CGAP PORTFOLIO ISSUE 1 APRIL 2005

Beyond Survival

How today's tsunami aid can help fight poverty in the long run

The images—of lives and landscapes washed away—prompted another kind of outpouring after the December 26 tsunami. Money, billions of dollars of it, has been pledged to the survivors, their families, their communities. Piece by piece, the money will help rebuild homes, schools, and hospitals. And, eventually, it will run out. That, say development workers, is why kick-starting local economies is at least as important as rebuilding roads and houses.

One interim solution is to create jobs. Anuj Jain of the international NGO CARE says his organization "has initiated a 'cash for work' program" that complements efforts to "re-equip communities." As community infrastructure is rebuilt, the idea is that program participants will be able to resume their own income-generating activities.

Enter Microfinance

"As initial relief funding wanes, restoring livelihoods will become a key priority," says Vijay Mahajan of the India-based non-governmental organization BASIX. In the long run, Mahajan says money to help people generate income should come not from grants but from small loans from sustainable microfinance institutions.

In many areas, local microfinance institutions are already at the vanguard of the reconstruction effort. Staff of Sri Lanka's SANASA Bank, for example, have helped identify and bury the dead, distribute food and clothing, and erect temporary shelters for the thousands of homeless. Like other microfinance institutions throughout Asia, they plan to help in many other ways.

"Our strategy is to build 1,000 shelter units, to provide kitchen items for 25,000 families, to provide guardianship of 100 children who lost their parents in the disaster, and help restart income generating activities," says SANASA's P.A. Kiriwandeniya.

But microfinance managers like Kiriwandeniya distinguish between these efforts and their institutions' long-term goal: helping their clients live more independent, healthy lives. Microfinance, they say, does that by providing access to small loans and savings services which help poor people build wealth and weather risk over the long run.

Credit Culture

One key to the success of microfinance is the disciplined "credit culture" lending institutions have nurtured with their clients, a culture that allows more and more poor people to have access to financial services. As billions in grants flow in to south Asia, that culture is at risk.

In fact, some microfinance practitioners and international relief agencies are sounding a note of caution about the tsunami reconstruction effort, urging all who are contributing to that effort not to confuse the relief activities of today with the long-term economic development of tsunami-affected areas. These activities, they say, should make "a clear distinction" between grant-making and the work of microfinance institutions, which should not be pressured to disburse grants.

Still, microfinance institutions like SANASA Bank have shown that they can facilitate their clients' access to grant funds. With well-established networks throughout south Asia, many of these institutions are well placed to act as a fulcrum of the massive aid effort. If they can do that while maintaining their focus on providing sustainable financial services for the poor, they will vastly improve survivors' lives in the long run, helping them do more than simply survive.

IN THIS ISSUE:

Want to learn more about the post-disaster role of microfinance institutions? See "Sustaining Microfinance in Post-Disaster Asia" on microfinancegateway.org. To request a print copy, email cgap@worldbank.org or send us a fax at 1-202-522-3744.

FRONTIERS&INNOVATIONS

Are MFIs Hedging Their Bets?

It may seem like good news. With poverty high on the development agenda of the world's wealthiest countries and the United Nations naming 2005 the Year of Microcredit, more and more funds are being established to invest in microfinance worldwide. Combined with public investments, commercial loans, and donor assistance, these funds could amount to hundreds of millions of dollars in new investment, nearly all of it in hard currency. But every dollar or euro brings a new kind of risk for microfinance institutions.

"When they have access to hard currency, MFIs have less of an incentive to attract domestic funding," says Scott Featherston of the International Finance Corporation. That hobbles the development of inclusive financial sectors—sectors that work for the poor—but it also "exposes the MFIs themselves to volatile foreign exchange rates."

Featherston, who is co-authoring a CGAP paper on the subject, says many MFIs do not understand the risks of assuming hard currency liabilities. When exchange rates fluctuate, an MFI's assets can suddenly depreciate, with client loan payments falling well short of what the institution needs to repay its own loans. That could force them to charge their clients higher interest rates or, worse, face insolvency.

Even so, most microfinance providers say they have no plan to manage this risk. In a CGAP survey of 216 MFIs, many said hedging would be too expensive. A more practical approach, says Featherston, would spell out multiple "methods for mitigating exposure" to foreign exchange rate risk. That is an industry-wide responsibility, according to CGAP specialist Patricia Mwangi:

"Not only do MFIs need to better understand and plan for the risk, more financially sophisticated investors need to take more responsibility. They need to consider the appropriateness of hard currency lending and fully disclose the implications to their borrowers."

