

A Billion to Gain?

Dutch Contributions to the Microfinance Sector



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Preface

In recent years, microfinance has been successful in attracting the attention of a wide range of actors. This has been the goal for many and seen as a means to ensure that microfinance can be a sustainable tool to bring financial access to millions of poor people. Unfortunately, during this transition from a donor activity to a viable social and commercial investment choice, there have been side-effects such as over-indebtedness and a lack of transparency. Yet there has been an unabated desire on the part of microfinance actors to counter these side-effects and further develop the sector. This desire has resulted in initiatives that emphasize a balance between microfinance institutions' financial goals and clients' needs. These actors recognize that microfinance institutions cannot be solely responsible for further development in the sector. Funders also must contribute through responsible investing and sharing knowledge to improve social performance. Fortunately we find that many actors in the sector are responding, in a variety of ways, during this critical phase.

As the Dutch have a long history with the microfinance industry and have provided large contributions to its overall development, we are well aware of these issues. Our policies are designed to reduce these unwanted side-effects, no matter how difficult it may be in practice.

To the Netherlands Platform for Microfinance (NPM) and ING, the importance of inclusive finance is incontrovertible. After all, access to financial services is an important aspect in the economic development of countries throughout the world. Together with the betterment of health services, access to water and education (among others), the inequalities between the rich and poor can diminish.

The Dutch Microfinance Offer covers a wide range of institutions: from traditional donors to commercial investors. Through a combination of values and convictions, ambitions and a vision of the future we all strive to balance the social and financial return of our investments. But what is the current status of the Dutch Offer? What are the characteristics of the Dutch Offer in comparison to the rest of the world? What are the main initiatives addressing the challenges that lie ahead and how can these initiatives increase the social performance of Dutch investments? And is there a difference between donors and investors with regard to social performance or are the Dutch all alike? This study represents an attempt to answer those questions.

In this study, we evaluate the Dutch Offer and highlight the trends and initiatives that will be decisive in improving social performance. The purpose of the report is to address the opportunities and challenges we currently face. ING itself will use the findings to refine its social and commercial strategy with regard to microfinance. NPM will discuss the findings with its members. And by sharing our conclusions with you, our intention is to provide input for the debate on how to improve contributions to the microfinance sector.

This report is an initiative of ING and in cooperation with NPM, but could not have been written without the help and input from an important group of institutions in the sector. We would like to express our gratitude to each party that shared data with us, took part in the interviews and round table meetings or contributed in any other way during the process of writing this publication.

