Success Factors in Microfinance Greenfielding

The creation of new microfinance institutions (greenfielding) is a key IFC intervention to increase access to finance in countries where there are few institutions serving micro and small businesses. IFC uses this approach extensively in Africa and in postconflict countries, and has supported the creation of 12 microfinance banks in Sub-Saharan Africa over the past four years. Another five are in the pipeline. Before 2006, IFC had made a grand total of only four microfinance investments in the region ever. So this program represents an extraordinary expansion of IFC’s microfinance activities in the region. The program’s focus on greenfielding has enabled the Africa microfinance team to identify some key success factors that can be applied to future projects in Africa and elsewhere.

Background

In 2006, the Consultative Group to Assist the Poor (CGAP) showed that there were only 181 microfinance institutions (MFIs) in all of Sub-Saharan Africa, representing less than 2 percent of the approximately 10,000 MFIs worldwide. Of the 181 total, only 22 institutions had a loan portfolio greater than $10 million equivalent; 103 had portfolios smaller than $1 million equivalent.

In response to the relative dearth of sizable and commercially oriented local entities, IFC put in place a strategy centered on greenfield projects, supported by specialized staff in the region. Under this strategy, IFC partners with experienced microfinance operators (sometimes called network partners), such as ProCredit, Accion, Advans, MicroCred, and Access, to set up new microfinance banks in many of the region’s most challenging markets. Some of these sponsors have related consultant companies (service providers) that supply the technical and management expertise to the greenfield projects (for example, IFC for ProCredit, LFS for Access, and Horus for Advans).

1 The term “microfinance bank” is used in a broad sense and may also include entities that are licensed as finance companies or savings and loan companies. The exact licensing form depends on what’s available under the local framework. Most of IFC’s greenfield clients in Sub-Saharan Africa are licensed as commercial banks.

2 Many of these organizations aim to create regional or global networks of microfinance banks. IFC’s collaboration with network partners has expanded in three phases: first with Procredit/IPC (1996 and beyond), then with Access/LFS, Advans/Horus, MicroCred and Accion (2005 and beyond) and then with Aga Kahn Agency for Microfinance, Swiss Microfinance Holding/Fides, and CHF International (2008 and beyond).
Greenfield microfinance banks are meant to operate according to global best practices in corporate governance, credit methodology, product design, anti-money laundering standards, and social and environmental standards. Operational and managerial capacity in the new microfinance banks are built from the ground up, and over time local staff are trained to take over virtually all functions of the new banks. Breakeven on a monthly basis should be reached within 18–36 months of operation, depending on the specific characteristics of the market (greenfield projects in Africa tend to take a minimum of 24 months).

IFC typically provides both equity financing and advisory services (AS) funding to greenfield projects (and occasionally also debt financing), so the preparation normally involves extensive discussions/negotiations regarding shareholder provisions and capacity building activities. The advisory services program—with a typical budget of $3 million to $4 million—usually lasts for 42–54 months (6 months pre-operational preparation, plus 36–48 months of operational support). Based on our experience with 17 projects (12 committed and 5 in the pipeline), a number of key lessons have emerged—including being alert to things that can go wrong (see box).

### Lessons for Increasing the Chances of Success

1) **Don’t assume they know what they are doing.**

The sponsor claims to have worked in microfinance for 30 years and supported the growth of some 15 microfinance institutions, some of which have evolved into industry best practice examples. So you can assume they know what they are doing, right? **Wrong.**

Starting a new microfinance bank is not the same as supporting an existing, functioning one. Many firms and organizations have experience in providing specific consultancy services to MFIs, but few have the necessary expertise and capacity to create, manage, and build them. The Africa experience shows that a focus on greenfielding is a prerequisite for capacity. Such focus will compel sponsors to make the long-term internal adjustments and investments necessary for **building and projecting** expertise and capacity in key areas: preferred IT platform, internal control and

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<tr>
<td># loans outstanding (thousand)</td>
<td>12</td>
<td>20</td>
<td>36</td>
<td>76</td>
</tr>
<tr>
<td>$ loan portfolio (million)</td>
<td>16</td>
<td>27</td>
<td>43</td>
<td>97</td>
</tr>
<tr>
<td># deposit accounts (thousand)</td>
<td>22</td>
<td>52</td>
<td>132</td>
<td>286</td>
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<tr>
<td>$ deposit volume (million)</td>
<td>15</td>
<td>53</td>
<td>103</td>
<td>139</td>
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<tr>
<td>% NPL &gt; 30 days</td>
<td>1.8</td>
<td>1.2</td>
<td>3.6</td>
<td>2.4</td>
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<tr>
<td># MFIs achieved monthly breakeven</td>
<td>1</td>
<td>1</td>
<td>5</td>
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Source: IFC Africa Microfinance Program.
Sponsors that are not focused on greenfielding are much more likely to have an ad hoc approach that relies on improvised solutions and recently contracted staff—resulting in an environment in which these lessons are not learned, knowledge is not effectively shared, and expertise is not built.