Mwangi also pointed to rating agencies, which she says can draw attention to the issue by tying foreign exchange risk to creditworthiness. Donors, too, should prompt MFIs to hedge their risks, sharing best practices from mainstream financial players and evaluating whether these practices are implemented.

The point, though, is not to force MFIs away from foreign funding. Institutions will continue to turn to foreign lenders in part because access to foreign capital is sometimes seen as a sign of prestige. That in turn may help MFIs attract more domestic funds, but observers caution that the current enthusiasm of foreign lenders may actually act as a disincentive to building domestic markets. That is why many are urging MFIs to set a prudent limit for foreign funds; a 2004 Women's World Banking report, for example, urged MFIs to keep foreign funds at 10 to 15 percent of total equity.

For more on foreign exchange risk, try a keyword search on the Microfinance Gateway, the Web's premier resource on microfinance. Visit www.microfinancegateway.org. For more on the microfinance industry in general, visit www.cgap.org.

Scaling Up

CGAP Offers Retail Advisory Service to Commercial Banks

More than 2 billion people around the world still lack access to financial services from the formal financial system. At the same time, commercial banks around the world have been taking an increasing interest in accessing lower income clients, provided that it makes good business sense.

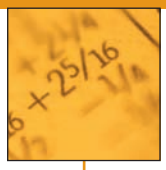
To help commercial banks break into this market, CGAP recently established the Retail Advisory Service, or RAS. The service offers strategic and operational advice and technical assistance to commercial banks and other retailers that are genuinely interested in expanding their range of financial services to include poor clients and microenterprises. Eligible partner institutions have access to an array of inputs that enable them to expand their franchise to the informal sector, to capture new markets among the poorer segments of the population, and to build up a profitable new business.

From market analysis to product design, training, and capacity building, the advisory service is designed to remove the mystique of microfinance for commercial actors in the formal financial sector. "There's nothing about microfinance that's so spectacularly different from the rest of the financial system," says RAS manager Martin Holtmann. "At CGAP, we predict that even the word 'microfinance' is poised to disappear eventually."

Learn More

The Retail Advisory Service has been met by strong demand from the industry. Several projects are in the early stages of development in the Middle East, southern Africa, and south Asia, but technical assistance is still available for eligible institutions. To learn how to qualify, email mholtmann@worldbank.org.

NEWS & EVENTS



Financial Transparency Award Goes to Compartamos

Financiera Compartamos of Mexico took top honors in the first-ever CGAP Financial Transparency Award while forty other institutions—representing Latin America, Africa, Eastern Europe, and Central and South Asia—received honorable mention for their "high level of compliance" with international financial reporting standards.

"This award marks yet another important milestone in the development of the microfinance industry," said CGAP Chief Executive Officer Elizabeth Littlefield.

By striving to comply with international disclosure guidelines, including the industry-specific CGAP disclosure guidelines, the institutions which participated in this year's competition are doing more than improving the world of microfinance, Littlefield added. "They are helping make microfinance institutions' performance better understood by the general public and hence helping build more inclusive financial systems for the poor."

In some markets, microfinance institutions are stronger and more profitable than leading banks. Collectively, such institutions are seeking more and more commercial funding, working hard to become more transparent in their financial reporting. The Microfinance Information eXchange, or MIX—the Bloomberg of microfinance—now reports on more than 400 institutions, several of which boast "5-diamond" ratings.

"For those of us who worked in microfinance even five years ago, this is staggering progress," said Xavier Reille, head of the board of the MIX. "We have gone from having no reliable information at all to having a wealth of data on a growing portion of the market." That achievement, say microfinance experts, helps set the framework for an entire financial sector, folding it into the mainstream while retaining its focus on serving the poor.

Nearly 150 microfinance institutions from 48 countries applied for the award. Of these, 110 met the entry criteria. Entrants were scored based on their compliance with key international and industry accounting standards spelled out in the CGAP *Disclosure Guidelines for Financial Reporting*—the most widely accepted benchmark for microfinance transparency.

Organizers say the award is already attracting attention from investors, policymakers, and regulators—another sign that the microfinance industry is growing into its own. Learn more at www.cgap.org.

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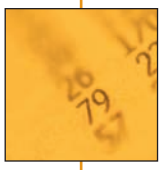
CGAP *SERVICES*

Fund Offers Expert Guidance on Information Systems

Microfinance institutions can qualify automatically for up to $10,000 in funding to help them strengthen their information systems, streamline operations, and boost efficiency. The CGAP IS Fund covers up to 60 percent of consulting costs for MFIs seeking to articulate their IS needs, evaluate current software, or select and launch new software.

Strong information systems help financial institutions track their day-to-day operations more efficiently. For microfinance institutions, that can mean lower transactions costs—one key to reaching poorer clients.

