In February 2006, Pro Mujer went one step further in increasing its trustworthiness, undertaking a rating with a specialized microfinance rater as well as a conventional rater who carried out their work simultaneously. The fact that these ratings occurred simultaneously will give the industry insights to better understand the differences and similarities offered by these two types of products.

The Relevance of Ratings

According to Velasco, the relevance of ratings for investors is one aspect that will determine the decision of MFIs to undertake a rating. This was one of the topics discussed in the Santa Cruz workshop. Representatives from international investment firms (Gil Crawford of MicroVest and Fernando Lucano of Cyrano Management) as well as domestic investors (Jorge Hinojosa of Caisa Bolivia) participated in a panel discussion on the importance investors give to microfinance ratings. The panelists described how these instruments affect their own investment processes and explored the future role for these ratings. The first point of consensus was on the meaning of a microfinance rating. For investors, a rating symbolizes the MFIs' commitment to transparency. Crawford, for

example, revealed that 80 percent of MicroVest's portfolio is rated. However, Crawford added "it would be a mistake to conclude that ratings attract MicroVest to prospective MFIs. The proper conclusion is that MicroVest is interested in working with MFIs that value financial transparency."

The panel confirmed information from a 2005 Rating Fund¹ survey, which reported that investors save roughly 20% of their due-diligence time by using rating reports. The survey also showed that investors value ratings differently: 29% of investors sampled consider ratings important, 47% somewhat important and 24% not important.

In the workshop, investors indicated their appreciation for the work of specialized microfinance raters, recognizing and valuing their intimate knowledge of microfinance operations. Nonetheless, investors said that specialized rating reports (or performance assessments) still suffer from an early design geared to satisfy donor requirements.

To be fully investor-friendly, investors explained, the comparability among ratings performed by different agencies must improve. Ideally, an investment officer should be able to compare between two potential investments even when analyzed by different raters. In traditional investment circles, a Moody's rating can be easily translated to a Standard & Poor's rating by using a simple table of equivalencies. Also, despite the progress in updating MFI ratings, these updates are still too infrequent. Investors have complained that a two-year-old rating report is of no use to support their investment operations.

The Challenges Today

Todd Farrington, manager of MicroRate for Latin America, explains the challenges faced today by specialized rating agencies: "While Moody's has grown into a multimillion-dollar-ayear international company, MicroRate



According to investors, there is still work to do in product design and comparability among microfinance rating products.

and those who followed, such as Planet Rating, Microfinanza or M-CRIL [Micro-Credit Ratings International], struggle to define their niche in a sector that is still part economic development and part financial intermediation. This is mainly because demand for specialized microfinance ratings, both from the capital market side and the regulatory side, is unclear at best: access to, and the price of funding for MFIs is not determined by a rating, nor do banking regulators uniformly require specialized ratings for MFIs in their systems. At least one of these elements of demand must be in place for specialized rating of microfinance institutions to flourish as a viable industry."

The microfinance rating industry is certainly evolving. Recent develop-

ments include the spin-off processes undertaken by Planet Rating (from Planet Finance in France) and Microfinanza Rating SRL (from Microfinanza SRL in Italy).² These efforts show a firm commitment to this line of business and reinforce earlier efforts put into developing rating methodologies for microfinance. Nonetheless, according to investors, there is still work to do in product design and comparability among microfinance rating products.

Despite growth in the market in the last decade, the reality is that the microfinance rating industry faces fierce competition in some of the most developed markets. This, together with a looming end to subsidies, means that rating products—and prices—probably will have to adapt to these new conditions. Also, traditional (conventional) raters, who are showing signs of interest in microfinance, may become important microfinance players in the future.

The end result, however, will most likely be a revamped and more sustainable microfinance rating sector, with more financial information available for regulators and investors and more MFIs on the road to accessing capital markets: *Not* a bad future.

—SERGIO NAVAJAS AND CLAUDIA SUAZNABAR

- 1. In May 2001, the Inter-American Development Bank (IDB) and the Consultative Group to Assist the Poor (CGAP) launched a joint initiative called the Microfinance Rating and Assessment Fund ("The Rating Fund"). The European Union's European Development Fund for African, Pacific and Caribbean States (EU/ACP) subsequently joined in January 2005.
- 2. Planet Finance is an international NGO that works in microfinance; Microfinanza is a private consulting firm specializing in the microfinance and rural finance sector.



Related websites:
www.ratingfund.org
www.mixmarket.org
www.microrate.com
www.planetrating.com
www.microfinanzarating.com
www.m-cril.com/
www.fitchratings.com
www.moodys.com

Banking

In Search of Solid Funding

How Should Microfinance Institutions Best Fund Themselves?

A few years ago, when no one was yet referring to microfinance as an "industry," microcredit organizations relied on funding from government-subsidized loans, international donors and philanthropic foundations. As microfinance developed professionally and donations became less common, a key issue was how

to offer and recover loans in order to become sustainable. While these continue to be aspects in managing microfinance institutions (MFIs), funding sources have proliferated to the point that it's worth analyzing which are MFIs' best funding alternatives.

Which is better: To attract deposits? Borrow money? Issue bonds? Sell stock? Such questions were the subject of a broad Inter-American Development Bank (IDB) study and also a seminar at the Inter-American Forum on Microenterprise in October 2005 in Santa Cruz, Bolivia.

Today, savings deposits are the main source of MFI funds, according to statistics from the database on 61 regulated MFIs in nine countries (Bolivia, Colombia, Ecuador, El Salvador, Honduras, Mexico, Nicaragua, Paraguay and Peru).

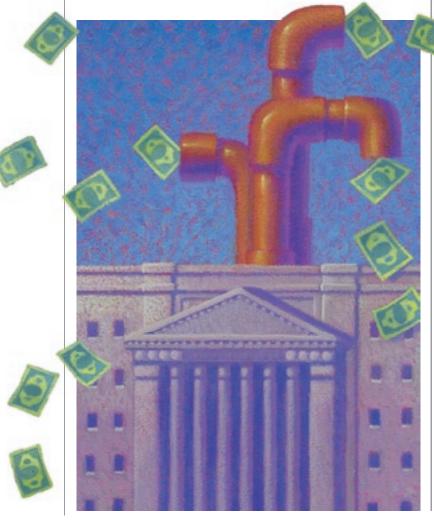
Funding sources have proliferated to the point that it's worth analyzing which are MFIs' best funding alternatives.

Altogether, the MFIs had US\$1.9 billion in liabilities at the end of 2003. Deposits (US\$1.2 billion) represented 65% of the total; loans (US\$517 million) 27%; and bonds (US\$33 million) 1.7%. The MFIs' total assets reached US\$376 million, or close to 20% of total liabilities.

At the end of 2003, the deposit/loan ratio reached 76% in the MFIs studied. At

the same time, borrowing has become less important in the institutions' financial structure. Bond issuance, a promising mechanism, is still rarely used. Although concrete data are scant, Latin American MFIs almost never issue stock. Instead, the institutions' capital base has grown mainly due to profit reinvestment.

Deposits. MFIs have attracted funds from the public with time deposits (74% of the total captured at the end of 2003), savings accounts (26%) and checking accounts (0.1%), a new source of funds. Time deposits offer clients a higher financial yield. For the MFIs, these deposits are more stable, at least in the short term, and have lower operating costs, advantages that counterbalance their



Deposits, Borrowings, Bonds or Stock?

Deposits. Given the low cost and support for matching assets and liabilities, capturing time deposits should be a priority for MFIs. Also, the problems of microsavings should be addressed and databases on savers should be analyzed to define clientele segments.

The MFI should develop annual management plans to capture deposits and evaluate them periodically, establish different interest rates by region and segment and offer incentives for clients who open savings accounts.

Attracting savings generates risks of liquidity, term mismatch, interest rates and exchange rates.

To manage these risks, the MFI should create management committees for assets and liabilities and adopt an annual management plan that includes a cash flow to be updated at least once a month.

To minimize exchange rate risk, the MFI should offer loans in local currency to clients that produce non-exportable goods and loans in foreign currency to clients who produce exportable goods. Thus, the MFI's liabilities

should match its loan portfolio. If there is a surplus offer of deposits in foreign currency, deposits in local currency can be encouraged through higher rates and better conditions, using them as guarantee to obtain borrowings in local currency and use coverage operations in local markets.

Borrowing. The MFI's diversification should include borrowing, given its low costs and alleviation of any excessive dependency on second-tier public entities. Foreign and second-tier borrowing is recommended to lengthen liability terms and bring greater funding stability, while the MFI should use local commercial bank borrowings for short-term funds and convert deposits collected in foreign currency into loanable funds in local currency through back-to-back operations. The MFI can use the balances of borrowings that have been approved but not yet been drawn down and additional resources from other sources,

especially second-tier institutions, donors and other foreign sources, to meet liquidity needs.

Bonds. The MFI should approach capital markets only after it is fully consolidated and operating in a stable macroeconomic context. The first issuance should be for an 18-month to 3-year term for the market to get familiar with the MFI and its risk profile. In seeking institutional

investors, it may be important to include a credit enhancement, which provides a partial

guarantee of principal and serves to raise the bond's rating and facili-

tate its purchase. In any event,
the MFI should obtain the ser-

vices of an investment bank with a solid reputation and extensive relationships with potential purchasers.

To diversify funding sources and minimize dependency on capital markets, some experts recommend that a Latin American MFI authorized to capture deposits should not fund itself with bonds that exceed 15% of its liabilities.

Stock. The MFI should define the role that profit reinvestment and new share issue will play in the framework of medium-term strategic planning. One advantage of selling stock is that it provides the most stable funds, which can cover risks and permit the MFI to leverage liabilities. Disadvantages include the high cost of capital attracted (for the risk premium that the investors demand) and high costs of information.

Adding new shareholders requires an in-depth evaluation of possible consequences. New shareholders can contribute additional funds, offer access to technical assistance and borrowings or contribute to the MFI's management and board. But they also can introduce potential problems, such as different expectations of profitability and investment horizons, eventual discrepancies in the definition of the institution's mission and the conflicts that may arise among shareholders due to other factors.

greater sensitivity to the interest rates paid.

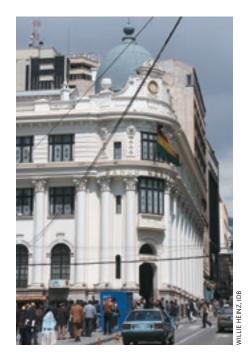
Evaluation of the savers shows that MFIs have attracted a high number of depositors, thereby expanding and diversifying their principal liability. A majority are small savers who contribute a tiny fraction of the captured deposits, as opposed to the intermediate segment of bigger depositors.

Borrowing. Analysis of the MicroRate database on borrowing by 23 regulated MFIs in seven Latin American countries shows that at the end of 2003, the public sector was the single most important source (providing 47% of total funds). Donors held second place (21% of total funds), followed by local commercial banks and other domestic sources (18%) and international social investors and other foreign sources (14%).

Borrowing from public institutions and donors allows MFIs to enjoy interest rates and maturities that would be difficult to obtain from other sources and to reduce liquidity risk or term mismatches. Also, these sources tend to charge near market rates, which prepares the MFIs to access more commercial financing.

Borrowing also affects the risks faced by MFIs in other ways. When MFIs have credit lines that are not fully utilized, liquidity management is greatly facilitated since these funds can be mobilized quickly to deal with short-term difficulties. Exchange rate risk is also aggravated, given that a substantial portion of MFI borrowing is in foreign currency, while most MFI loans are in local currency. Interest rate risks also increase, given that most MFI borrowing is at variable rates (especially borrowing from government second-tier facilities, donors and social investors) and most MFI loans are at fixed rates. Finally, borrowing may increase concentration risk, by leading MFIs to depend on a small number of creditors.

Costs. A study on financial and operating costs of the four funding sources focused on 10 MFIs repre-



senting a range of sizes and financing combinations, factors that influence costs of different instruments.1

The study concludes that capital is generally the most expensive resource, while total costs of other resources vary according to the MFI's size. The cost ratio between deposits and borrowing largely depends on the degree

and operating costs, the average cost of savings accounts is 15% vs. 12.2% for time deposits. Operating costs for SAs are much higher and reach an annual average of 11.4% of the amount deposited, while the average cost of TDs is 2.4%. The interest rates offered for deposits reflect the difference between total costs and operating costs, and are 3.6% for SAs and 9.8% for TDs. For TDs, whose main costs are the interest rates paid and not operating costs, it is important to set rate levels so funds can be captured at the lowest cost. However, many MFIs do not give this task priority because their wide financial margins allow them to absorb these costs easily.

Given these statistics, MFIs should give priority to time deposits since their total costs are less. TDs have another advantage: they are easier to manage and more stable in the short and medium term, and potentially they help term match between assets and liabilities.

The lower operating costs of TDs

RANKING OF FUNDING SOURCES BY TOTAL COST (FROM LEAST TO MOST EXPENSIVE)

Large MFIs	Small and Medium-sized MFIs
1. Bonds	1. Borrowing
2. Deposits and Borrowing	2. Deposits
3. Capital – Shares	3. Capital – Shares

Note: Large MFIs attract more than US\$50 million in deposits; small MFIs have less than US\$5 million. It is assumed that small MFIs would not issue bonds since they would not meet the minimum volumes needed to undertake an issue and capital markets would have little or no appetite for their paper.

of subsidized borrowing, especially for large MFIs, which usually enjoy greater economies of scale in capturing deposits.

The 10 MFIs examined attract deposits through two basic products: savings accounts (SAs) and time deposits (TDs), in both local and foreign currency. Of the institutions studied, nine MFIs offer both products. According to data on financial

are mainly due to the average size of these accounts, almost 20 times larger than SAs (US\$7,396 vs. US\$399, respectively). The decisive factor is not that the SAs have many more transactions than TDs. The monthly operating cost *per account* is much larger for TDs than for SAs in all MFIs, and on average is more than three times higher (US\$12.40 per month for TDs vs. US\$3.50 per month for SAs). It appears that the highest cost per account for TDs comes from the attention that agency heads give to the biggest clients. While SAs generate more transactions, lower-paid employees handle them.

The study's comparison of the two smallest MFIs with the two largest provides evidence in support of economies of scale. For SAs, the two smallest MFIs have an average monthly unit cost of US\$5.95, compared to US\$3.20 for the two largest MFIs. With respect to TDs, the average monthly unit cost for the two smallest MFIs is US\$13.70 vs. US\$4.40 for the two largest MFIs.

The other six MFIs don't show evidence of such economies of scale. These medium-sized institutions show the lowest average unit cost for SAs (US\$2.20 per month) and the highest average unit cost for TDs (US\$14.57 per month). However, it may be difficult to detect economies of scale in data such as these, except between extreme cases such as the smallest and the largest MFIs. This is due to difficulties in assigning a number of important operating costs to each product and to differences in management efficiency among MFIs.

Microsavings. Accounts with balances under \$100 make up 74% of the total number of accounts in small MFIs and 76% in large MFIs. Their balances represent 2.5% and 3.0% of total captured, respectively. These small deposits also concentrate 30% and 59% of the transactions in each case. Annual operating costs of these accounts reaches 200% or more of the amount in each deposit, implying that the clients with small balances are subsidized by other clients.