In the Africa microfinance program, we have seen a clear correlation between sponsor specialization and the quality of project preparation. Projects led by sponsors that are not specialized in greenfielding tend to suffer from poorer coordination of activities, longer delays, and greater cost overruns. They also tend to experience greater turnover in key staff.

Analyzing and understanding the capacity of the sponsor to effectively create, manage, and support the new microfinance bank are probably the most important aspect of preparing a greenfield project. However, you can likely save yourself some headaches by working with a specialized sponsor that has a couple of projects under its belt.

2) Negotiate inputs; monitor outcomes.

If you think the sponsor and service provider know what they are doing, make sure they feel responsible for the project. Review, critique, and negotiate the design, but once that’s done, allow them the flexibility and authority to implement the project without being continually second-guessed by IFC. This policy can be reinforced by a performance-based approach to the advisory services program, linking some AS payments to agreed outcome targets (rather than inputs), such as the bank’s loan and deposit accounts, net income, and non-performing loans. The Africa microfinance program incorporates a substantial performance-based component in every greenfield project.

To avoid the scenario of insufficient AS funding, it needs to be clear to the sponsor early—before preparations start—what level of AS funding IFC expects for the project to go ahead. Also, it makes sense for the microfinance bank to shoulder part of the cost of the AS program, since this will ensure that the investors in the bank pay attention to the AS program. Another critical aspect of keeping the budget under control is to not allow the sponsor to put people in the field until there is a reasonable certainty that the bank’s operating license will be granted by the relevant authorities. The Africa microfinance program requires that at least two-thirds of the AS budget is raised from external sources (the responsibility of the sponsor), that the bank (investors) pays 15–33 percent of AS costs, and that no preparation activities start in the field until there is a high degree of certainty that the operating license will be granted.

3) Respect the speed limit.

If the sponsor tells you that the project will reach a portfolio of 75,000 loans in three years—well, don’t believe it. Greenfield projects have an upper speed limit for the first several years—defined in large part by the nature of the microenterprise lending methodology, infrastructure considerations, and the availability of skilled human resources. In addition, market demand may impose further limitations by its size and composition. Trying to exceed this natural speed limit (for example, by relying on credit scoring or establishing half a dozen branches the first year) is wishful thinking and could invite disaster. Different countries and regions have different speed limits, but you need to be realistic. In Africa it is difficult to establish in a sustainable fashion more than two or three branches per year, and to aim for a portfolio of more than 15,000 loans at the end of the third year.

4) Profits before impact.

We support microfinance greenfield projects because of their long-term development impact in improving the reach and quality of financial services to underserved populations. However, since these projects are significantly loss-making during their first two or three years, it is critical that they reach financial sustainability as quickly as possible. The first three years is not the time to perfect poverty-targeting approaches or develop products with long payback periods. Rather, the path to commercial viability is fairly narrow and requires strong focus, disciplined execution, and attention to costs. The project has to find the trajectory that effectively balances expansion with operational control. Only if operational and financial sustainability is reached can the bank start meeting its long-run development targets. Preferably, monthly break-even should be reached no later than 30 months into the project. In Africa, the monthly break-even is typically reached with a loan portfolio of $10 million and 10,000 clients.

5) It’s under the hood.

If the project performs poorly once it is under way, don’t let the sponsor or the bank’s management tell you that external factors are to blame. Greenfield projects are overwhelmingly driven by internal factors, practices, and decisions. The operations of greenfield microfinance

MicroCred Madagascar.
banks are fairly shielded from events affecting the economy and the financial sector at large. On the asset side, microfinance banks target a client segment that is not as exposed to major economic events as larger companies are. On the liability side, microfinance banks rely heavily on equity and deposits, which are less vulnerable than borrowings to deteriorating market conditions. This does not eliminate the influence of external factors, but it means that the source of the problem can usually be found inside the bank. A clear sense of responsibility and accountability by the sponsor and management is key to identifying, admitting, and addressing such problems.

6) You are one team.

Microfinance greenfield projects are exceptionally integrated with regard to investment and advisory services. Multiple links and mutual dependencies exist between the two components (for example, the funding schedule on the advisory side may impact the funding needs of the bank), so they cannot be prepared and negotiated in isolation from each other. Also, the internal processing of these components must keep pace with each other. This means that the IFC advisory and investment staff really must be one team. In the Africa microfinance program, the need for investment and advisory to work closely together—as equal partners—is emphasized from the beginning of every project.

Conclusion

Microfinance greenfield projects are by their nature complex and unpredictable. To minimize the many problems that can occur, it is absolutely critical to carefully design, negotiate, and address issues ranging from sponsor capacity to AS funding to market approach. There is no shortcut to the hard work and effort involved, but you can help yourself by keeping an eye on the most common problems and pitfalls. Successfully addressing these issues requires an extensive engagement between IFC staff and the sponsor/service provider, as well as among IFC staff themselves.

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3 An exception to this general observation would be negative changes in trade conditions (for example, the closure of borders), which can hit microenterprises hard, since many of them rely on trade to sustain their activities.

4 An exception may be the rate of deposit mobilization, which, despite internal levers, appears difficult to predict and fully control.