To qualify for an IS Fund grant, microfinance institutions must have at least 3,000 active clients; a minimum loan portfolio of $300,000; and at least two years of microfinance operating history. Learn more at www.isfund.org.



New Donor Guidelines to Foster Aid Effectiveness in Microfinance

CGAP has launched an information campaign around the *Donor Guidelines on Good Practice*, known as the "pink book." The guidelines aim to boost awareness within donor agencies about the need to build more inclusive financial systems for the poor.

The campaign began with a February 1 inter-agency event in Washington, D.C., hosted with the Inter-American Development Bank. Over the past two months, CGAP staff visited 11 member agencies for on-site presentations and discussions.

"The purpose of this new 'pink book' is to update and refresh the good practices that we have been able to observe and disseminate them broadly, so they serve as a guide to the international donor community in supporting microfinance programs and institutions," said IDB President Enrique V. Iglesias. "Given that 2005 is the UN International Year of Microcredit," the timing, he noted, is "particularly opportune."

The guidelines are based in part on peer reviews evaluating the microfinance programs of 17 donor agencies. Drawing on lessons learned over the past 30 years, the new guidelines aim to raise donor staff awareness and promote harmonization on standards and good practice.

They also aim to offer guidance to other microfinance stakeholders, such as international non-governmental organizations, apex facilities, social and commercial investors, and consulting companies.

Building Inclusive Financial Systems: Donor Guidelines on Good Practice in Microfinance is available at www.cgap.org.

HIGHLIGHT

Exiting Microfinance Profitably: The Case of ProFund

With 76 percent of its capital owned by multilateral and bilateral agencies, ProFund Internacional, a pioneering equity investment fund operating in Latin America and the Caribbean, is a good model for using public money to attract commercial funds to microfinance. In this issue of Portfolio, *Alex Silva, president of Omtrix, a fund management company, discusses ProFund's approach and successes to date.*

P: How does ProFund differ from other, socially oriented investment funds? Silva: Other investment funds might have different strategies regarding exits. For its part, ProFund was created in 1995 as a close-end fund with a liquidation date set for late 2005. Basic to its divestment strategy was thinking of exits from day one. As such, it plans to sell off its stakes across Latin America and the Caribbean by the end of 2005 and return all capital, plus profit, to its shareholders. So far, we have managed to sell our stakes in all but three microfinance institutions, delivering a 7–8 percent return on investment for our shareholders. This is an impressive result, given the volatility of financial markets in many of the countries where ProFund operates.

P: Tell us about your investments. Silva: With over US $22 million in assets, ProFund has invested in 13 different financial institutions in Bolivia, Columbia, Ecuador, Guatemala, Haiti, Mexico, Nicaragua, Paraguay, Peru, and Venezuela over its nine years of operation. Earlier this year, ProFund held minority stakes in eight financial institutions, all of them with positive return on equity ranging from 5 to 98 percent. With their combined outstanding loan portfolio grown to nearly $500 million, these institutions—including BancoSol, Compartamos, BanGente, Finamerica, Mibanco, Vision, Solidario, and Sogesol—served 550,000 microfinance clients at the end of June 2004.

P: What's next for ProFund? Silva: Several of the fund's shareholders—together with other socially responsible investors—have created the Emergency Liquidity Facility (ELF) to address liquidity shortages and disruptions in operations that MFIs suffer amid political and economic crises or natural disasters. ELF serves as a "lender of last resort," helping MFIs in Latin America and the Caribbean cope with sudden increases in credit demand or temporary arrears in loan repayments in the wake of crisis.

P: So no ProFund 2? Silva: No—thanks to the growing interest of traditional commercial banks in the microenterprise sector as well as the large number of funds and other sources of equity available today to MFIs. The fact that ProFund is not extending its life makes clear that Latin America and the Caribbean, with its established and highly profitable MFIs—some even outperforming mainstream banks in several markets—is a region where private and commercial capital is entering and should not be crowded out by public money.

For more on ProFund, download the full Highlight or see "Linking MFIs to Commercial Financing in Latin America" (a CGAP case study), both available at microfinancegateway.org. To request a paper copy of this publications, please email portfolio@cgap.org or send us a fax at 1-202-522-3744.

DOUBLE CLICK!

today's most downloaded documents on the Microfinance Gateway

1. *The Microfinance Revolution: Sustainable Finance for the Poor, Vol.1*, Marguerite Robinson (2001).
2. *Management Information Systems for Microfinance Institutions: A Handbook*, Charles Waterfield and Nick Ramsing (1998).
3. *Business Planning and Financial Modeling for Microfinance Institutions: A Handbook*, Anthony Sheldon and Charles Waterfield (1998).
4. "Financial Ratio Analysis of Micro-finance Institutions," SEEP Network (1995).
5. "Commercialization: The New Reality of Microfinance?" Robert Christen and Deborah Drake (2002).