Nick Jue
CEO, ING Netherlands

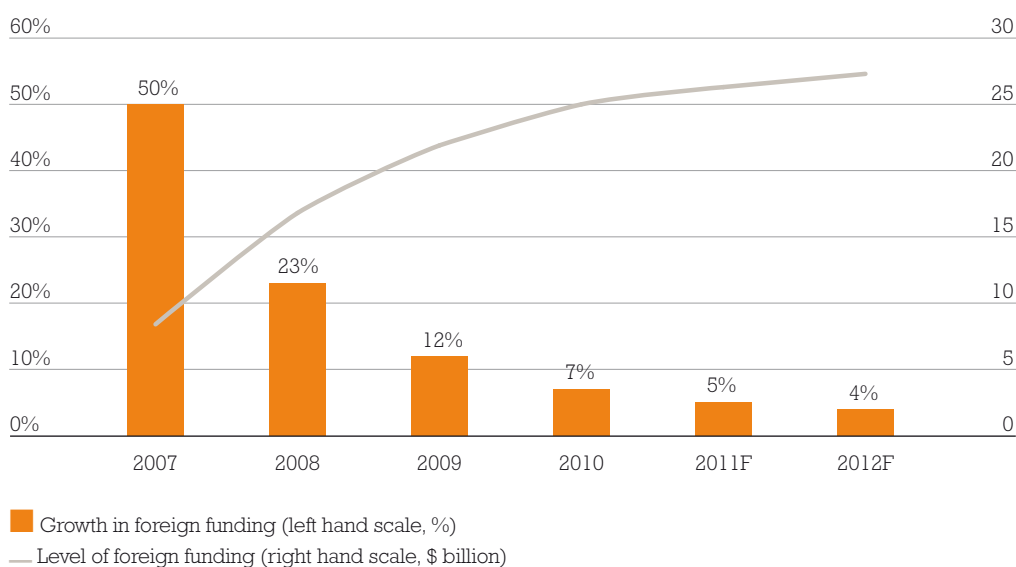
Ab Engelsman
Chairman NPM

Executive Summary

The Dutch Microfinance Offer: a major contributor to foreign investment in the microfinance sector

- This report is the first comprehensive overview of the Dutch Microfinance Offer (Dutch Offer). It reflects the active role of the NPM members in promoting initiatives geared towards the improvement of the sector. Our findings are as follows:
- The microfinance sector is estimated to be around \$80 billion globally.
- Total cross-border funding accounts for approximately \$25 billion of which \$2.1 billion is provided by the 16 NPM members (8.4%).
- Of the \$25 billion foreign funding, \$5.7 billion is provided by multilateral and bilateral agencies, the rest by Development Financial Institutions (DFIs) and private funders such as institutional investors, donors and Microfinance Investments Funds (MIVs).
- The Dutch market share is especially high for cross-border funding by investors and MIVs. Together they account for 25% of global funding by these types of funders. This illustrates the high commitment by private institutions to microfinance.
- Despite the crisis, the market for foreign capital to microfinance has continued to grow albeit at a much slower rate (figure 0.1). In fact, the financial crisis has put corporate responsibility and impact investing higher on the agenda of many investors.
- We expect moderate growth (4% in 2012) in global foreign funding to microfinance in 2012 if Europe is able to handle the economic and political crisis effectively, but a sharp decline if the European Monetary Union (EMU) breaks up. This is still a low probability risk but will certainly undermine global growth and negatively affect investor confidence if it materializes.
- The combined portfolio of the 16 NPM members has an overweight on Latin America (31%) in comparison with the rest of the world (22%) and an underweight on the Africa region (13% versus 16%).
- The Dutch are active in 68% of the 40 low income countries in the world, to which they allocate 24% of their funds, which is considerably higher than the rest of the world (16%).

Figure 0.1 Growth rate of global cross-border Microfinance funding, 2007-2012



Source: CGAP and ING Economics Department.

- The NPM members prefer direct funding to Microfinance Institutions (MFIs) (79%) over indirect funding. In comparison, other foreign funders only provide 37% directly to MFIs.
- NPM members mostly provide debt financing (76%) to MFIs.
- Equity financing is expected to increase since there is a need for MFIs to improve their solvency while scaling up investments and the debt market has become highly competitive, putting margins under pressure.

Donors and investors: different motives in investment choices

In this report we categorized the funds of the NPM members as donors, MIVs or investors. We find that these peer groups differ significantly from each other (table 0.1).

Table 0.1 Main focus of peer groups

Main MFI characteristics	Donors	Investors	MIVs
Charter type	NGOs	NGOs/NBFIs	NBFIs
Tier group	Tier 3	Tier 3	Tier 1
Scale	Small	Small, Medium, Large	Large
Age	Mature with 30% to start up MFIs	Mature with 20% to start up MFIs	Mature with 20% to start up MFIs
Regulated	Non regulated and regulated	Balanced	Regulated
Profit status	Mainly non profit	Mainly non profit	Profit and non profit
Financial return MFIs	Return on Equity on average 1%	Return on Equity on average 6%	Return on Equity on average 7%
Breadth of outreach	Small number of active borrowers	Small number of active borrowers	High number of active borrowers
Depth of outreach	High (small loans)	High (small loans)	Low (larger loans)

Source: ING Economics Department.