MFIs generally opt to subsidize small savers as part of their social mission. The cost of this subsidy is rarely calculated or rationalized. Competitive pressure can cause MFIs to be more selective with these clients, setting higher minimums in opening accounts, paying interest on balances, charging for each transac-



Glenn Westley of IDB

tion or imposing monthly fees for account management. Another option is to expand the base of microsavers to reach a critical mass of clients who can be tended to more economically by automatic tellers and who can choose from a wide range of financial products to facilitate transactions and recover costs. Prodem and Banco Sol in Bolivia have found that automatic tellers have greatly reduced the cost of deposits, improved client service and mobilized additional deposits.

The fact that borrowings have lower total costs should not lead small MFIs to give them priority over attracting savings. In selecting a funding source, MFIs should consider the following factors:

- The amount an MFI can borrow is restricted by limits the lenders place on the amount of credit they are willing to extend to each intermediary.
 - A significant amount of borrow-

ing concentrates funding risks and may make the MFI overly reliant on government and donors. As a result, liquidity management and the ability to do medium-term planning would be adversely impacted.

- Deposits diversify funding sources and offer much greater stability to overall liabilities. MFIs depend less on governments and donors, and thus achieve greater self-sufficiency.
- Increasing the volume of deposits can help reduce their average operating costs since it is possible to spread fixed costs over a greater volume and generate economies of scale.

Attracting deposits presents other significant advantages such as the possibility of knowing the clientele better through examination of their liability operations, greater integration of local and regional economy, more prudent management and greater possibilities for cross-sale of other financial products such as credit, transfers, credit cards, debit cards and microinsurance.

The relationship between borrowing and deposits is more one of complementarity than of substitution. In the medium term, it would be good if deposits are the main funding source, supplemented by borrowing to lengthen the average maturity of the MFI's liabilities and reduce total costs. Later, these sources can be complemented by access to local capital markets, through bond issuance.

—GLENN WESTLEY AND PETER BATE

1. Of the 10 MFIs, six are in Peru (the Municipal Savings of Arequipa, Piura, Pisco and Chincha, and Rural Savings of NorPerú and Señor de Luren), two from Bolivia (FIE and Banco Los Andes ProCredit), one from Colombia (Finamérica) and one from Nicaragua (Confía/Procredit). The emphasis on Peruvian and Bolivian MFIs is due to their preponderance in the study: 47 of the 61 MFIs are from those two countries, which together hold 78% of total deposits.



Banking

In Case of Emergency: Break Glass

An Innovative Fund Helps MFIs Respond to All Kinds of Disasters

The tsunami of December 26, 2004, which killed more than 200,000 people and displaced another 2.2 million in four Asian countries, generated an extraordinary wave of solidarity around the world. Public and private donors promised unprecedented sums to help the victims. In their eagerness to channel resources to the most affected communities, some began promoting micro-credit as a tool to help local economies recover more quickly.

However, those good intentions ran into insurmountable obstacles: the remotest areas lacked microfinance institutions (MFIs). And the areas that *did* have MFIs suffered the effects of the catastrophe's impact: missing clients, impassable roads, lost documents, destroyed equipment and unusable installations. The MFIs themselves needed to be saved, beginning with recovering their liquidity in order to resume operations.

For the donor community, this presented new dilemmas: Should they rescue *all* the MFIs? If some were weak before the tsunami, they probably wouldn't survive, and resources would be lost without attaining a multiplier effect. But how to tell which institutions were worth supporting? Such evaluations cannot be made overnight, and less so in places that have just been wracked by the sea. In fact, the most detailed reports on MFI operations in areas hit by the tsunami weren't released until mid-2005.

Half a year passed before the institutions were able to present their projects to donors, who in turn needed time to study the proposals before deciding whether to disburse funds. With the advantage of hindsight, we can say that it would have been simpler to provide the MFIs with a lender of last resort,



VID MANGURIAN, IDB

one capable of responding rapidly to the liquidity needs that result from catastrophes, regardless of whether they are caused by nature or man.

Plan, Prepare and Proceed

In fact, such a mechanism does exist, but it operates only in Latin America and the Caribbean. It is the Emergency Liquidity Facility (ELF), which specializes in providing short-term loans to pre-qualified MFIs that encounter liquidity problems caused by exogenous factors. The list of possible calamities is seemingly endless: hurricanes, floods, earthquakes, droughts, freezes, forest fires, famine, epidemics, blackouts, industrial disasters, financial panics, terrorist attacks, social disturbances and political uncertainty. The ELF has been able to respond to clients in a matter of days, instead of months. The secret, according to manager Juan Carlos Pereira, is to have evaluated the MFIs beforehand. If it hadn't previously appraised its clients, the ELF couldn't act with such agility and speed. "Evaluating an affected institution in the middle of a crisis could take weeks or months," says Pereira. "I believe that's what happened with the tsunami in Asia. A lot of goodwill existed among the agencies to inject resources into the microfinance institutions, but it takes time just to get to know them, evaluate them and see what their needs are, and thus the money arrives late."

It's no accident that the idea for the ELF was born on the heels of a natural disaster of enormous proportions: Hurricane Mitch, which lashed Central America in late 1998. As did the tsunami, the floods and mudslides unleashed by that hurricane affected the lives of millions of people and swept away roads, bridges, buildings, vehicles, livestock and crops. Mitch also hurt countless microenterprises and the institutions that provided them with microcredit. As with other organizations in the international community, the Inter-American Develop-

ment Bank's Multilateral Investment Fund (MIF) realized the urgency of helping the Central American MFIs get back on their feet in order to participate in the reconstruction process. Nevertheless, as does any organization that depends on public sector donors, the MIF must comply with rules and procedures before it can disburse significant sums of money. Projects must be conceived, designed, analyzed, approved and documented, a cycle that can take many months, especially when it involves complex negotiations with numerous beneficiaries, different

The floods and mudslides affected the lives of millions of people.

executing organizations, multiple ministries and other cooperative agencies or financial institutions. By the time the MIF obtained approval for its program to strengthen the MFIs that had suffered Mitch's fury, nine months had passed. The MIF managed to provide support to 33 institutions, but for others, the help arrived too late.

The hard lesson of that experience resulted in a call within the MIF to create an independent fund with the capacity to disburse resources in a minimal amount of time to meet liquidity needs that result from factors unconnected to the MFI's management. Its clients would be institutions that are mainly dedicated to microfinance and known to be sustainable. Loans from the fund would be short term, with market interest rates, so as not to become a substitute for the MFIs' usual funding sources. The new mechanism could channel resources from different donors, which would contribute funds for the operations. and in the process avoid costs and paperwork. The fund also would provide technical support to help clients improve their disaster risk management and strengthen their preventive measures, a soft spot for most MFIs.

For Troubled Times

The Emergency Liquidity Facility was established in August 2004 with nearly US\$2.2 million of capital and US\$8.5 million of contingent lines of credit. Its shareholders were not limited to cooperative agencies, but included private sector organizations, philanthropic institutions, nongovernmental organizations and specialized funds. In addition to the MIF, capital was provided by the Swiss State Secretariat of Economic Affairs (SECO), the Open Society Institute, the Argidius, Calmeadow, Calvert and Rockdale Foundations, the specialized NGO ACCION International and the Gray Ghost Microfinance Fund. The credit lines were provided by the MIF, Oikocredit, Gray Ghost, the U.S. Government's OPIC, SECO, SEDF and the Spanish Agency for International Cooperation (AECI). In addition, the MIF, SECO, Rockdale, OSI and Argidius provided a total of US\$780,000 in donations for the technical support facility. The ELF's administrator— Omtrix of San José, Costa Rica-manages other funds, which further lowers the operational costs.

"In the past decade, more than 40 specialized funds have appeared in microfinance institutions, but their resources are mostly available during good times, with financial stability, good growth perspectives, low default rates and high returns," notes Tomas Miller, who represents the MIF on the new facility's board. "The ELF was created for hard times, when funds are scarce and risks increase. When the others are trying to get out, the ELF is ready to move in."

Once the new facility's structure was complete, a database of Latin American and Caribbean microfinance institutions was compiled (MIF's charter limits its operations to this region). Of the more than 200 MFIs identified,

ELF managers selected 96 that were able to meet the requisites for clients: to have been in operation for at least three years, and have more than half of their loan portfolio in microcredit, good solvency, reasonable levels of default and adequate performance. "The goal was to support wellmanaged, solvent entities that had suffered an external shock," explains Pereira. "It's no good to lend money to institutions so weak that the crisis could make them disappear."

Upon passing the region's MFIs through that first filter, Pereira and a consultant began to visit the selected sites

one by one, traveling to 11 countries, to convince them of the advantages of being an ELF client. Oddly, it took some time for the message to soak in. Pereira speculates that people were suspicious of an idea that had yet to be put to the test. There is also a natural resistance to thinking about emergencies until one happens. "It's like going to the dentist. Nobody likes to do it, so they postpone and postpone. But when your molar hurts, you have no choice but to go," comments Pereira. Once the first MFIs signed up, though, others soon became interested and requested more information. In just over a year, the ELF recruited 35 organizations in Bolivia, Colombia, Ecuador, El Salvador, Guatemala, Haiti, Honduras, Mexico, Nicaragua, Paraguay and Peru.

Since its creation, the ELF has had various opportunities to act. The first was in Bolivia, as a result of the social explosion that would cut short the presidency of Carlos Mesa. The protests included prolonged roadblocks that affected the clients of microfinance institutions. In order to ensure



liquidity and assist its borrowers, one of the MFIs received the first ELF loan. Thanks to a facility's pre-qualification and periodic monitoring of clients, the only delay in disbursement is the time it takes to determine an affected MFI's solvency and liquidity needs. On average, it takes two weeks for resources to reach institutions, although it has taken the ELF as little as one to disburse.

ELF loans are for six-month terms and can be renewed for equal terms for an accumulated maximum of two years. However, the interest rate increases with each renewal so as not to create a dependency on its resources. Though the ELF tries to ensure profitability in order to cover costs and obtain a modest margin of earnings for its shareholders, the interest rates of its loans are set according to the rates of the applying MFIs' financial markets prior to the crisis. Until they use credit from the ELF, the MFIs need merely pay a one-time fee to cover the cost of evaluating their organizational structure and financial

status. Like a fire station, the facility awaits the next emergency. During calm periods, it concentrates on monitoring MFIs and efforts for disaster prevention and mitigation.

When the ELF first assesses an institution, its consultants identify areas of disaster-related risks that can be corrected with technical assistance. Generally, MFI risk management means taking steps to avoid operational problems or protect assets such as equipment and databases, Pereira explains. In recent years, many institutions have had to improve their emergency plans at the demand of regu-

lators. But when it comes to disaster risk, aside from a few institutions that suffered the effects of Mitch, few MFIs have dealt with it.

Part of ELF's mission is to strengthen client capacity to prevent and manage risks from external factors. With the facility's technical assistance component, consultants map areas vulnerable to threat or catastrophes, for both MFI offices and areas where clients are concentrated. Based on lessons learned and best practices from international experiences, they set up emergency plans and prepare the institutions for the moment when they have to confront an external crisis. All this so that they can protect their assets, stabilize their loan portfolios, and evaluate their own and their clients' liquidity needs to help them overcome the crisis.

Speedy Recovery

Salvadoran MFI Apoyo Integral is a typical case. It received ELF technical assistance shortly before two almost simultaneous natural disasters in October 2005: Hurricane Stan and an eruption of the Ilamatepec Volcano. Flooding after five days of torrential rain killed 73 people and forced more than 70,000 to abandon their homes in the capital and several regions in the country. Volcanic ash from Ilamatepec's eruption caused landslides in several municipalities, forcing yet more people to become refugees. Losses and

damage to the country's economy were calculated at US\$335 million, including housing, farms and infrastructure. According to Apoyo Integral's financial manager, Imelda Zaldivar, the microfinance institution had already begun to implement the contingency plan developed with ELF assistance. They took preventive steps to protect their installations and fixed assets, as well as to ensure the safety of personnel. Afterwards, they evaluated damage suffered by their

clients. Of the approximately 20,000 micro and small businesses with which Apoyo Integral works, 1,620 were directly affected, representing some US\$900,000 of a total of US\$14.5 million in the loan portfolio.

When natural disasters hit, microfinance institutions can expect a surge in demand for credit from their clients, as well as an increase in withdrawals and delays or interruptions in payments due to transportation problems or paralysis of commercial and productive activities. Often there is an urgent need for liquidity that, if not satisfied, can force an MFI to reduce or even stop disbursing funds, affecting not only the ability of its clients to recover, but of local economies as well. In anticipation of such a surge in demand for resources, Apoyo Integral obtained a loan from ELF for US\$750,000.

Based on the inventory of the disaster's impact on its clients, the MFI negotiated arrangements individually: it pardoned interest, suspended punitive fees, extended payment terms and granted grace periods, according to each case. As a result of such emergency measures, Apoyo Integral not only managed to mitigate the increase of default in its portfolio, but also was able to provide clients with additional



credit to speed up recovery.

The ELF will operate for four years, after which its shareholders have to decide whether or not to extend its charter. During its first year, the facility managed to cover its operating costs, thanks mostly to its administration of treasury resources. According to Pereira, if there is a low demand for emergency loans in the next few years, the ELF's shareholders at the very least will avoid losing their investments. Paul DiLeo, CEO of the private Gray Ghost Microfinance Fund, expresses satisfaction with its participation in the ELF. That fund, created by a family of real estate investors in Atlanta, Georgia, has a portfolio of US\$75 million. Their decision to participate in the ELF resulted from contact with other sponsors of the facility and their interest in supporting initiatives that

could open the door for more private investors to become involved in microfinance. Gray Ghost works primarily with investment funds specializing in microfinance institutions, which typically make long-term allocations to support the development of selected MFIs. The ELF is an exception to this rule because its operations are short term, but it plays a key role in serving a true need of MFIs. "Certainly

we don't want there to be more catastrophes in the region," stresses DiLeo, "but we would like to think that, simply by virtue of the ELF's existence, microfinance is now seen as a more robust industry within the financial sector. because it has the kind of mechanisms that can increase the stability of its institutions. We haven't taken polls to show that this is the case, but we are confident that the ELF contributes to a stronger infrastructure for the industry, and we are

very pleased that this has taken place."

For DiLeo, one of the most attractive aspects of the ELF is its technical support facility, which receives resources from the Rockdale Foundation, an institution linked to Gray Ghost's investors. "Perhaps it isn't a terribly striking subject, because it doesn't involve crisis or emergency loans, but technical assistance that prepares microfinance institutions to prevent catastrophes and mitigate their effects will probably be the accomplishment of the ELF that has the greatest impact. In the long term, it will be as important as, if not more important than, its financial operations."

—PETER BATE



Banking

From Rural Credit to Cows for Rent

Exemptions for the Impoverished

In the shade of Nitlapán (which means "I plant" in Nahuatl), the nickname used by the Instituto de Investigación y Desarrollo (Institute for Research and Development) of the Universidad Centroamericana el Nicaragua (Central American University of Nicaragua), the Fondo de Desarrollo Local (FDL, or Local Development Fund) was born some 15 years ago. It



is a nonprofit organization that promotes rural credit, a particularly difficult sector for Latin American finance institutions.

"Some 60% of our clients are farmers, and of those, some 45% are women, [while] some 50% of the credit is offered in terms of more than 18 months," says Father Peter Marchetti, FDL president and a Jesuit priest in the United States and PhD economist from Yale University.