With its library of more than 4,000 documents, the Microfinance Gateway is the most comprehensive online resource for practitioners, funders, and technical advisors.

Visit www.microfinancegateway.org for these and other publications in English. For French publications, visit www.lamicrofinance.org. An Arabic gateway is coming soon! For details, call Gateway Manager Ira Singh at 1-202-473-1515.

ABOUT PORTFOLIO

At CGAP, our investments—standards, services, scale—are as diverse as the industry we serve. Keeping track of it all can be daunting, which is why we created Portfolio. In it, you'll find the context to help you make sense of the latest microfinance trends. You'll get a diverse look at what others are reading, writing, and saying. And you'll keep up-to-date on key events worldwide. Read and react at cgap.org.

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PORTFOLIO PLANNER

Current events through June 2005

Africa

7th MicroSave CEO's Meeting
24-27 May, Kenya

East/South Asia & the Pacific

International Conference on Achieving Results in Private Sector Development
18-20 April, Philippines

Principles and Management of MFIs/ Business Planning for MFIs
2 May-30 June, Nepal

Management Information Systems for Credit Programs
13-15 June, Laos

Europe & Central Asia

SME Cluster Development: Principles and Practice
18-29 April, Italy

Business Planning and Financial Projections with Microfin (Spanish)
2-6 May, Spain

Inter-Agency Conference
6-7 May, Switzerland

Business Planning and Financial Projections with Microfin
9-13 May, Spain

ILO and ECLOF Meeting
12 May, Switzerland

Strategies for Local Economic Development
16-27 May 2005, Italy

Remittances and Financial Inclusion
19-20 May, Belgium

8th Annual Conference for Microfinance Institutions
26-28 May, Romania

Seminar on MFIs in Transformation
10 June, Netherlands

Fostering Private Sector Development & Leadership
15 - 24 June, Switzerland

Microfinance Conference 2005: High-Level Meeting
20 June, France

Microfinance Conference 2005: New Partnerships for Innovations in Microfinance
23 - 24 June, Germany

Conference on Securitization, Microinsurance and Technology
23 - 24 June, Germany

Latin America & the Caribbean

Latin America/Caribbean Region Microcredit Summit Meeting of Councils
19-22 April, Chile

4th Roundtable on Microfinance in the Caribbean
13-14 May, Guyana

North America

Blue Book Global Meeting
1-31 May, United States

Loan Fund Management Essentials Training
4-6 May, United States

Evaluating Business Plans Training
5-6 May, United States

15th Annual AEO Conference and Membership Meeting
10-13 May, United States

CGAP/UNCDF Donor Training - Building Financial Systems for the Poor: How Donors Can Make a Difference
7-10 June, United States

Christian Economic Development Institute: Two-Thirds World/Transitional Economies Track
13-18 June, United States

National Community Investment Fund Annual Network Conference
15-16 June, United States

For more information and updates, visit microfinancegateway.org

"As initial relief funding wanes, livelihood restoration will become a key priority. This is a time for bold and innovative thinking… Funds earmarked for livelihood restoration should be disbursed not as grants but as a combination of short- and long-term loans to the affected families."
–Vijay Mahajan, BASIX, India

"As a cooperative network with intensive engagement with the community, we are able to implement a comprehensive long-term plan to help the victims of the tsunami. Our strategy is to build 1,000 shelter units for disaster affected people; to provide kitchen items for 25,000 families; provide guardianship of 100 children who lost their parents in the disaster; and help them restart their income-generating activities."
–P.A. Kiriwandeniya, SANASA Bank, Sri Lanka

"For restoring and rebuilding livelihoods, CARE has initiated a 'cash for work' program to get people who have survived and are without livelihoods to go to work. At the same time, efforts are underway to 'retool' and 're-equip' communities that have lost assets in the sea or under the debris. Housing reconstruction will start soon, and this calls for coming up with a housing finance mechanism. Providing people with additional working capital, loans for productive assets, and a range of other financial services will come through sustainable microfinance initiatives, thereafter."
–Anuj Jain, CARE

Want to learn more? We recommend:

"Sustaining Microfinance in Post-Disaster Asia," CGAP, microfinancegateway.org (January 2005)

Surviving Disasters and Supporting Recovery: A Guidebook for Microfinance Institutions, World Bank and UNCDF (February 2005)

"Microfinance and Disaster Management," Foundation for Development Cooperation (September 2003)

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