On average, donors fund MFIs that are NGOs, not for profit and relatively smaller and younger. These MFIs usually have a small number of active borrowers (breadth of outreach) and typically provide relatively smaller loans (depth of outreach), which indicates a focus on the poorest clients. In conclusion: the balance between social and financial return is more geared towards social return for donors.

At the other end of the spectrum MIVs, on average, fund MFIs that are non banking financial institutions (NBFIs), relatively large, mature and regulated. These MFIs have a high number of active borrowers and the size of loans is relatively larger. In comparison to the other peer groups, the balance between social and financial return for MIVs is clearly more geared towards earning a financial return.

Investors are positioned between donors and MIVs in terms of financial and social return of the MFIs they invest in.

Dutch have a unique way of operating in the sector.

The Dutch Offer consists of a wide variety of funders such as donors, MIVs and investors and both public and private parties.

1. Dutch funders have a relative high market share in foreign funding to the sector and they support many of the current initiatives, such as the PIIF and MFTransparency. This wish to 'do good' maintains a sound business sense to balance the social return with a financial return.
2. Dutch funders have a global perspective as they serve every region in the world and both low income and middle income countries. They have the expertise and mandates to fund MFIs directly and use all available funding instruments.
3. The shared good intentions have resulted in high cooperation between the NPM members. Often the funding to an MFI is provided by a collaboration of multiple funders in which each party focuses on what it knows best.
4. The Dutch have thought leaders that provide support in improving the microfinance sector so that it becomes, without any doubt, a useful method for creating an inclusive world. The contributions of Her Royal Highness Princess Máxima are an example of this type of support.

Opportunities, challenges and recommendations concerning investments

- Over the last decade, the number of low income countries has fallen from 60 to 40. Nowadays only 20% of poor people live in low income countries as compared to 93% in 1990. Most of them live in Africa but this region is relatively underweighted by the Dutch. Although there are major challenges in terms of political instability, high operating expenses and portfolios at risk, the need for foreign funding is high. Opportunities exist for donor funding towards capacity building in Africa.
- As countries have grown and graduated from one income level to the next, it is not guaranteed that this progress results in greater financial inclusion. Currently there are 2.7 billion poor people excluded from formal financial services and microfinance is estimated to reach 190 million clients (7%). Another \$250 to \$300 billion (approx. 0.45% of world GDP) is needed globally if microfinance would provide access to formal financial services to every poor household. Although the sector has grown rapidly over the years, there is still a long way to go.
- The need for equity investments is growing as the industry develops and grows. However, many practitioners mentioned challenges since equity funding is more risky while it is not yet clear whether the social impact is higher in comparison to debt financing. But equity does provide opportunities as well, since margins are higher in this niche market in comparison to the very competitive debt market.
- Small and Medium Enterprises (SMEs) are very important to stimulate employment and economic development. But it is not easy for SMEs to get funding since they are too small for the formal banking sector and they don't fit the standardised products of MFIs.

Opportunities, challenges and recommendations concerning initiatives

Recently the sector has initiated four important initiatives (table 0.2).

- With a long history in the sector, NPM members have the knowledge and ability to collectively work towards implementing the initiatives in a streamlined way. However there are questions of efficiency and effectiveness with so many initiatives with overlapping topics and references to other initiatives. By taking a supply chain approach, we expect the emergence of two leading initiatives in the next few years. One aimed at funders and the MFIs and the other at protecting clients.
- Social performance indicators are in their infancy. We recommend NPM members to actively stimulate or even require MFIs to report on these indicators to the MIX.
- Regular reporting on social and financial performance indicators, initiatives and other relevant topics serves the needs of funders and society at large. We recommend yearly reporting in order to track progress and to be able to report growth rates with a high level of accuracy.