Currently, FDL's operating portfolio contains some 36,000 active loans for more than US\$21 million, which means that FDL is the largest institution of its type in Nicaragua. But FDL's vision goes beyond simply offering credit to individuals and cooperatives. "We want people to be able to rise above poverty;

credit is not a panacea, it is also essential to take care of health and education," Marchetti says vigorously. He also points out that the FDL maintains solid relations with five other non-financial service companies, which allows FDL to offer technical assistance and training to its clients, as well as other innovative products.

Among these is the program for renting milking cows, an initiative that Marchetti describes as an exemption for the impoverished. "Small producers are risk-adverse, they do not invest in top genetic- quality cows that will produce high volumes of milk since it costs so much, and they don't want to put all their hope in one single animal. We buy the cow and they rent her, paying a fixed charge based on the productivity of the animal," he explains. The renters become small entrepreneurs since they assume the risk of selling the milk for profit. As a sound exemption, this requires the beneficiaries to follow certain regulations, such as building a barn and keeping it in optimum condition.

Reaching this point has not been easy, says FDL manager Julio Francisco Flores. Conquering the rural market has been hindered by the geographically isolated clients, the poor conditions of the roads, and the fact that half the clients are women, while farming activities continue to be viewed as men's work. But it has been worth the effort to see "how our work has influenced the development of rural families," says Flores. FDL's successes were also recognized in 2005, when the institution received the Inter-American Development Bank (IDB) Award of Excellence in Microfinance in the category of unregulated entity.

Marchetti passionately defends the unregulated microfinance institutions, since, according to him, regulation "would kill rural microcredit as it is now." He promotes flexible rules of the game, affirming, "Rural credit is high risk and we would be obligated to provide everything; this is not possible, and we have less risk than a commercial bank; our arrears are only 1%."

—GADOR MANZANO



Banking

Strength in Variety

Mexican society shows that institutional investors support microfinance when solid performance is evident.

Fifteen years ago, while doing social work in rural nutrition and health at the Mexican NGO Gente Nueva (New People), Carlos Danel, Carlos Labarthe and a small group of volunteers discovered what some people called "microfinance." It happened when they got involved with a communal banking program of the United States Agency for International Development (USAID).

This discovery led to the creation of Compartamos, a microlending program that five years ago became a limited finance company (Spanish acronym SOFOL). During its first 10 years, Compartamos grew to be one of the largest microfinance companies in Latin America. During the eighth Inter-American Forum on Microenterprise in Santa Cruz, Bolivia, in October 2005, Compartamos received the Award for Excellence in Microfinance in the category of regulated institutions that make microfinancing available to a large number of entrepreneurs.



In 2005 the organization succeeded in expanding its services to the greater part of Mexico and bringing credit to women in rural areas, where 95% of its clientele reside. An average loan is US\$308, and part of Compartamos' value is in financing loans with resources from capital market investors more than from donor organizations.

Compartamos' early days were not easy. Banks always requested solid collateral to finance the organization's plans, and Compartamos had to wait until its third anniversary to become regulated, in 1990, and begin its first growth cycle. This occurred when the Inter-American Development Bank (IDB) financed one of its programs. With those funds, Compartamos achieved operational self-financing by 1995, and within two years began to turn a profit.

However, financial challenges remained. Outside of the banks, Compartamos' growth came from retaining earnings and donations, which brought Danel and Labarthe to the decision to turn it into a SOFOL in 2000. Since then, it has all been smooth sailing. While in the 10 years from 1990 to 2000, Compartamos' microfinance operations had mobilized US\$6 million among 60,000 clients, in the five years after becoming a SOFOL, the portfolio had reached US\$130 million and the number of clientele surpassed 400,000. "It's not that we are pioneers; we have taken advantage of other models, such as the ACCION Network and the MicroFinance Network," says Labarthe.

The Mexican organization reached a landmark in 2004 when its portfolio surpassed 310,000 clients, it had 100 branches throughout most of Mexico, and the number of staff surpassed 1,300. The results, though not exceptional, were significant, with an outstanding performance in capital returns and assets. That year, when the organization won CGAP's Transparency Award, Compartamos also inaugurated its training center with a capacity to train 250 employees in a one-year program.

There is a compelling reason behind this process: Compartamos has become an attractive investment instrument for the Mexican financial market. It issued its first bonds in 2002, beginning with US\$20 million, all sold to individual investors. "It was an important moment of maturity because in the first three years [as a SOFOL] it was a struggle," Danel

Carlos Labarthe of Compartamos

said. "But with the first bond issuance, we helped the [microfinance] industry to be seen as worthy of receiving money from capital markets."

That capital helped finance development in later years and also allowed the organization to stop depending on bank financing, an expensive alternative for capitalization. By the end of 2005, Compartamos was known for its sound financial discipline; it had repaid 75% of its 2001 issuance and was able to cancel the rest by February 2006.

In the midst of this process, an important event occurred: In October 2005, Compartamos again issued bonds for another US\$50 million, and *this* time the demand not only exceeded the issuance by some 300%, but the buyers were institutional investors such as mutual funds and pension funds, and no longer the individual investors who acquired the first issuance. *Financial Times* labeled the issuance "Sustainable Deal of the Year." "We are the first to

issue debt backed with its own guarantee," Labarthe says. "And we have shown the finance sector that this is an activity worth investing in. In five

or 10 years we will speak of the niche that microfinance has in the finance sector and no longer view it as a separate activity."

For 15 years, Compartamos focused on lending working capital and microcredit, but that money will now finance new projects, such as the microinsurance program initiated in June 2005 together with Citibank/Banamex, Mexico's largest bank. At the end of the third trimester of 2006, Compartamos and Citibank/Banamex will begin the second phase of this initiative, based on voluntary enrollment. In that phase, each client can buy coverage of US\$1,300 by paying US\$0.20 per week.

Compartamos' latest challenge is to



reach 1 million clients by 2008, in regions not yet covered in Mexico (such as the Northwest) and to continue expanding its assets, which sur-

passed US\$170 million in 2005. The year 2006 should mark a new milestone if, as targeted, the microfinance institute surpasses 600,000 clients, opens 35 additional branches, expands its microinsurance and creates new credit tools, besides finalizing the steps to becoming a bank. All in all, the challenge is the same as from the start, 15 years ago. "The big motivation is the social and financial return that we generate: money reaches the people in the most direct way possible," Danel concludes.

—DIEGO FONSECA





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When Commercial Banks Move into Microfinance

By Marc Labie¹

For many years, connecting microfinance with regular commercial banking activities was seen as a nearly impossible challenge.

And in the few instances where it was done, it was usually in a fairly indirect way, such as partnerships between NGOs and commercial banks that prepared microentrepreneurs to "graduate" (as they used to say) to regular commercial banks. Even though this type of operation still exists to some extent, it is clear that microfinance is increasingly becoming a part of mainstream finance, attracting new and major interests.

A key issue is to find the "right" structure to "do microfinance right."

Three trends (at least) can be seen as heralding this evolution: the accelerating emergence of more investment funds dedicated to connecting microfinance institutions to capital markets, the upscaling of many microfinance institutions to either regular commercial microfinance banks or specialized (and regulated) microfinance institutions (MFIs) and, last but not least, downscaling.

Downscaling is the practice of regular commercial banks moving into microfinance. As part of last year's Forum on Microenterprise in Santa Cruz, Women's World Banking

> (WWB) and Federation of Latin American Banks (FELABAN) hosted a seminar to present a paper they co-produced on this topic. Titled "Banking for the Majority,"2 this paper offers a framework which, as argued by Nancy Berry, "shares knowledge on how to enter the market and how to do it right." Combined with another WWB document, titled "Expert Group + 10—Building Domestic

Financial Systems That Work for the Majority," "Banking for the Majority" offers an excellent discussion of why commercial banks may decide to move into microfinance, the risks this move may entail and, most important, the strategies that can be used in such a move.

To put it simply, there are three major reasons a commercial bank may move into microfinance: the bank realizes that microfinance markets may present huge opportunities for expansion and good returns if done well; working its way into microfinance would most likely improve the bank's image; and microfinance could be a key sector for future developments, such as remittances, which have attracted a lot of attention lately.

Benefits and Risks

In moving into microfinance, commercial banks have some advantages and some weaknesses when compared with traditional microfinance players. Advantages may include better and cheaper access to capital (including the ability to develop savings products), a superior banking (and system) infrastructure and well-known names (favoring a brand effect). Weaknesses may include the tendency of a bank to underestimate the competition in this market, and the need to adapt infrastructure and practices and to adjust to a different business culture. This is probably the most important lesson that came out of the WWB/FELABAN seminar in Santa Cruz: when entering microfinance, banks should always keep in mind that microfinance has been developing for more than 30 years, and the field has accumulated knowledge on how to do microfinance right. Therefore, if banks want to be part of it, they should make sure that they first assimilate this knowledge and don't try to re-invent the wheel. This implies many key factors, chiefly: a decentralized methodology (where credit advisers are key to success), a close relationship with clients (adopting languages, procedures and facilities compatible with microfinance practice) and a foundation in family and business cash flow analysis (not on business plans).

It is necessary for commercial banks to understand that in order to be successful they must build close relationships with their clients, the way MFIs have done for the last 30 years. Indeed, not all commercial banks are well-suited for the daily realities of microfinance. As mentioned in Santa Cruz and in a February 2006 seminar in Amsterdam hosted by International Netherlands Group (ING), "Downscaling in microfinance is to be done by local banks and certainly not by 'global banks.'"3 That doesn't mean there is no room for global banks in microfinance, but that they are bet-



ter suited to working at other levels, such as developing partnerships with existing microfinance institutions (i.e., developing "remittance products and services") or working as second-tier institutions.

There are also risks for commercial banks entering microfinance.

The first risk is oversimplification, which tends to make everyone believe that "now that even banks are coming into microfinance, it is clear that this field is no longer a part of development strategies, and that commercial microfinance is going to fulfill all the needs of the sector." Believing this would be a big mistake. Even though commercial microfinance has proven extremely positive in some contexts, it doesn't yet fulfill all the financial service needs of microentrepreneurs and their families. Therefore, there is still much room for different institutions and innovations to fill the remaining gaps. It should be remembered that microfinance is still a young field.

Another major risk is when banks entering the market choose to strongly modify methodology by confusing microcredit with consumer credit practices. This would result in unfair competition, which, as experienced in Bolivia some years ago, could damage part of the market and the traditional microfinance clients and institutions within it.

The third risk is for the banks themselves. In some cases, as noted

by Liza Valenzuela, the involvement of commercial banks in microfinance turns out to be short-sighted, plying door syndrome"

and a "revolving door syndrome" is observed.4 Banks enter with high expectations and leave disappointed, sometimes fairly rapidly, for not having been able to make the type of profits they initially expected. Microfinance can sometimes be done on a commercial basis as a fairly profitable business, providing great services to its customers, but only when it is done right and within an appropriate framework. Of course, this suggests the proper handling of many parameters, including product design, interest charged, cost management, collateral requirements, monitoring practices, human resource management, decentralized decision process, and adequate structure.

A Ouestion of Structure

A recent paper by Glenn Westley, of the Inter-American Development Bank, analyzes this last issue in detail: What type of structure should a commercial bank adopt if it wants to enter microfinance? This question has no easy answers. However, based on previous experiences, some points can be made. Westley considers these cases: an in-house microlending unit, a service company, and either a lightly or heavily regulated subsidiary. Working in two steps, he first considers when to do microfinance internally and when to favor external solutions. He then considers the advantages and disadvantages of various external structures (when to go "external"). These issues are complex and cannot be summarized in a few words. However, a key issue is to find the "right" structure to "do microfinance right." And, as Westley says, it "comes down to the specific circumstances of how much more freedom the external

organization is likely to enjoy and *how* much greater its incentives are to be efficient and profitable, versus *how* much cheaper and faster to start up and cheaper to run the internal unit is likely to be."⁵

Downscaling in microfinance carries a lot of potential to vastly increase the size of the industry. However, it also carries its share of risk. Therefore, there are grounds to argue for a cautious approach, capitalizing on what has already been learned about the way to "do microfinance right."



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For more information, visit: www.swwb.org www.felaban.com www.swwb.org/English/4000/ Felaban.htm

SPECIAL SECTION MARKETS ACCESS TO MARKETS

The Missing Link

Linking into productive chains is an option for those who enjoy daily competition.

By Diego Fonseca

In the beehives of Cuautitlán Izcalli on the outskirts of Mexico City, some of the best honeys of Wal-Mart—the largest retail chain in the world and the leading chain in Mexico—can be found. There, all types of honey are produced: organic, pure and mixed. Small glass jars of 300 and 600 grams are sent daily from the hives to supermarkets and large stores throughout Mexico.

These products belong not to Wal-Mart, however, but to DeMiel Mexico, a small Mexican gourmet honey company. Two years ago, DeMiel was distributing its products to small stores catering to wealthy consumers. But ever since it gained a foothold on Wal-Mart's shelves, the company has enjoyed accelerated growth. Mexico's growing middle class is now also getting to taste the honeys with almonds, nuts and hazelnuts.

DeMiel Mexico is a good example of a small company opting to link into a productive chain. In fact, joining Wal-Mart's distribution network meant DeMiel could take considerable advantage of its old competitors. In increasingly competitive settings, linking into a productive chain can mean survival and, if things go well, success. But this option also has some risks, and not all small companies are willing to associate with an emporium with enormous power to fix the prices and buying conditions of its suppliers.

Many Mexican and Chilean entrepreneurs—already used to rules of open competition with American, European and Asian companiesknow about productive chains. But some cases are appearing in small economies that have been steadily opening to international markets.

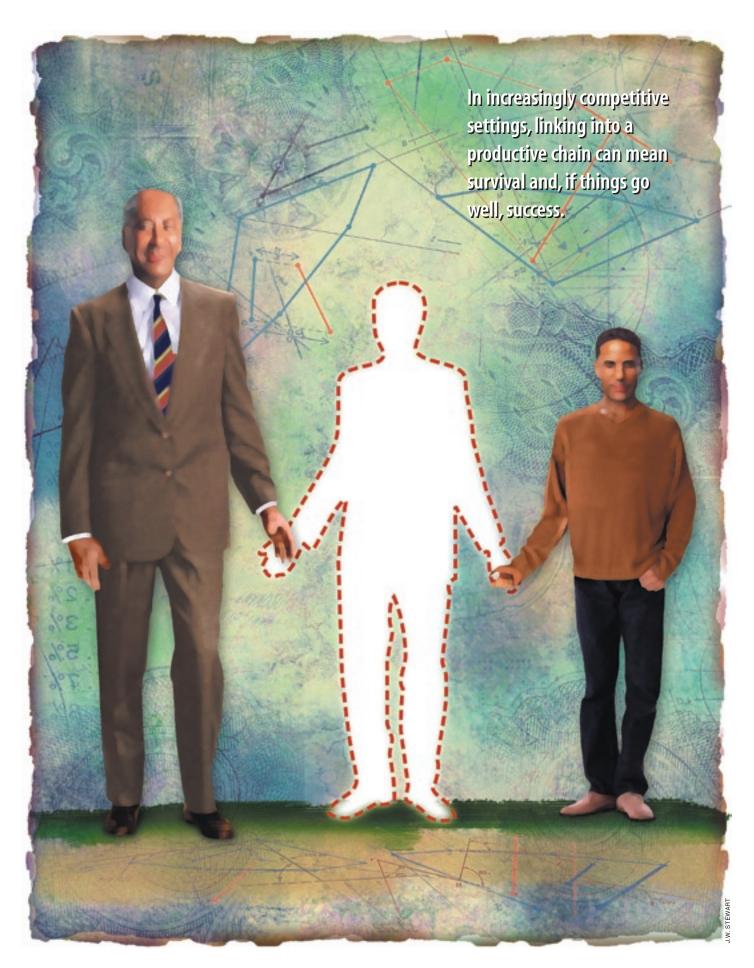
For some time now, the United States Agency for International Development (USAID) has been following the linking process of several small, productive microenterprise chains in Central America. According to Elizabeth Dunn—research team leader for the U.S. organization ACDI/VOCA, which is supported by USAID—the goal of promoting these processes has been to see if wealth can be created by linking poor communities in developing economies with productive chains.