Table 0.2 Overview of initiatives

SPTF Theme: Social performance	Smart Campaign Theme: Responsible finance	MfTransparency Theme: Transparency	PIIF Theme: Responsible investment
Year: 2005	Year: 2008	Year: 2008	Year: 2011
Main focus: Social performance	Main focus: Over-indebtedness and transparency	Main focus: Transparency in pricing	Main focus: Inclusive finance
Targets: All stakeholders in microfinance	Targets: MFIs	Targets: MFIs	Targets: Investors
Initiative of: Argidius Foundation & Ford Foundation	Initiative of: The Center for Financial Inclusion at ACCION International & CGAP	Initiative of: Chuck Waterfield	Initiative of: PRI, UNSGSA, CGAP and other key industry investors
Headquarter: USA	Headquarter: USA	Headquarter: USA	Headquarter: UK
Promotes: MFTransparency Smart Campaign	Promotes: MFTransparency	Promotes: N/A	Promotes: Smart Campaign, SPTF, MFTransparency, IRIS and MIV disclosure guidelines

Source: ING Economics Department



Introduction

Joint cooperation

ING Microfinance previously commissioned the research and publication of three reports in the series "A Billion to Gain?". These reports gave insight into the microfinance activities and future plans of a select group of large global financial institutions. This fourth edition in the series "A Billion to Gain?" shifts the focus to the Dutch contributions in the microfinance sector. It is a joint cooperation between ING and the Dutch Platform for Microfinance (NPM). Currently the NPM has 16 members who account for the majority of Dutch microfinance activities.

Three objectives

This report has three main objectives which are dealt with in part I, II and III respectively.

1. Provide a current overview of the trends and developments in the microfinance sector.
2. Provide a first comprehensive sector analysis of microfinance activities by Dutch funders, as represented by the 16 NPM members.
3. Investigate whether Dutch donors, Microfinance Investment Funds (MIVs) and investors differ significantly in the type of MFIs they fund. And if they do, does it result in differences in social and financial performance.

Part I provides a good introduction for a layman in the field but can be skipped by readers with a thorough background on microfinance.

This report has been written for a wide audience. We therefore start with an extensive part on trends and developments in microfinance that caused the sector to grow and develop. In part I we also discuss the recent initiatives by the sector aimed at balancing the financial and social return. Since these trends and initiatives are well known to practitioners they are advised to skip this part.

Part II and III are of interest to practitioners, researchers, as well as laymen

Since part II provides the first in-depth analysis of the Dutch contributions to the microfinance sector, it can be of interest to practitioners, academics and laymen. It presents extensive data on issues that were often spoken off but not backed by reliable quantitative data. This also applies to part III, which provides insight in how different peer groups differ in their motives and the MFIs they fund and the resulting differences in financial and social return. Currently this is an important discussion for both practitioners and academic researchers.

To be able to deliver on the second and third aim of this report we did desk research, held interviews and constructed an extensive database based on the 2011 CGAP surveys of the NPM members and data found on the MIX. These surveys were conducted in the spring of 2011 and reported on data as of December 2010. As of March 6th 2012, when we will present the findings at a joint conference by ING and NPM, this is still the most recent data on Dutch funders.

Part I: Trends and developments changing the microfinance landscape

1.1 Introduction and overview

In part I we describe five main trends that are changing the microfinance sector. These trends are:

1. **More growth in direct lending to MFIs.**

The sector has been growing globally 43% per annum since 2005 and despite the financial crisis the sector is still growing. Funders continue to provide massive capital flows to the sector.

2. **An expansion of services provided to clients.**

In the past, microfinance has mainly focused on providing small loans to help the poor improve their livelihoods. But it has become clear that they need more products, services, and a broader range of loan products to actually improve their standard of living. Such additional products now include savings, insurance, energy lending, etc.

3. **Convergence of the formal and informal banking sectors.**

As the services offered by MFIs increase and the clients improve their financial status, many MFIs are 'moving upmarket' and behave more like the formal banking sector. Along with investors, local and international banks have observed the success of these MFIs and an increasing number are participating in the sector. Therefore, the formal and informal banking sectors are converging.

4. **Adoption of new technology.**

New technology enables MFIs to provide new products that reduce operating costs, such as mobile banking and digital fingerprinting. This technology will continue to be a main driver in the growth of the sector.

5. **An increased need for transparency for all stakeholders.**

As the sector grows, investors demand more transparency from MFIs when allocating their capital. This puts pressure on MFIs to be more transparent both in their operations and the pricing of products being offered to clients.

These trends and developments are changing the microfinance landscape. There has been substantial growth in cross-border funding, MFIs, products and the number of clients being reached. This has all happened in a rather short time frame and has not been without side-effects. This has caught the attention of all stakeholders in microfinance and many are re-evaluating their contributions to the sector. These stakeholders are now proactively engaging with each other to limit these side-effects. Over-indebtedness and a lack of transparency are two examples of the side-effects currently affecting the sector. Both of these side-effects have consequences to funders, MFIs and the clients they serve.

It is critical that clients know the pricing of the loans and that they are receiving the loans they actually need. Without this transparency and responsible financing, clients may make the wrong choices. The consequence of making these wrong choices not only adversely affects their own betterment, but also has a 'trickle up effect' to all stakeholders in microfinance. With that respect, the current state of the microfinance sector is at a critical juncture. The sector has to make sure that clients get the products that match their needs. In the long run this is also in the interest of MFIs and their funders.

The sector realizes that to be socially responsible is to be client focused. This means that funders must be responsible in their investments and MFIs in the financing provided to clients. This entails MFIs and their funders to find the right balance between a financial and social return. In order to do so, the sector has developed initiatives that we describe briefly in part I. These are the Social Performance Task Force, Smart Campaign, MFTransparency, Principles for Investors in Inclusive Finance and the Microfinance Information Exchange.



1.1.1 More growth in direct lending to MFIs

Funders can invest direct or indirectly in the sector (figure 1.1).

Direct funding through direct relations with MFIs.

Direct funding is the provision of capital to MFIs that in turn provide loans to clients. This is typically as close as donors or social investors will get to the clients. The direct lending of funders can also include funding to governments, since in some cases, governments lend directly to clients.

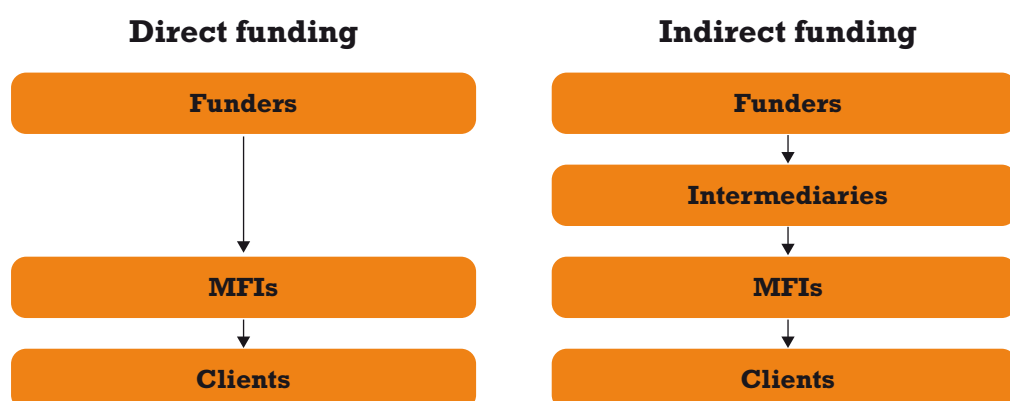
Indirect funding lacks direct contact with MFIs.