Together with the economic opening, Central America's supermarket chains have grown significantly in the last decade, according to Claudio González-Vega, an Ohio State University professor. In the last 10 years, Central American retail chains have gone from holding 4.5% to 40% of all food sales. They also have stabilized agricultural prices, modernized trade relations and introduced new contracts and innovative efficient criteria with

respect to scheduling and logistics among suppliers. "Also, the new chains are significantly helping to deepen financial markets," says González-Vega. "It's as if it's the beginning of a revolution similar to that of microfinance."

According to Dunn, linking into productive chains has helped microentrepreneurs innovate their processes and products, specialize their operations and enter new markets. "If such improvements are happening, it is because entrepreneurs have learned," says Dunn. "Now they have more information on markets, are paying closer attention to new opportunities and are acquiring the knowledge and skills to successfully introduce new products, procedures and operations."

But if this is happening, it is because supermarket chains have taken a proactive approach to microentrepreneurs. The Central American Retail Holding Company (CARHCO) and its associates in the region—La Fragua in Guatemala and the Corporación de Supermercados Unidos (United Supermarkets Corporation or CSU) in Costa Rica—have shown interest in helping microentrepreneurs adopt stricter standards. "They are key sources of information on changes in market, procedures and products, and as service providers [they also offer new markets for microenterprise products]," says Dunn.



Chain Reactions

USAID began a project called "Jump Starting" in Honduras in 2002, which financed and followed the process of linking agricultural microentrepreneurs into productive chains through technical assistance mechanisms coordinated by agriculture experts from the Centro de Desarrollo de Agronegocios (CDA, or Agrobusiness Development Center). USAID put forth the idea that microentrepreneurs could compete in "top potential" chains occuring in general competitive settings, both global and domestic. USAID wanted to

identify the characteristics of successful entrepreneurs and figure out how to help those who were reluctant to link and compete.

USAID began working with CDA in the wake of the disastrous Hurricane Mitch, which destroyed Honduras'

agricultural sector in 1998. "The key factor was that everything hinged on a rapid response and obtaining concrete results in a matter of months," says Geoffrey Chalmers, USAID financial development adviser in Mexico. "In a short time, [the producers] had new sales, exports and products."

In addition to financing, the project included international technical assistance from CDA agricultural experts. The plan was to build relations with the productive players, transfer skills to create new products and through technical assistance create a sustainable plan over time.

Initially, the project focused on obtaining immediate results in order to show the buyers, sellers and providers that this type of relation and ties could work. But later, sustainability came to be viewed as important a goal as increasing sales. "We wanted to connect results and sustainability, and show that they are not exclusive, that results can bring sustainability," says Chalmers.

The plan was based on developing loyal, long-term commercial relations between clients and buyers. CDA technicians performed the work. Many of them were from Zamorano University, and went to the fields to transfer knowledge. They met with suppliers to convince them to help their buyers. They took the sellers to the fields so that they could teach, for example, how to apply fertilizer more efficiently. They did the same with the buyers-medium and large supermarket chains—and convinced them to work with small producers and invest in development.

Finis Chara

Value chain panel in Santa Cruz

Results have been positive. Corporación de Supermercados Unidos was involved in the process and it opened relations with producers. Today, the Costa Rican chain buys fruits and vegetables not only from Costa Rican farmers but also from small producers in Nicaragua who receive technical support from nongovernmental organizations, and also from microentrepreneurs in Honduras supported by USAID. CSU's commitment is growing beyond these relations, as it has begun to invest in the producers in Honduras and, as always, finance and buy from Costa Rican farmers, who never received support from donors.

CSU's experience has shown that several of the existing preconceptions on the competitive potential of microentrepreneurs were wrong, or at least incomplete. USAID says it is wrong to think that small producers cannot compete in top-potential chains; experience has shown that although this road is not for all producers (risk is an important factor in the decision to enter into a high-production chain), it is possible to do it with sustainable improvements and training. According to Chalmers, this can come from building vertical relations and demonstrating to the buyers (the chains) that they won't lose money working with microproducers. "The issue is to facilitate and motivate win-win relations." he says.

In the case of CDA, for example, small exporters in Honduras received

high-quality services in logistics, coordination, packaging and marketing. In Honduras, USAID sought to involve more private-sector entities as well as service providers, whether they were buyers, intermediaries or suppliers, to transfer their expertise to the producers for sustainable, long-term relations. In this

process, USAID learned that these kinds of links also change its *own* role as donor. "The role of donor is that it also has to understand that some of the best investments are those with longer-term results, of several years," says Chalmers. "Now [in Honduras], there is another expanded program called RED, with new components such as financing, that works with banks and microfinance institutions to see how to finance producers in a more sustainable way."

According to Chalmers, they also showed that the chains are more willing to incorporate into a vertical relation when they don't have to work individually with the small producers. The big buyers always prioritize ties with groups of farmers, given that negotiating with only one focal point is more practical and less costly in time and money. "Jump Starting" also showed that the poorest producers can unite in associations and compete, and find local and commercial sources to acquire knowledge and improve.

Cultivating Credit

Equally, USAID found that in many cases financing continues to be dependent on external sources, such as donors, especially in countries with poorly developed capital markets. However, the more sophisticated the market that companies want to enter, the greater the need for an improved process and greater capital investment to incorporate diverse technologies. "The example of this is irrigation equipment: it is very expensive, but in some countries it is affordable for small producers who have financing," says Chalmers. "Without good equipment, it would be very difficult for a small producer to participate in a domestic market or export market with sophisticated buyers."

But the need for capital from foreign sources is not always necessary. Chalmers says that some producers are able to finance with capital or cash from their own savings, or through a client or provider. The producers learn how to plan a more flexible planting schedule, and then finance their activities using the profits of a sale precisely when they need to start the next planting. "However, this is quite a sophisticated technique and [those who apply it] have to have an [advanced] source of knowledge," says Chalmers. "Also, it doesn't work for investments that require more capital, such as irrigation systems."

Although banks never show interest in rural microproducers, and few microfinance institutions possess adequate instruments for them, USAID found several positive experiences in Costa Rica that refute that idea. There, Hortifruti, an affiliate of CDA and a principal provider for CARHCO supermarkets, owned a small independent commercial bank. In the past, the bank did not offer loans to the producers associated with the company. But when Hortifruti began to show it had some high-performance products, the bank began to pay attention.

Chalmers says that Hortifruti did

not guarantee the entrepreneurs would pay, but they did say to the bank: "You know us, you know our reputation, and we can give you a list of 25 small producers and several cooperatives from whom we have been making purchases for a year, we have assessed and monitored, and they have always made reliable deliveries. We have a contract with them, often verbal and not written, that says we will buy this quantity at more or less this price." The financial entity understood that there was a strong informal guarantee by personally knowing the cli-

In many cases financing continues to be dependent on external sources, such as donors, especially in countries with poorly developed capital markets.

ent and it decided to give loans to some producers without asking for real guarantees. "It is credit from a financial institution, but it takes into account the relation with Hortifruti. which calms the bankers, because they often want to offer loans but require guarantees that cannot be met," says Chalmers. It is a pilot project, but it could be a potential model for other banks and chains. "If the donors enter into agreements with banks, microfinance institutions and credit unions, they help with product design, they favor loans based on commercial relations, and finally they favor small producers."

For some small producers, linking into a productive chain is an attractive alternative to achieving sustainability and expanding access to financing. "That new credit recipient can in time show that it has the ability and willingness to pay and that it understands loan technology," he says.

Experience in Guatemala

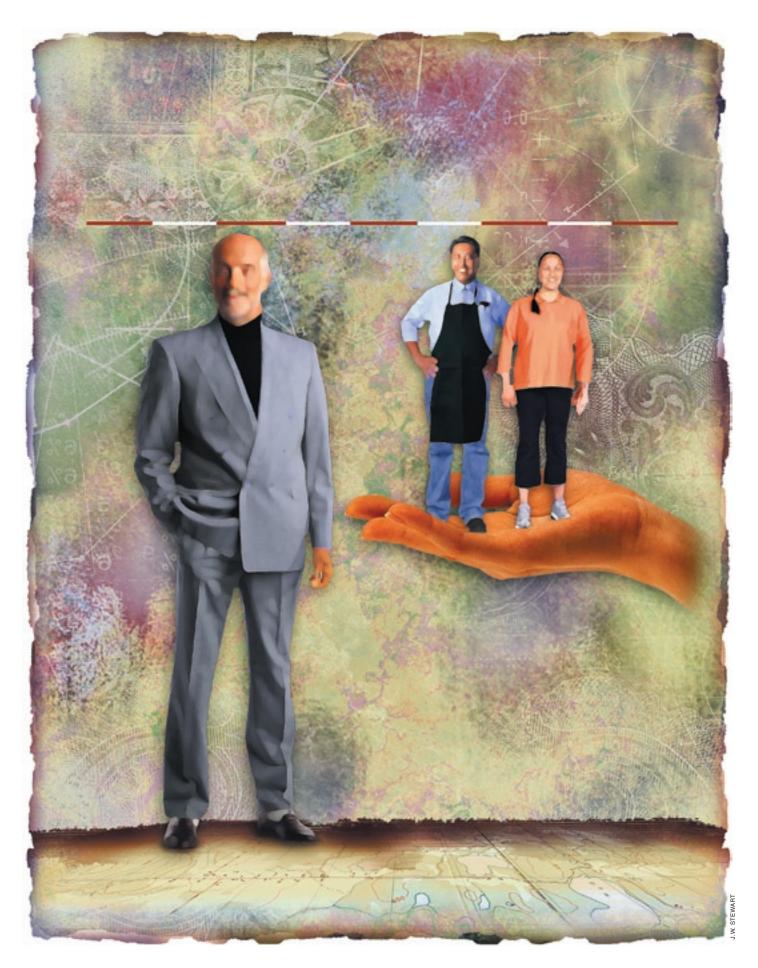
When USAID implemented a similar project in Guatemala to adopt quality standards in the agriculture market, it emphasized that linked small producers are examples for economic development. As in Honduras, in Guatemala USAID tried to prove that vertical and horizontal relations contribute to an improvement in productive conditions. Guatemala was an interesting place given that its productive chains have a high number of participating microentrepreneurs. Like the rural producers in Honduras, Guatemalans faced a new competitive scene after CAFTA.

That practice in Guatemala led the USAID to see that there are new lessons that donors can learn to improve assistance to microenterprise, suggests Phillip Church, director of DevTech Systems, a U.S. organization that works with developing markets. Among the lessons: consider including international standards in their development programs; connect producers with buyers and suppliers that help to reduce times and costs in improving activities; adopt new product standards (from phytosanitary norms to eco-sustainable production) in order to improve the relations with the productive chains; and communicate to other microentrepreneurs news of the successful cases.

Not by accident, globalization has put the small Honduran, Nicaraguan and Costa Rican farmers who sell their products to Hortifruti on a path similar to that taken by the Mexican honey producer DeMiel Mexico. At the beginning of the year CARHCO was renamed Wal-Mart, after the U.S. giant acquired control of the Central American corporation. A regional chain became part of one of the major productive chains in the world, a new challenge that promises both risks and opportunities.



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Protecting the Little Guy

Gradually, public procurements are opening up to microenterprise. Do these small players need government protection, or should they have to compete like all other suppliers?

By Diego Fonseca

What does the international promotion video of ChileCompra—the Chilean government's web portal for public announcements of competitive bids—have in common with Peruvian police boots or with a stream of government contracts in the Bolivian city of Oruro? These are all cases of microenterprises participating in public bidding and competing with the big traditional suppliers.

During the roundtable discussion on "SME [Small and Medium Enterprises] Access to Public Sector Markets" at the eighth Inter-American Forum on Microenterprise held in Santa Cruz, Bolivia, in October 2005. it was clear that governments were opening up to doing business with microsuppliers of goods and services. The experiences of the ChileCompra portal, the Promperú system and Bolivia's Inverse Fairs are testimony to this progress.

While a consensus exists that the public-bidding market needs to be democratized, an in-depth debate persists: Should the state favor microenterprises, or should they have to compete with big providers? Should the government take the initiative, or should society determine the opening of public procurement systems?

Competition, Pure and Simple

In Chile, public purchases are equivalent to 15% of the country's GDP. Several years ago, the government

noted some problems and decided to reform the market by instilling greater transparency and access. Thus, ChileCompra was born: a web portal designed to improve prices and management of government procurements and to promote government business online.

"ChileCompra broke the mold of traditional marketing where each participant establishes multiple relationships with different agencies in order to ensure sales," says Tomás Campero, ChileCompra's Director of Public Purchasing and Contracts. "The portal centralizes all of that; in one single site it brings together both sides government demand and business supply—which makes the government purchasing and private management system more efficient."

ChileCompra's key element is its electronic platform, which ties in some 900 agencies and 12,500 public employees with more than 120,000 suppliers. The Chilean government makes 80,000 purchases per month through the portal, which in 2005 transacted US\$2.5 billion in purchases, 31.6% more than the previous year.

In ChileCompra all bidders—from the smallest to the most powerful compete to offer the best products and services at the lowest price. "We're not interested in using ChileCompra to benefit microenterprises," Campero says. "Our business is to see that the e-market functions efficiently and

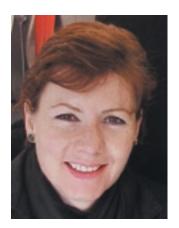
transparently."

And it has worked. According to Campero, even though microenterprises and small businesses represent only 18% of the value of Chilean economic activity, through ChileCompra, they transact 30% of the value of public-sector purchases.

The experience has enabled microenterprises to advance in technology and plant their feet within a new entrepreneurial culture, characterized by competitive practices and learning strategies to ensure quality. Campero asserts, "Microenterprises have helped meet complex demands and, thanks to their agility and wide-ranging geography, they can innovate quickly and provide new products that the big guys don't consider."

However, the Chilean government was concerned with improving market access, so it eliminated restrictions such as forbidding purchases or contracts to be shared as well as collateral on purchases under US\$40,000. All government agencies were required to accept any legal document as an invoice, allowing suppliers to recover their working capital quickly.

Through business associations the government made information available, organized training workshops, and signed up those interested. Training instructors were placed at Internet centers, free of charge, and a nationwide telephone help desk was set up to answer questions and give guidance on the supplier process.



Régula Chávez, Swisscontact, moderated the panel

Executives were assigned to clear up particular issues, and instructors from ChileCompra were available, on request, to the chambers of commerce to conduct weekly training courses.

In addition, an SME observatory follows developments in areas where small bidders rarely participate, while a technical cooperation agency identifies new operational niches.

ChileCompra is now incorporating financial applications. In 2005, a pilot program was set up to use bank collateral in an electronic format and to issue electronic invoices to certify domestic taxes. Electronic payment transfers are scheduled for 2006. And an ordering system in the pipeline will allow banks to certify purchase orders issued, so they can be used as collateral on loans.