Indirect funding is typically through funds or holding companies. In indirect lending, investors often syndicate their capital by forming funds or other investment instruments that can share risk and invest in many MFIs. Donors and investors may also choose to invest in organizations or network associations that provide support to the sector in various ways, such as improving regulation or sharing of best practices to MFIs. These network associations are also known to provide funding to MFIs. While this is seen as a direct investment to the sector, it is considered indirect lending since the funds do not go directly to those providing loans to clients.

Four ways of direct funding.

- Institutions investing in the microfinance sector currently have four primary ways to invest directly: grants, loan guarantees, equity and (subordinated) debt.
- Grants: providing donations to an MFI.
- Loan guarantees: backing a loan so that an MFI can obtain capital from a domestic bank
- Equity: purchasing an equity stake in an MFI
- Debt: lending money directly to an MFI

Figure 1.1 Direct versus indirect funding of MFIs



Source: ING Economics Department.

“Grants have been vital in the development of the microfinance sector and it is widely held that they will continue to be in the start up of new MFIs.”

“It is important to stay client focused in the future to ensure that social performance isn't just a short-lived trend.”

Grants are used to finance new and uncertain activities.

During the initial phase of microfinance, grants were vital in the development of the sector and it is widely held that they will continue to be in the start up of new MFIs, funding innovation and helping manage market inefficiencies that may persist in certain geographies or business models.¹

Loan guarantees increase creditworthiness.

Loan guarantees have been important in assisting MFIs to gain creditworthiness so that they can obtain commercial lending to have the access to credit needed to grow and reach more clients.

Debt has become the main funding instrument...

Through the past support of grants and guarantees, the microfinance sector has developed over time and now obtains most funding in the form of debt. These loans vary in terms, from market interest rates to concessional rates, depending on the investment goals of the donor or investor. The growth of debt financing available to MFIs highlights the increased perceived value and awareness of investors in the microfinance sector.

...but the scale of debt now also increases the demand for equity to remain at a healthy solvency.

MFIs that have taken on debt in the past may no longer have a need for further loans due to various reasons. As an example, an MFI that have transitioned to a regulated institution is able to provide savings to clients, replacing the capital previously needed from foreign funders. This has been one of many drivers in the growth of equity investment in the microfinance sector that presents both opportunities and obstacles for donors and investors.

Growth in direct lending has come with a side effect.

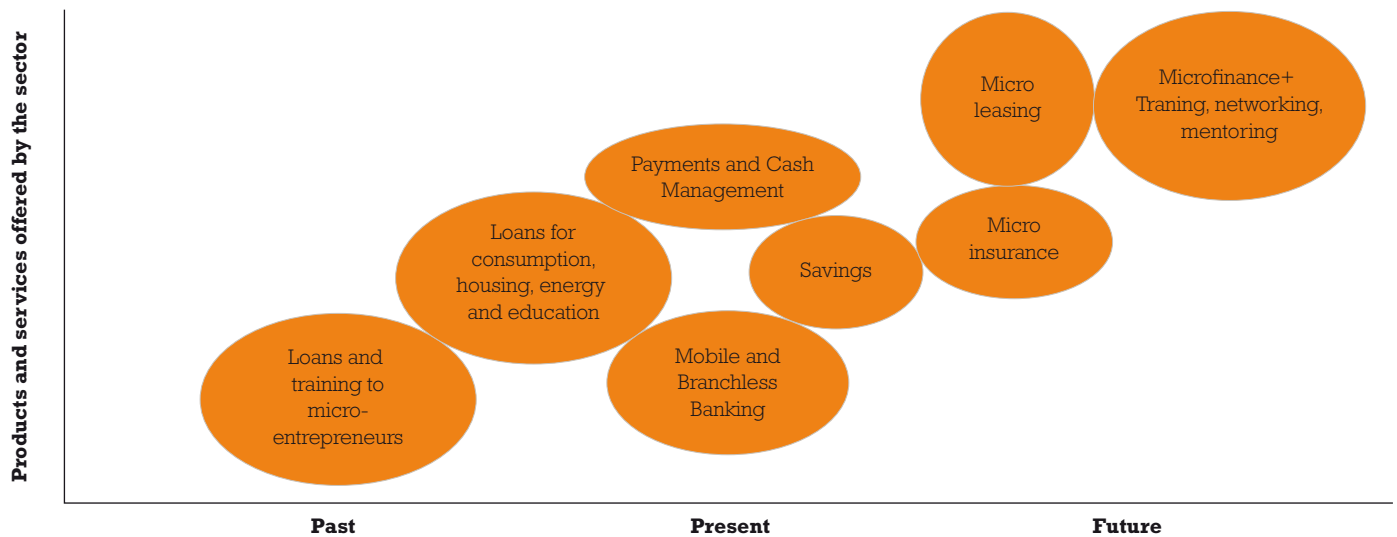
There has been incredible growth in cross-border funding in recent years as the microfinance sector has shifted from being a 'grant giving' sector to a more commercial sector. This has had consequences to the sector where investors have saturated certain markets with debt financing, causing heavily leveraged MFIs to either give larger loans or multiple loans to clients. This 'over-indebtedness' of clients has spurred many stakeholders in the sector to reassess the current business models. This industry self-assessment has led to initiatives calling for better self-regulation and government regulation to assure that clients come first. The fact that the industry has responded by promoting initiatives to be more 'client focused' does give promise that many of the recent problems in the sector are simply growing pains. While this may bring confidence to many for the short term, it is important to stay client focused in the future to ensure that social performance isn't just a short-lived trend.