Flavia Giménez, Procal

Bolivian-Style Fairs

In 2002, the nongovernmental organization Procal won a contest for innovations held by the Multilateral Investment Fund of the Inter-American Development Bank (MIF/IDB) with a project to create a system for more transparent public-sector procurements. It was called Ferias a la Inversa (Inverse Fairs).

The IDB funded training courses to prepare people for negotiating with agencies, municipal governments, the armed forces and the police. "It was a long process of persuasion," says Dieter Wittkowski, senior operations specialist in the IDB's Micro, Small and Medium Enterprise Division. "It meant opening the procurement process to micro and small enterprises—in no way a simple matter."

The difference in access to information between large and small bidders was a major problem. And microentrepreneurs' difficulties in gaining access to public contracts aggravated these differences. "Now, with this tool, we do things just the opposite from what brought us into poverty," says Flavia Giménez Turba, the coordinator of Procal's Inverse Fairs and former top public official in El Alto. "We've moved beyond the immediate, which is government purchases, to focus on the structural aspect of market dynamics."

In traditional markets, the sellers exhibit their wares. Under the Inverse Fairs system, public agencies come out to exhibit, either physically or through a database, what they want to buy.

Bids are awarded at public fairs, but private fairs also are held to meet with business owners, and there is an information system that cross-references supply and demand to immediately identify who is requesting what and in what quantities.

On the supply side, Procal and IDB work to inform bidders about the existence of the fairs. They also are involved in training and technical support—including instruction in carrying out required procedures and using

invoicing tools—in order to assist small suppliers who are tendering bids and applications in response to requests for proposals. "Business wheels" also have been organized to link groups of suppliers of different goods and services to the government areas that need their products.

"After the first fair, the project was a success, because public procurements had previously been marked by little transparency, corruption and favoritism, and ties to firms that had sources of information to which others had no access," says Wittkowski.

Currently, Inverse Fairs is working with 20 public institutions and agencies that have opened their books to display their budgets and report their annual purchases, with a value in excess of US\$100 million during 2004–2005. The Ministry of Defense alone awarded contracts for bids to provide 100,000 products, and shared its entire budget with the microenterprises.

Inverse Fairs has improved access to information on major public projects. Requests for bids are now more accurate, publicized in advance, and available with improved graphic and instructional displays and more details. In addition, the price of obtaining a bid announcement or call to tender has dropped from US\$50 to US\$1.

The project's success can be measured not only by the fact that the first four fairs were held on schedule, but also by the growing interest and new markets that are opening with additional financing from other donors. Wittkowski emphasizes the acceptance that Inverse Fairs has achieved. "Part of the project's success is due to the experienced, committed team that Procal contracted—they believe in what they're doing and are convinced that it will benefit the country."

Guaranteed Access in Peru

The Center for the Promotion of Small and Medium-sized Enterprises of Peru (Prompyme) was created in 1997. But

it was not until 2003, under a law to promote small and medium-sized producers, that the center was granted the authority to facilitate SMEs' access to public purchases and contracts, which reaches US\$4.8 billion annually.

In Peru, this market has always been highly centralized. While 60% of the national government budget is concentrated in Lima, the city also supplies 68% of government demand for goods and services. Historically, only the large companies developed good business connections with the public sector.

Prompyme set out to change that situation. Iván Mifflin, the center's executive director, lobbied for public agencies to announce their annual procurement budgets at the beginning of each year. With further lobbying, he managed to get purchases to be divided into small batches, appropriate for the size of microenterprises.

But he did not declare victory until a law was passed requiring the government to assign 40% of purchases to small businesses and microenterprises. Thus, the share of products and services supplied to the public sector by small companies rose from 23% in 2001 to more than 44% by September 2005.

Thanks to the law and Prompyme's work, a group of 42 small producers supplied half of the uniforms budgeted for the national police in 2002. A dozen consortiums of small and medium textile firms tendered the winning bid to manufacture 285,000 promotional T-shirts for the National Office of Electoral Processes, an operation that created 400 temporary jobs.

Prompyme trained the firms and performed follow-up on the bids awarded. The center also works with state procurement managers to eliminate barriers to access and increase transparency. Mifflin has implemented an online course on the center's website, and approximately 12,000 suppliers having signed up to learn to sell to the central government.

One main challenge is to decentralize purchases through pilot regionaliza-

tion programs. The idea is that in the near future, for example, the Army will purchase boots locally for its troops in Arequipa or Trujillo, and not buy them in Lima. If the strategy works out, Mifflin assures, it will improve efficiency in public expenditures. "At present, social security, which has a national structure, makes all its purchases in Lima," he says, "and thus it must add freight charges to the cost of all products going to the country's interior, when these expenses could be saved by purchasing from a local supplier."

The center also is working to overcome technical and financial barriers, standardize specs for products in demand and substitute the providers' collateral (which currently represents 10% of the total value) with smaller amounts to allow them to make regular payments on operating debts and avoid financial stress. Mifflin also supports the proposal that government purchase orders serve as collateral in applying for bank loans.

Protection or Free Competition?

These three models have the potential to incorporate the smallest businesses into the extensive state procurement markets, but they differ in how to establish such access. Campero (of ChileCompra) believes that the quota system distorts the market. Mifflin defends it as a cost-reducing factor. "One cost being eliminated is that of corruption, since increasing the number of participants gives more control through greater transparency," he says. "Quotas don't necessarily go against free competition but instead let you know that more businesses exist beyond those that usually participate."

Campero does not agree. "There are many myths about how microenterprises cannot access technology or participate in high-tech or complicated bidding," he says. With its open system, Chile has managed to get three out of every ten dollars of public procurement into the pockets of small producers.

However, Peru's guaranteed model



Iván Mifflin, Prompyme

has put US\$4.40 of every US\$10 in the hands of small suppliers. But does having guaranteed sales make them more competitive?

Without a guaranteed platform, in Chile's public procurement system, the portion awarded to microenterprises is greater than their share in the real economy. On the other hand, protective mechanisms are not *always* counterproductive in terms of facilitating competition. They can even cause market distortions. "A municipality may end up making poor decisions in public expenditures, because it might buy a lower-quality product simply to meet a quota," Campero explains. "On the other hand, when the business person has good instinct, things get arranged *per se*."



Tomás Campero, ChileCompra



For more information, visit: www.chilecompra.cl www.prompyme.gob.pe www.ibce.org.bo/eventos/inversa.pdf

SPECIAL SECTION ARREIS ACCESS TO MARKETS

A Partner In-House

Is your country heading toward free trade?

Don't worry—the government and small businesses can work together to improve competitiveness.

By Diego Fonseca

In Costa Rica, there is a word with a history of its own: "associativity." Cooperatives such as Dos Pinos, the largest dairy company in Central America, exemplify the concept. And now two new projects—Costa Rica Fashion Port and Consorcio Metalmecánico (Metalwork Consortium) have joined the group. Both are examples of the Costa Rican government's efforts to prepare small businesses for CAFTA, the free trade agreement among the United States, El Salvador, Guatemala, Honduras, Nicaragua, the Dominican Republic and Costa Rica. As this edition of *MicroEnterprise* Americas went to press, the Costa Rican Congress had not yet ratified CAFTA, but that hasn't kept government agencies such as the foreign trade promoter Procomer from forging ahead in anticipation of the opening.

Procomer is, in fact, behind Costa Rica Fashion Port and Consorcio Metalmecánico. And the Costa Ricans aren't the only ones preparing for competition. Chile, the Latin American nation most open to trade, has set the bar for helping micro and small producers prepare for free trade. In both cases, the agencies promoting exports have tried to address the core issue: how the government can get producers into shape for a competition in which there will be winners—but also losers.

These strategies would appear to be exportable; what is needed is to raise awareness and knowledge about how to acquire a competitive edge, take advantage of institutional support and forge associations in order to obtain a critical mass and coordinate competition, a trend called "coopetition." According to Procomer director Martín Zúñiga, "The signing of a free trade agreement should be accompanied by support policies—complementary or parallel agendas—that provide particular help to micro, small and medium enterprises in raising their levels of competitiveness."

Linkages

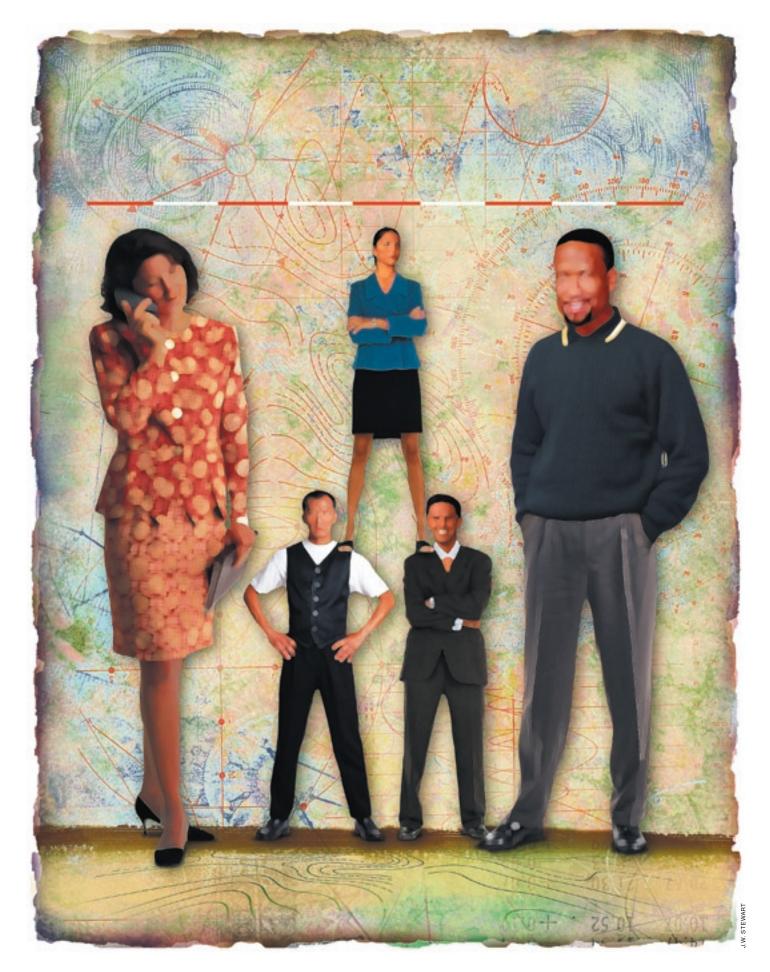
Three years ago, Procomer set out to get small businesses and microenterprises better positioned to deal with CAFTA. To this end, it laid out a series of strategies that ranged from concentrating enterprises around their current creative capabilities to developing consortiums of partners and engaging in market research. The main objective was to make the smaller companies as competitive as if they were in the global market, so they would not be destroyed when a competitor eventually crossed the border.

Procomer managed to get 300 small and medium enterprises (SMEs) to go international as suppliers for export firms. Others, such as the companies that make up Costa Rica Fashion Port, have begun to abandon the constraints of the assembly plant, or "maquila" model, to produce clothing under their

own brand names for the domestic market, as a step toward entering the global market.

Costa Rica Fashion Port's first step was to link together textile firms that were operating individually. Procomer provided training in managing markets and conceptual instruction in the fashion business. It hired Inexmoda, Colombia's Fashion and Export Institute, to provide training in clothing design. Integration has helped the firms improve in several ways, such as exchanging information on customers and supplies. They've also learned to coordinate their production, so when one member faces excess demand, it can channel work to another.

The Consorcio Metalmecánico put 13 SMEs on the path to consolidation by providing them with know-how and experience. When these companies wanted to become suppliers for international companies, they were given guidance on transforming their production lines, adapting their manufacturing methods and incorporating new machinery in order to meet the quality standards and supply times that such buyers demand. "Companies in the domestic market use less-sophisticated processes [than international companies]," says Zúñiga. "But our criteria for internationalization isn't necessarily to sell abroad; even though they produce for the domestic market, firms should meet quality standards that would be competitive in any part of the world."



Both consortiums have also helped their member firms gain experience in post-sale services and management of inventories, cash flow, invoicing and accessing financial services. Another equally important factor was improving their supply of raw materials. Individually, those SMEs didn't have sufficient power to negotiate prices for the small volumes they demanded, so they often wound up purchasing low-quality materials. Once they partnered, though, they gained a better negotiating position vis-à-vis suppliers.

The experiences of the metal and textile workers have been replicated by a plastics manufacturers' association formed in 2005 under the aegis of Procomer. In the past, when those polymer producers made individual purchases of raw materials, the time and place of delivery were determined by the manufacturer's schedule. Their partnership has enabled them to cut supply times and persuade manufacturers to deliver materials directly to their plants.

Members of the polymers association are small and medium firms with underutilized machinery, since they don't have enough contracts to operate two or three shifts per day. When an association member faces excessive demand, the consortium allows the member to shift part of that production to another member's under-utilized plant. In this way, they are constructing a single, large production line from various factories, so that none of them will miss lucrative opportunities.

When firms are ready to enter the international market, Procomer offers one more instance of support. The agency's economic research department works with its marketing management to identify niche markets in various countries. The search consists of identifying commercial opportunities and describing the conditions in each of the eight markets where Procomer has offices: the United States, Canada, Puerto Rico, Mexico, El Salvador, the Dominican Republic,

Trinidad & Tobago and Chile. That information is then sent directly to the firms. "Market prospecting is quite expensive and knowledge-intensive for SMEs," notes Zúñiga. "But if they organize, they gain greater access to more and better information."

Is There Life After Death?

Various analysts agree that the internationalization of small producers, or helping them to meet international quality standards, allows those firms to raise their competitiveness to levels that should allow them to survive



The panelists discussing free trade agreements

in an open market, even when their operations are exclusively domestic. "Along these lines, partnering through associativity is indispensable," says Zúñiga. "Small firms will neither grow stronger nor exploit advantages on their own, but if they form a partnership, synergies start to happen."

The point is particularly significant in the context of trade liberalization. Free trade agreements (FTAs) are customarily viewed by critics as triggering crises and are blamed for the disappearance of economic players. IDB consultant Laura Rojas, a Venezuelan expert on international trade, thinks this perspective is wrong. "The [domestic] impact doesn't begin with an FTA per se, but comes from globalization," she says. "FTAs are instruments that accelerate globalization, broadening markets while bringing to the fore other globalization trends such as product segmentation or differentiation."

Nevertheless, small producers do

face the risk of becoming extinct, which is the way competition works. To confront that risk, as the experiences of partnering in associativity have shown, small players need to identify their strengths and weaknesses and create policies to deal with them. According to Juan José Llisterri, senior specialist for entrepreneurial development in the IDB's Micro, Small, and Medium Enterprise Division: "Among firms, there are winners and losers, and just as companies should be encouraged to take advantage of opportunities, losers need to straighten things out or adapt to the

demands of their sector if they are going to survive."

In this context, focusing on market niches is an excellent opportunity for SMEs, especially for those that value local products. The cases of Mexican and Costa Rican coffee producers are well known, and new examples are appearing

all the time, such as the shared brand name for crafts produced by artisans in the Dominican Republic. "Niches are not simply a cliché," says Rojas, "As the market expands, a product can become increasingly differentiated, which makes it more feasible to find a point where it can enter the chain."

Beyond the Traditional

Chile represents a successful case of integrating nontraditional and niche markets into international trade. Salmon production didn't exist in Chile 30 years ago, but today, the country is among the world's top three salmon exporters. Nor were there small suppliers in the salmon industry, which provides direct and indirect employment for 45,000 people.

Nontraditional Chilean exports now account for 25% of total sales to Europe, 50% of sales to the United States and 75% of sales to Latin America. SMEs in the country's farming, fishing, food and metal industries have either directly or indirectly gained entry into the international market. For instance, some 500 growers participate in the fresh fruit export market. Although nontraditional products still represent only a fraction of total exports, they have been growing at rates of more than 35% and form an integral part of the country's development strategy.

"Our procedure has been to diversify markets, and the participation of SMEs within it has basically been as suppliers of goods and services to the major exporters," explains Hugo Lavados, director of the export promotion agency ProChile.

But not everything is rosy. ProChile figures show that 60% of the country's internationalized SMEs are exporting to a single market, a level of dependency that makes them vulnerable. Together with private institutions, and with support from the IDB's Multilateral Investment Fund, ProChile has launched the Pymexporta program to help SMEs that are already exporting

within Latin America to gain entry into more complex markets, such as Europe and the United States.

Apart from the customary snags of financing and technology, ProChile has identified three major problems these companies need to address: upgrading their packaging, containers and labeling; overcoming obstacles such as complicated product safety, food hygiene and customs regulations; and identifying distribution networks, which are generally concentrated among a few buyers.

After assessing firms' export capabilities and capacities, the program implements a training project to help SMEs make the necessary modifications to the products and services they supply. "One of the strategies is to shift away from the concept of 'This is what we produce,' to: 'We produce what the market demands,'" says Lavados.

Pymexporta, like ProChile, is part of a chain of support for small producers and companies. The Fondo de Solidari-

dad e Inversión Social (Solidarity and Social Investment Fund) offers financial and technical support to emerging microenterprises, whereas Servicio de Cooperación Técnica (Technical Cooperation Service) provides education and training to industrial SMEs. The Instituto de Desarrollo Agropecuario (Agricultural Development Institute) provides financing to farmers and ranchers, and the Corporación de Fomento (Development Corporation) acts as a second-tier bank and brings together firms to improve their procedures, certifications and technological innovation. "An organization that promotes exports is simply the last link in a chain of support for SMEs," notes Lavados. "For it to work well, there must be a high level of interaction and synchronization of shared strategies."



For more information, visit: www.procomer.com www.prochile.cl www.pymexporta.cl





Best practices help Caribbean MFIs improve their performance and knock down persistent myths

By Lene Mikkelsen

"Definitely an eye-opening experience," stated Debra Williams, executive director of Jamaica's Micro Enterprise Financing, Ltd. She had just finished visiting a small office of one of the leading Bolivian microfinance institutions, PRODEM in Santa Cruz de la Sierra, and was clearly impressed by what she had seen. The office works with low-income vendors who run stalls at a market across the street in downtown Santa Cruz. PRODEM gives its clients what they want, when they want it and how they want it: timely credit on terms tailored to their individual needs.

Williams was one of 13 representatives of Caribbean microfinance institutions (MFIs) invited to the Microenterprise Forum held in October 2005 in Santa Cruz. Besides participating in the meeting's workshops, panels and networking, the Caribbean delegation visited several successful local institutions working in microenterprise development, including PRODEM, BancoSol, Jesus Nazareno Cooperative, FUNDECO and CEDE MYPE. The point of the tour was to place what was preached at the forum into perspective by seeing it in practice. Apparently, the goal was achieved. "How do they do it?" asked Williams, shaking her head after learning PRODEM's high ratio of clients per credit officer and its low level of delinquent loans.

The answer is in the methodology PRODEM and many other MFIs employ to attract, assess and monitor clients. Like many of the forum's 1,200 participants, the Caribbean contingent was acquainted with microfinance best practices, but watching credit officers carry them out thoroughly and consistently made it much more tangible—perhaps even replicable in the Caribbean, long perceived as a tough market for MFIs.

One of the panels of the Santa Cruz forum, "Microfinance in Difficult Situations," analyzed the Caribbean case. Practitioners have argued that conditions are more complex in the Eng-

lish-speaking countries in that part of the world due to factors that set them apart from their Spanish-speaking neighbors. Not necessarily so, argues IDB economist Glenn Westley. In his study "Microfinance in the Caribbean: How to Go Further," Westley holds that many Latin American MFIs have encountered and overcome

numerous problems and equally difficult environ-

ments, and cases in Bolivia, Colombia and Peru prove that MFIs can survive and even thrive in hard times.

Westley further maintains that conditions that Caribbean microlenders see as root causes of their underwhelming performance are by no means insurmountable. One of the obstacles often cited in the Caribbean is a limited demand for microfinance, given the region's smaller population, fewer microenterprises, relatively better economic conditions and access to other sources of financing. And it is true that Caribbean MFIs in general have to cope with smaller microenterprise markets and smaller populations than Latin America. On the other hand, the ratio of microenterprise to the population is not that different—in fact, Jamaica has almost the same ratio as Bolivia (16% and 16.7%, respectively).

Another factor is the availability of donor- and government-subsidized financing for MFIs, which undermines institutions' incentives to control their operating expenses and guard their loan portfolio quality. But however big and widespread a program that donors or governments implement, there always will be large market segments that go unserviced, as numerous Latin American MFIs can attest to, having survived and prevailed in similar situations for at least three decades.

According to Westley, poor performance in profitability and delinquency rates almost always can be traced back to internal factors, such as inadequate management. In fact, he believes there is little or nothing to hinder Caribbean institutions from performing as well as their Latin American peers, provided they apply the right methodologies and manage their portfolios as studiously as their Spanish-speaking counterparts. "Management almost always can trump environment," says Westley. And some of the Caribbean institutions represented in the forum are already proving that point. Interviews with four participants conducted six months after their visit to Santa Cruz show that best practices and good examples are now being employed, with encouraging results.

Keeping an Eye on Clients and Paybacks

Perhaps the single biggest concern among microfinance practitioners is loan delinquency. To keep it under control, they must make sure to have the right clients. Solid character assessments of borrowers should enable MFIs to weed out unreliable prospects. Equally important is the efficient and immediate follow-up of any delay in repayment.

decreased slightly, but he feels the overall clientele quality is better. Best of all, Chapman adds, the delinquency rate has fallen from 35% to 21%, still too high for comfort, but definitely on the right track.

Julian Henry, general manager of MICROFIN in Trinidad, reported similar changes. "It's not that we

Workshop for Caribbean participants in Santa Cruz



Errol Chapman, of the Institute of Private Enterprise Development in Guyana, took the critique of his MFI's lax delinquency controls to heart. With the arguments he heard at the forum still fresh in his mind. Chapman asked the Bolivian institutions he visited about their approach to evaluating clients and ensuring prompt payment. Armed with the impressions from institutions such as BancoSol and PRODEM, he organized seminars in his own MFI shortly after returning to Guyana, focusing on the establishment of a set package for managing loans at every stage. In the past his institution relied exclusively on collateral. "We have now become much more diligent in assessing the character of our clients, and we have gotten much tougher and consistent in our repayment follow-up," Chapman says. After six months, the number of loans has

didn't know these things, but seeing the institutions actually doing it in practice, and hearing the credit officer on the ground explaining how to do it, that is very different, and very concrete." With the introduction of a more thorough system to monitor loans, MICROFIN is already seeing signs of improvement in its control of arrears.

One Size Won't Fit All

Another issue that seemed to hit home with numerous participants was product diversification and development. Williams has no doubt as to what she took away from the forum and the institutional visits. According to the Jamaican executive, most microfinance institutions in her country are run by bankers with little appreciation for the keys to successful microfinance, which results in inadequate products for their

small clients. The Bolivian institutions showed her another reality. "Their approach is totally different; whereas we offer more or less one product, they offer numerous products depending on the demand and the type of clients," she says. "It just really emphasized to me how in Jamaica there is a lack of understanding of microfinance, and we don't know how to adapt to this type of market and the needs of this type of client." Since her visit to Bolivia, Williams has taken steps to diversify her MFI's products and loan terms for different clients. Her most successful experiment was changing the methodology for serving rural clients, whose needs are very different from urban

A new mindset can be noticed in other institutions. "Our main revelation was that the cookie-cutter approach is simply not good enough," says Stephanie Missick-Jones, credit and SME specialist at the Bahamas Co-Operative League Limited. Her institution is increasingly aware of the importance of assessing demand, particularly in rural areas, as well as of designing different products for different clients. "We definitely have product development on our radar screen," she says. The next goals are to gauge demand more accurately and develop strategies to market new products effectively.

These four Caribbean institutions have concluded that there is great potential in improving products and services, even if their clients are very few or very small. "I guess we saw that with better services and greater attention to the individual client, you also get better customers in return," Williams says. Her Kingston office, for one, is now open for extended hours to better serve its clients.



For more information, visit: www.microfin.org www.bfsb-bahamas.com/member_detail.lasso?id=33181 www.ipedgy.com

At the Click of a Mouse

By Gador Manzano

César Hugo, a 58-year-old Ecuadorian ironsmith, earns his living along with his four children fabricating doors, windows and iron bars. His business is in demand in the poor neighborhoods of Guayaquil, where robberies are common and iron bars serve as protection against break-ins. But Hugo's business cannot grow or flourish due to a lack of capital. Yet he has not sought a local loan to solve his problem: his hope is the Internet. Hugo is counting on connecting to enough individuals who will each lend him at least US\$25 so he can get the US\$500 needed to invest in making a showroom to be able to present his products to potential clients.

In this circumstance, the magic of connecting small microentrepreneurs with investors, baby step by baby step, comes courtesy of Kiva, a microfinance organization whose website allows investors to select the business that seems most viable or interesting to them from an active portfolio of microentrepreneurs and then make a loan using a credit card. As the loan term passes, normally six months to one year, the investor recovers his/her investment. But all investments run a risk. If the loan is not paid back, the investor loses the loaned capital, something that has not happened during Kiva's year in operation.

"Kiva has ties to 10 organizations that work in the field, all with access to the Internet; they select the investors and put that information and profile of the microenterprise into our system," explains Matt Flannery, Kiva's founder. The technology allows lower financial costs and greater transparency, according to Primal Shah, Kiva's president. Investors know exactly to whom they are lending money and can follow the negotiation process online throughout the loan's duration. "In Latin America we work in Honduras, Nicaragua and Ecuador," adds Shah. The technology makes it possible to create a connection between microentrepreneurs and small investors that goes beyond financing, allowing donors not only to invest money but also emotional capital, if they so choose, Flannery explains.

United Strangers

Rural women in Central America have found an unexpected friend in the technology. "There is growing pressure to make microcredit sustainable. The amount of the microloans has continued to increase and the interest in rural zones dried up," explains Bob Graham, founder of NamasteDirect, an organization that collects donations online to offer loans to rural Guatemalan women seeking credit for the first time. The funds raised by NamasteDirect are in turn donated to

local microcredit organizations that manage the nointerest loans that the women will receive.

Graham is an expert in microfinance. He previously founded Katalysis, which led to the Katalysis Microfinance Network of Central America. Currently, 13 microcredit organizations are united in the net-



Investors know exactly to whom they are lending money

work. Graham is openly enthusiastic about the boost that new communications technology is giving this field, and he recites with passion how the Internet can benefit NamasteDirect: "It allows us to establish a close connection between the borrower and donor; it lowers the cost of keeping current and potential donors informed; it's accessible to the small donor without us having to assume any additional



cost; it allows quick and efficient collection of funds for us and our associates; and finally, it allows users to donate as impulsively as they shop on the Internet."

Another advantage, Graham notes, is that the Internet is here to stay and it is an indispensable tool for the new generation of philanthropists. "We wanted to create an organization that would last through time, that would help poor people become less poor with the help of small loans and that would do good social work using sound business practices," Graham explains.

Simplifying the Complicated

Technology is useful only to the extent that it facilitates something that previously was not possible, lowers costs or opens the market to new products or players. Prodem's automated teller machines represent a good example. They can be used by microentrepreneurs who do not know how to read or

> write, since the teller speaks to the user not only in Spanish, but in Aymara and Quechua as well. Clients respond by selecting different-colored options on the screen without having to key anything in, and they can withdraw money in both bolivianos and dollars.

> ATMs also offer security to the customer because they use a fingerprint reader that authenticates the card's owner. They can operate in rural areas that are not connected to any computer communication network, since the users have a card with a chip that contains encrypted information about their account.

The ATMs offer an advantage not only for clientsmany of whom are accessing credit and traditional banking services for the first time but also for Prodem, because it has been able to dramati-



cally increase its number of real and potential clients and bring microcredit to thousands of new borrowers, many of whom live in rural areas which have been excluded by traditional banks.

Clients view the Prodem ATMs as belonging to them and they value the services that the machines provide. In the last couple of years, during the protests in Bolivia against the government and globalization, in which banks and public installations were targets of destruction, not one Prodem machine suffered damage. In some towns, the community organized to physically defend the machines. The image of a peasant defending an ATM is a real tribute to the power of technology to reduce the inequality gap.

With the Bank in the Pocket

The technology not only helps microentrepreneurs but also is a good ally of the organizations that work with them. The program Microenterprise Access to Banking Services (MABS) is a good example. According to John Ownes of Chemonics—the consulting firm that led the project—the goal was to help rural banks develop their capacity to provide profitable financial services to microenterprises.

"In the Philippines there are a large number of rural microfinance clients whose small transactions are extremely costly. At the same time an extensive network of low-cost cell telephones exists, and we saw the opportunity to operate virtual bank accounts using cell phones that allow the user to buy and pay for goods and services, send and receive money and make domestic and international transfers," explains Ownes. The transactions and transfers are made through text messages, a technology that was not new to many users, which meant that there was no need to teach clients how to be familiar with something unknown. "When the program began, one company, Globe Telecom, managed more than 200 million messages per day," Ownes reports. MABS made an agreement with Globe Telecom that led to the creation of G-Cash, a type of virtual money that can be used in the real world.

The system is fairly simple. Many small stores allow the exchange of cash for G-Cash. This saves time for the client, especially in urban areas where no bank is nearby, since there is no need to go to a branch. G-Cash

is stored in the cell phone, which becomes an electronic purse. Through text messages in the phone, loan payments can be made, transfers sent or purchases made—instantaneously—at any time of the day or night.

Until now, use of cell phones for this type of activity has been more common in Africa and Asia than in Latin America, but this situation could change soon. According to data from the International Telecommunications Union, 32% of the Latin American population had cell phones in 2004, a percentage that is growing quickly and that is almost four times more than the number of users connected to the Internet. Between 2000 and 2004, the number of people with subscriptions to cell phones rose by 171%, a figure that continues to rise and that surpasses the number of people who have computers. It's not strange then that as the number of cell phone users rises, at all income levels, they keep their bank in their pocket.



For more information, visit: www.kiva.org www.namaste-direct.org www.prodemffp.com ww2.rbapmabs.org

Business Services

Financial Education: The Next Training Frontier

You may not have read it in the headlines, but one of the most ambitious campaigns to bring financial education to millions of microentrepreneurs in developing countries is under way, with funding from the world's largest financial services company.

The Financial Education for the Poor Project, financed by Citigroup's corporate foundation and run by the U.S. non-profits Microfinance Opportunities and Freedom from Hunger, started this year to

recruit and prepare master trainers at 60 microfinance institutions around the world. The goal is to form a global network of financial educators who will help more than 2 million people acquire essential concepts and skills to manage money and credit. Many of the people who will receive training are barely literate, and all of them are either poor or almost poor.

Over 2006 and 2007 the project will disseminate its curriculum, currently published in Spanish and English, consisting of modules on budgeting, saving, managing debt, understanding banks and financial negotiation. In Peru, COPEME will co-host the first regional training-of-trainers workshop, drawing participants from 10 institutions in Peru, Bolivia, Colombia, Chile, Dominican Republic, Ecuador and Mexico. Other TOT workshops are planned for India, Eastern Europe and the Middle East. The nascent network will expand, with opportunities to share adaptations to the curriculum as well as new materials they may develop.



Many of the people who will receive training are barely literate, and all of them are either poor or almost poor.

Timely and Pertinent

Financial literacy is not a new idea. In rich countries, it is an integral part of civic education. These nations have sophisticated banking systems that encourage people to take advantage of their services. Savings accounts, credit cards, business loans and mortgages are so common that they are almost taken for granted. In contrast, few of these services are available to low-income households in developing countries. Poor families, who are always struggling to stay one step ahead of the next crisis, are particularly in need of financial services that can help them accumulate assets. Basic financial education can increase their capacity to save more, spend less, borrow wisely and manage their debt with discipline. More experienced clients can learn to effectively use more advanced financial products and services, from money transfers to insurance.

The Financial Education for the Poor Project started with a focus on microentrepreneurs and clients of microfinance programs. For this group, financial education is more relevant now than ever before.

In the context of microenterprise development, financial education is a precursor to the more common business skills training. It is broader in scope and useful to a wider range of learners—indeed, to anyone who makes decisions about money and finances. Many women bear responsibility for household cash management, oftentimes in unstable circumstances. Financial education can prepare them to anticipate lifecycle needs and deal with unexpected emergencies without assuming unnecessary debt. For youth, financial literacy can reduce their vulnerability to risks associated with the transition to adulthood and enhance their money management skills as they enter the world of work.

As the microfinance industry matures, providers are proliferating (banks, finance companies, consumer lenders, NGOs, self-help groups, village banks, etc.) and offering a growing array of products and services with diverse features, benefits, costs and obligations. Clients who are not familiar with banking products risk mismanaging them once they gain access to them. To benefit from this expanded range of options, the poor need to understand how products differ, how to calculate and compare their costs and how to determine what they can afford.

Developing a Curriculum

The limited experience in developing countries with financial education dictated a comprehensive design with three major components for the Financial Education for the Poor Project:

- Market research to assess people's current financial strategies
- Curriculum design
- Framework for outcome measurement.

To implement these three components, the project followed a bottom-up approach involving seven partners around the globe¹: While each organization set different objectives for its engagement in this program, all followed the same process. Microfinance

Opportunities and Freedom from Hunger used these findings to develop a generic, field-based curriculum:

Market Research. Faced with a relatively blank slate, new market research was vital to answering the questions about what to teach (content) and how to teach it (delivery of content). The findings informed designers about existing client behaviors, knowledge, skills and attitudes. Across three continents, consistent demand was identified for five broad themes that were ultimately developed into five distinct training modules:

- Budgeting: *Use Money Wisely*
- Debt Management: *Handle With Care*
- Savings: *You Can Do It!*
- Bank Services: *Know Your Options*
- Financial Negotiations: *Communicate With Confidence*

Curriculum Design. Beyond providing information, the project seeks to change behavior: to enable people to transition from reactive to proactive financial decisionmaking. To achieve sustained behavior change, the curriculum content addresses a combination of knowledge, skills and attitudes. It is built on a learner-centered approach based on the premise that adults acquire knowledge more effec-

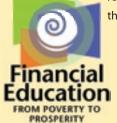
BENEFITS OF FINANCIAL EDUCATION

Clients will gain:

- Knowledge and skills to manage their money wisely.
- The capacity to use financial services more effectively.
- Increased self-esteem and confidence as they succeed in achieving financial goals.
- Greater ability to demand better quality products and services from financial institutions.
- More financial stability as they learn to borrow prudently, budget wisely and save regularly.

MFIs will gain:

- Strengthened client performance.
- Improved portfolio performance.
- Enhanced customer service.
- Ability to attract new clients.
- Increased retention of existing clients.
- Recognition for meeting social



responsibilities in their communities.



Poor families, who are always struggling to stay one step ahead of the next crisis, are particularly in need of financial services that can help them accumulate assets.

 Candace Nelson of Microfinance Opportunities

tively when they can relate the content to what they already know. To change their financial behaviors, adults must have an opportunity to reflect on new content, relate it to their personal situations, practice using it and determine how they can apply it.

Measuring Outcomes. Outcome assessment is an integral part of the curriculum. It is an important tool for understanding the extent to which a financial education program is meeting its objectives at both the client and institutional levels. The outcome assessment component focuses on:

- Client level changes in knowledge, skills, attitudes and behaviors
- Client level changes in financial well-being
- Institutional level changes in financial performance.

Financial educators can use this measurement framework with two goals in mind: to improve the program and to prove its impact. Understanding how learners are responding to the material will help trainers improve the content and delivery of their training, tailor it to particular target groups, and keep programs accountable to learners. Positive results can also be used to justify support for financial education programs.

Organizations face many questions and options as they consider how to use financial education. How should it be offered? Who should participate? Who will pay for it?

ProMujer, a Bolivian MFI offering integrated services (credit, health and education) to thousands of poor women in the Andes, has championed financial education and is grappling with these issues. Its standard training program consists of mandatory 30-minute educational sessions that are part of clients' monthly meetings. At each gathering, clients choose the class they will attend that day from three or four topics offered simultaneously. To gauge client interest in and assess the impact of financial education, ProMujer first offered it as a separate course outside the normal curriculum. This course met for three hours a day for one week. Clients, who pay a small fee for course material, have so far been very satisfied with the training.

However, these results pertain to a small group of 60 clients who participated in the first two financial education courses (two classes of 30 women each). To extend the service to all of its clients, ProMujer has also incorporated financial education into curriculum offerings with shorter, stand-alone sessions that have reached approximately 40,000 clients.

This training is financed by the organization through a combination of earned income and grants. As with any educational offering, financial services providers have several financing options. Training firms may charge a fee for service; banks may expense it against their marketing or public relations accounts; not-for-profits may seek grant funding.

Next Steps

Beyond the basic financial literacy, the project is working on new curricula with new partners. Many themes are emerging as changes occur in the economy, workplace, labor force and banking technology. For example, remittances play a very significant role in the lives of millions of low-income households, offering a new arena for financial service providers. Financial education will be key to helping clients understand and use such new services effectively.

Once people acquire financial literacy, it cannot be taken away. A one-time course can have life-long rewards. For microfinance institutions, financial education is an additional service that will attract and retain clients, eventually translating into a stronger bottom line. Ultimately, financial education is a win-win investment for both clients and financial service providers.

—CANDACE NELSON

1. Pro Mujer (Bolivia), Teba Bank (South Africa), Al Amana (Morocco), Equity Building Society (Kenya), SEWA Bank (India), CARD Bank (the Philippines) and the Micro-Finance Center (Poland).



For more information, visit: www.microfinance opportunities.org www.freefromhunger.org www.copeme.org.pe www.promujer.org

Business Services

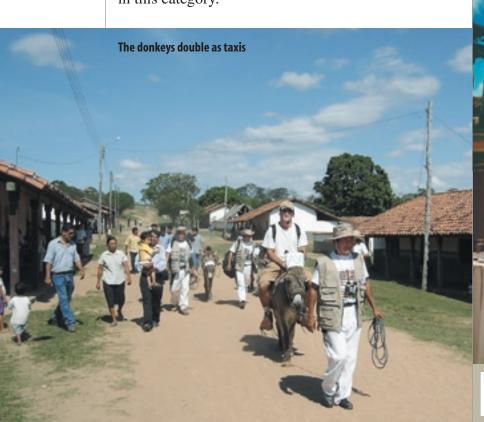
Capital, Markets, Networks and Leadership

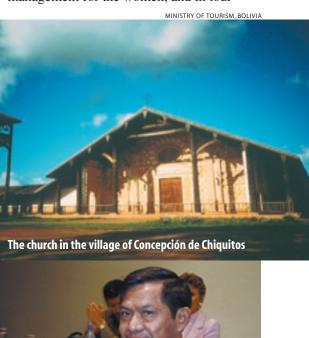
Four critical ingredients to promote entrepreneurship

The village of San Antonio de Lomerío, with some 6,000 inhabitants, is one of the official stops on the Jesuit Mission's tour in Chiquitos, Bolivia. This is a significant feat, given that the tour's main attractions are the Baroque churches built by the Loyola community in the late 17th and early 18th centuries, and the church in San Antonio de Lomerío does not fall in this category.

The man who made this possible is the town's mayor—Angel Sumami Parapaino. This burgomaster, seeing how nearby neighborhoods were benefiting from tourism, figured that if the villagers joined the tour, they could improve their lifestyles. Now, the mayor hopes that the villagers—who until now have subsisted on what they have planted, cattle and the sale of cheese and milk—will become entrepreneurs.

To facilitate this challenging process, the mayor has undertaken a series of activities, such as improving the road that connects the village with the tour, and thus, with the rest of the region, and purchasing donkeys to use as taxis, all with the purpose of increasing tourism to the village. Which in turn will favor development of entrepreneurship and improve the chances for success of the businesses located there. The mayor also has organized classes in cooking and hotel management for the women, and in tour-





Sumami Parapaino is a good example of a visionary leader

OGD-SCZ

ism and handicraft production for the men, in order to promote the startup capacity of the townspeople and microenterprise.

The case of this Bolivian town illustrates the most cited reasons for promoting start-up activity: to generate employment and accelerate economic growth to reach a higher standard of living. Also it is representative of a new tendency not to depend on foreign economic resources or foreign companies' establishing businesses in the locality. Instead, the focus is on promoting development of the area to generate revenue.

It is still not known what type of elements or actions are needed to achieve a successful start-up, nor what local conditions are needed to reproduce those processes that have been successful.

Financing and Market Access

Some general factors are common to successful start-up projects. One is access to capital. Latin American entrepreneurs agree that this is the major obstacle in establishing a company—not having a direct relation between the business talent and resources.

Locally, the challenge of obtaining financing has its own peculiarities. "When financial institutions work in small communities, they are always very traditional banks and more adverse to risk than in larger communities," explains Pablo Angelelli, an economist and specialist in business development at the Inter-American Development Bank (IDB). While this is a problem for small towns, sometimes being in a small place works in favor of the entrepreneur who wants to start up a business: "Although an entrepreneur cannot show that he or she is a reliable payer and that the business is going to succeed, at the local level people know each other better, there is more confidence in the person and more possibilities of getting the loan," adds Angelelli. It's

different in big cities, where there is a specialized market to finance startups, bank agreements, incubators, capital funds or private investors.

Obtaining financing is not the only challenge in a local setting. Market access can also be complicated. By definition, in small localities, opportunities are not very diverse and their scale is limited. In many cases, it is necessary to create a space for the new business. Angelelli says that generally there are only two options: either

In any country there is a business class with experience, resources and connections that can be used to nurture the next business generation and reduce the complexity of starting up a company.

export the goods or attract demand, such as the mayor of San Antonio de Lomerío has done. Industries also can be created to supply the demand for production factors created by successful industries already in the region.

The Power of Networks

If access to financing designed to meet the needs of local businesses is a factor that tends to favor entrepreneurship, another important factor is to work in societies with social mobility. "One reason is that existence of channels of communication between people from different social sectors enriches the interaction, the learning and the flow of information and resources needed to start," explains IDB's Angelelli.

Information, access to entrepreneur support services and contacts are also important factors, since they can facilitate alternative routes to needed resources, help solve problems, fulfill entrepreneurs' management or technical shortages and provide information on opportunities. In fact, in any country there is a business class with experience, resources and connections that can be used to nurture the next business generation and reduce the complexity of starting up a company.

Maximizing the power of this type of network is one of Parquesoft's objectives, a technological park for informatics programs that bring together 135 companies with some 600 employees under the same roof in Cali, Colombia. Parquesoft actively seeks to create a space to gather knowledge, exchange ideas, solve common problems and promote entrepreneurship. To this end, Parquesoft's founders promote mutual trust among the different companies and have established a goal that benefits all: promotion of a network of software technology parks in southwest Colombia that could catapult the country into being the technological center of Latin America.

Alfredo José Roldán, founding member of Parquesoft, points out that the technology park also has a goal that goes beyond promoting entrepreneurship: it aims to generate social capital, open opportunities for youth and assure that Colombia's image is no longer associated with "drugs, violence, or even coffee—but instead with software." It is "a clean industry, which does not work with conventional raw materials nor require great infrastructure; it has a huge market and needs only a small initial investment in financial resources," adds Roldán. "Parquesoft offers individual entrepreneurs the chance to sell software under this brand name, something that helps capture market, since the client gets the assurance that the product has the support of this group," explains IDB economist Angelelli,

who knows the Colombian initiative well.

When deciding upon an enterprise, it is important to ensure that the business is economically viable and that there are no insurmountable obstacles to limit growth. As real estate agents know, location is critical and has a price. This is true not only for individual houses but for companies as well. "In a small place there is less demand for what can be produced, fewer learning sources, fewer entrepreneurs to be inspired by," says Angelelli.

Leadership

One common factor in successful local business development is leadership, which should not be confused with domination by one solo player. In the case of San Antonio de Lomerío, the mayor represents a good example of a visionary and focused leader who can establish a process of "local empowerment, where the citizens, when they are convinced of something, they themselves by their own efforts seek to rise out of poverty," explains Ricardo Ortiz Gutiérrez. He is the expediter of the world launching of the Jesuit Mission in Bolivia and worked hand in hand with Sumami Parapaino to include the village in the religious tour as an example of living culture.

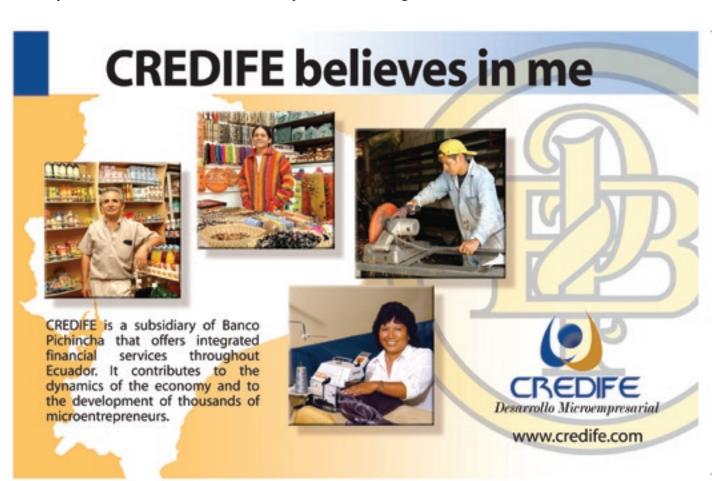
On those occasions in which the leadership is public, such as in San Antonio de Lomerío, the administration organizes trade fairs, imparts technical training, offers fiscal incentives, improves the regulatory framework that affects the companies or facilitates the integration of the area into a broader economic project. In other cases, the entrepreneurs exercise the leadership, either individually or collectively, through an association or cooperative.

But apart from the driving force

behind the initiative, it is important that a support system exist. This is not to say, as Angelelli clearly points out, that much is needed from the state. Because one of the risks of promoting local business activity is that municipal authority, in an effort to regulate and control all new undertakings, invents paperwork and procedures that worsen the situation and create reasons to flout the law, which can lead to increasing numbers of informal businesses. The intention is to strengthen the local economy through established businesses. In reality, it is enough that the "state not be an obstacle, that it facilitate productive activity and promote individual activities," concludes Angelelli.

—GADOR MANZANO

For more information, see *Developing Entrepreneurships*, Kantis M. et al., IDB and FUNDES, Washington, DC, 2005.



Business Services

Change in Mentality

Uruguay's Centro de Almaceneros Minoristas, Baristas, Autoservicistas y Afines (better known as "the Center" or CAMBADU) is undoubtedly the oldest institution to have won the Inter-American Development Bank (IDB) Award of Excellence in Business Development.

CAMBADU was founded in 1892 by a group of retailers. The purpose was to protect the interests of their trade association in the face of voracious taxation by a government hungry for income in the midst of an international financial crisis provoked by bankruptcy of the Baring Bank. CAMBADU weathered that crisis and many more, becoming Uruguay's most representative organization of "traditional business" and helping thousands of members confront innumerable transactions.



More than a century later, CAMBADU would again be put to the test. Its members—the majority of whom own micro and small businesses selling domestic consumer products—faced the new challenges of globalization, in this case the overwhelming advance of big supermarket chains.

These mega-enterprises have several advantages over their more modest competitors: professional management, modern business technology, greater negotiating power with suppliers and, above all, access to an enormous volume of information on prices, consumer habits and market trends, in Uruguay and also internationally.

Thus, the average CAMBADU members continued old-fashioned management of their businesses. In the words of CAMBADU President Mario Menéndez: "The cat on the counter, that's over now." Small businesses must modernize. The same was true for CAMBADU, which could no longer limit itself to traditional support services for its members.

CAMBADU signed an agreement with IDB's Multilateral Investment Fund (MIF) in 1998 to promote a program to strengthen

small businesses.

"Often, small scale is only in our heads."

Launching this initiative was fortunate, as one of the worst recessions in Uruguayan history began the same year.

Opportunities can also arise from a crisis.

CAMBADU underwent profound change. Under the MIF-supported program, the old center established new business development services to offer its members the same management tools used by big businesses—yet adapted to the scale and needs of smaller businesses.

CAMBADU bet on a new model, promoting the concept of "business of proximity" rather than "traditional business." In addition to modernizing their businesses' management, CAMBADU members should take advantage of belonging to neighborhoods and family-like relationships with their clients, which are values almost impossible to reproduce in a supermarket.

Thousands of business owners—grocery stores, self-service stores, restaurants and bars—received training in business admin-

istration and financing, strategic planning, cost calculations, prices and margins, sales management, inventory management, data processing and negotiation. They also participated in workshops on marketing, customer service, sales technology, and product placement and restocking.

For members who want to establish or expand a business, CAMBADU offers a complete menu of technical assistance that includes site evaluation, analysis of competition and viability, economic and financial assessment, project preparation, marketing, human resource management, establishment of performance benchmarks, and even layout of sites and sign design. CAMBADU also offers courses and workshops for employees appropriate to the business.

One key support is the monitoring of prices and strategies of the big chains, which provides small



Mario Menéndez, President of CAMBADU

businesses with information needed in order to compete. CAMBADU encourages group purchases to get better prices and payment terms from suppliers. Another service appreciated by members is the opportunity to take guided tours of businesses in Buenos Aires, where new innovations can be examined.

Program Director Susana Ramela emphasizes that one of the project's results is that the sector, which had once been threatened, has succeeded in recovering ground. Many members who had previously clung to a survival strategy today speak of growth. CAMBADU itself became an innovative organization that is constantly conducting research to anticipate market trends and meet member demands. "Often, small scale is only in our heads," Ramela points out.

—PETER BATE





ProCredit: Banks for "ordinary people"

The ProCredit group provides banking services for "ordinary people" in 19 developing countries and transition economies. In May 2006, the ProCredit Banks had a combined outstanding loan portfolio of USD 2.1 billion divided among 640,000 loans.

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All over the world, we are making a difference by supporting micro and small enterprises and by bringing many lower income families into the banking sector. We:

- provide straightforward financial services designed to meet the needs of these target groups
- build lasting business relationships with our clients based on trust, responsibility and transparency
- apply a policy that combines a clear, long-term development vision with a commercial approach



In the Latin American region, ProCredit is present in 5 countries. Further expansion is planned.

Leaders

Micro-Accounts Can Be Attractive

Saving is not easy. And if you are poor and wish to put your savings in a financial institution, the task is even more complicated. In fact, in some companies it is easier to get a loan than a savings account. And it is not difficult to understand why, since in many countries, regulations—luckily—are stricter for savings accounts than for microcredit services.

Several undesirable consequences can result. On the one hand, microcredit institutions have trouble thriving, as they are unable to grow with the savings



Laurie Dufays of WSBI

of their clients. On the other hand, a large portion of the population has limited access to financial savings services. The situation is far from ideal. Commercial banks offering savings products do not reach the lowest-income sectors, while those institutions that do serve these sectors are usually not authorized to offer savings accounts. The solution is not easy.

"There must be a minimum regulation that guarantees savings deposits, but it should correspond to the institution's level of activities," says Chris De Noose, Chairman of the Executive Committee of the World Savings Banks Institute (WSBI). De Noose knows what he is talking about. According to WSBI data, his organization represents more than 1,000 financial intermediaries in 86 countries that together form 75% of the total savings accounts coming from noncommercial financial institutions.

"In Latin America, the banks need to be physically close to the clients, includ-

"The institutions attend to the needs of the new poor, whether they are singleparent families, ex-convicts or tsunami victims."

ing [those clients who live] in remote areas, and also good governance is needed and the clients need to be educated on savings and loans," adds De Noose.

What is certain is that regulation is only one of the factors that complicate the entrance of microcredit organizations into the

savings market. For many organizations, it is more advantageous to work only with capital provided by donors than to have to set up the infrastructure to be able to attract small savers.

It is also true that micro savings accounts have a high management cost. One study of 61 Latin American regulated microfinance institutions by Glenn Westley, finance expert at the Inter-American Development Bank, showed the following: 75% of the savings accounts have less than US\$100, account for 30% to 60% of the transactions yet hold only 2.5% to 3%

of the savings. Thus, the challenge and cost of servicing low-income populations are higher, at least in the short term.

However, Westley suggests that offering micro-savings accounts can also provide some advantages: it allows diversification of the micro-finance institution's funds, makes the institutions less dependent on donations and thus more independent from donors and governments, increases the clientele base and finally opens the possibility of developing economies of scale, resulting in lower costs.

Competition Enters Into Play

Savings institutions were born from banking entities that promoted this activity, which in great part consisted of capturing deposits. This is still an objective, although competition from banks has now "forced us to look for innovative savings products that the savings institutions adapt to their local clientele," explains Laurie Dufays, Assistant Director at the WSBI headquarters. Among these new products are savings accounts to prepare for daughters' weddings or savings programs for Muslim clientele to pay for the pilgrimage to Mecca.



WORLD SAVINGS BANKS INSTITUTE

Dufays expresses satisfaction with the savings institutions' work to facilitate access to financing by all sectors of the population: "The institutions attend to the needs of the new poor, whether they are single-parent families, ex-convicts or tsunami victims." The resulting reward is "our loyal clientele come back, they stay



Chris De Noose, Chairman of the Executive Committee of WSBI

with us as we begin to grow," adds Dufays.

This loyalty has given WSBI a competitive advantage in offering diverse financial services. "Microcredit in many cases has become a vehicle that for the first time has put citizens in touch with a formal banking institution," says Dufays. An example is the loans for housing associations offered by Peru's Caja Municipal de Cusco (Cuzco Municipal Fund). Its clients are people displaced in the city due to violence, extreme poverty or lack of opportunity, who, united by family or social ties, want to buy land where they will settle. In many cases the institution participates by identifying the land, registering and titling the property and negotiating the transaction. It is not unusual for housing associations to approach the Caja Municipal de Cusco to solicit a second line of credit for general works, water treatment services, sewers, electricity or to build housing.

Reaching Financial Democracy

Dufays travels throughout the world assuring that the lessons learned from the experiences of several savings institutions are useful to others. The challenges that many face are similar, wherever they are located. "We have many products but often little information. The WSBI brings experts to visit the savings institutions, who offer training and information on what other countries are doing successfully."

Dufays says that in Sri Lanka there was a successful experience in which the savings institutions took interest in the citizens who were traditionally excluded from formal financial markets. Several techniques were used: programs with savings booklets for children, municipal events and megaphones in the streets. The purpose was to inform the population—including illiterate people—about the advantages of savings without making them feel intimidated. A study is now under way in Cochabamba, Bolivia, to see how to adapt this idea to local reality. One fund is exploring the possibility of using free buses that take women from their villages to Cochabamba on market days, so that during the bus trip the information can be presented to them on the advantages of keeping their savings in a banking entity.

For De Noose, "access to financial services—whether savings or credit—is extremely important for reaching sustainable development. This is something that WSBI has known for a long time and for which it will continue to work, for the sake of achieving funding financial democracy."

—GADOR MANZANO



Leaders

Seek and Ye Shall Find

Julio Alem Rojo—a native Cochabamban, chemical engineer and rural development enthusiast—is a man who speaks his mind. Last year, when he received the Award for Excellence in Business Development Services, he went right to the point. In Bolivia, a credit *apartheid* exists, he said.

Alem backs his statement up with numbers: of 2.2 million Bolivian families, only 650,000 have access to credit. Of that group, an elite 2% holds 60% of the bank credit. "And this is in Bolivia, supposedly the star of inclusive financial systems," he adds.

From the Center for Investigation and Regional Development (CIDRE)—a nonprofit, nongovernment organization that he has headed since 1994—Alem is working to change that reality, especially in the challenging field of agricultural finance.



Julio Alem Rojo receives the Award in Santa Cruz

Driven by a personal mission to help put an end to the persistent poverty and inequality suffered by Bolivia's peasants, Alem left a career in the oil industry in 1983 to devote himself to full-time work promoting development in some of Cochabamba's most impoverished zones.

Like the great majority of peasants throughout the rest of the world, those in Bolivia have difficulty getting credit at terms convenient in the agriculture calendar, which typically has longer cycles than those of commercial negotiations that microfinance institutions tend to finance. Yet small Bolivian farmers also face legal obstacles, as regulations prohibit small landowners from using their land as collateral for credit.

While such legislation aims at protecting peasants from losing the main asset of their livelihood, such a restriction hinders the possibilities of obtaining credit. This pitfall, added to the fact that few of Bolivia's small farmers have titles to their land, led Alem and his team to get creative.

CIDRE's latest innovation in alternative collateral for agricultural credit is the use of forest assets. Two decades ago, under a reforestation program supported by the Swiss government, some 10,000 hectares were planted with trees in marginated land of the Cochabamban mountains. The goal was to protect the slopes, improve water retention and establish sustainable sources of wood and firewood for the small farmers who work on land 3,000 to 4,000 meters above sea level. Almost all the plantations are small; the largest is barely 131 hectares. Altogether, some US\$10 million worth of trees were planted.

For CIDRE, these trees represented an asset that could be exploited more fully. The small farmers were making a living not off the wood but from raising vegetables and cattle. Although they had no formal titles to the land they were working, they could claim ownership of the plantation of trees. On this basis, CIDRE designed a program for sustainable forest development to promote these assets and use them as collateral for credit.

The concept is based on recognizing the small farmers' rights of ownership to the trees. An expert can come to a lot and verify the existence and dimension of the trees. Then, the Forestry Superintendency issues certificates

with data generated by satellite imaging. CIDRE takes these certificates as collateral for credit. In two years, 4,000 peasant families have registered 1,400 plantations. They use the loans to expand the forest plantations as well as to improve other productive activities.

CIDRE applies interest rates of 12% to 14% to its loans, notably lower than those offered by other Bolivian microfinance institutions. How does CIDRE do it? Alem says that a balance exists between income and expenses. "Nobody gives us money," he explains. "CIDRE's financial profit is low, but its profitability in social terms is extremely high."

Another notable CIDRE program is "Agua Tuya" ("Your Water"), which funds the installation of small drinking-water systems in marginal Cochabamban communities, including the site of the first battle of the so-called "water war" after the failed privatiza-



tion of the municipal public works company. Under the program, the communities themselves own and operate their own water services, instead of waiting for the municipal network to expand. Through this line of activity, water service has reached 4% of the population that previously lacked it.

As proof that it does not shy away from controversy, CIDRE also operates in Chapare, a Cochabamban region where coca grows and violence is rampant (one of the most violent areas in all of Bolivia). Of course, CIDRE does not make loans to people with a history of drug trafficking. Loan agents, who speak the native languages, use geo-

positioning information for each lot to verify what each client is cultivating.

Alem stresses that many people in Chapare earn a decent living with legal products, such as peppers, palms, papaya, pineapples and bananas. Thanks to the zone's particular climate and geographical location, tomatoes grow in August, unlike anywhere else in Latin America, except in greenhouses. But it's not enough to plant a hectare of papaya: eight or nine hectares should be planted, and for this, credit is necessary. Alem has also seen that farmers are fed up with illegal crops. Given opportunities for a respectable livelihood, they'll never return to planting coca, he says. Based on these factors, CIDRE's program is reaching further into the community.

"We don't practice counterinsurgency; we just offer people wider options," Alem explains.

—PETER BATE



IV INTER-AMERICAN CONFERENCE on Corporate Social Responsibility Salvador, Bahia, Brazil

Themes

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IV Inter-American Conference on CSR: Good Business for All

The Inter-American Development Bank (IDB), in partnership with ETHOS Institute and the Federação das Indústrias do Estado da Bahia (FIEB), will be holding the IV Inter-American Conference on Corporate Social Responsibility in Salvador, Bahia, Brazil, on December 10-12, 2006. This event has as theme Good Business for All.

The conference has become an important contribution to the discussion of CSR in the Americas. As in previous years, the event has a regional emphasis concentrating on the impact of CSR in equitable economic and social development. The purpose is to achieve a social and environmentally responsible private sector that has a positive impact on wealth and wellbeing as well as quality job creation.

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Access to New Markets and Better Services for the Majority

The title of this year's Forum reflects the significant role that microenterprise development plays in the new initiative that was launched by the Inter-American Development Bank at a conference in June 2006, highlighting the necessity to implement tools and methodologies that Build Opportunities for the Majority.

The Forum agenda will focus on two major pillars that were identified at the conference: Financial Democracy, and Enterprise Compact. Within these two pillars, the Forum will introduce four new tracks to highlight the importance of microenterprise development as a vital part of the strategy to reach the majority at the base of the pyramid.

FINANCIAL DEMOCRACY

- Microfinance will focus on the latest developments in areas related specifically to microfinance products and services.
- Financial Markets will highlight areas that relate to microenterprises, but also to larger population at base of the pyramid in generall.

ENTERPRISE COMPACT

- Access to Markets will discuss methodologies for ensuring access to markets for the majority, such as linkages and value chains.
- Environment and Human Capital will explore ways to improve overall level of human capital and provide opportunities for increased competitiveness of people at the base of the pyramid.