1.1.2 Extensive expansion of services

Microfinance began as an idea that loans could help the poor improve their livelihood. Most of the poor throughout the world are self-employed and the first microfinance loans were targeting these micro-entrepreneurs. In these early days, measuring the impact of these investments was not needed since the betterment of the livelihood of the loan recipients was observed first-hand as the MFIs were close to the clients. Since this time, microfinance has broadened its offering to the poor and now gives loans to different types of clients for various purposes (student loans, consumption smoothing, mortgages, energy lending, etc). With such an extensive range of products now offered to clients (not only micro-entrepreneurs) and to such a large scale, the impact of these investments is not observed first-hand as it once was.

¹ World Economic Forum (2006). Blended Value Investing: Capital Opportunities for Social and Environmental Impact. Geneva, World Economic Forum.

Figure 1.2 Products and services offered by the sector at different times



Source: ING Economics Department.

“Many MFIs have now grown in scale and are offering a wide array of services. The expansion of these services can benefit clients and the number of poor people reached by an MFI.”

Many MFIs have grown in scale and now provide different products and services...

This growth in the microfinance sector has been through the excitement that loans can be a financially viable option to help the poor improve their lives through better access to finance and many business innovations have resulted. The potential of microfinance for many goes beyond financial inclusion and is seen as a potential tool to combat poverty, alongside other policies such as access to education, healthcare, water, energy etc. Through this excitement and commitment of many different types of actors, business innovations have improved the business model of MFIs. As a result, many MFIs have now grown in scale and are offering a wide array of services. The expansion of these services can benefit clients and the number of poor people reached by an MFI.

...but possibly with unwanted side-effects.

The expansion of products and services creates a potential negative side-effect as well. In trying to serve the poor people, by increasing the product range, MFIs might actually end up serving a larger portion of the upper poor and stray away from serving the poorest. Take for example mobile banking in rural areas. These services often can only be paid for by the ‘upper poor’. The expansion of products and services often – consciously or unconsciously – changes the business model of MFIs and many question if the sector is becoming too business oriented.

Microfinance started off as loans to micro-entrepreneurs and has since expanded to financial and non financial services (figure 1.2). As microfinance developed more loans were provided for consumption smoothing and now have expanded even further to include loans for housing (micro mortgages), energy needs and education. Additional financial services include:

- Micro savings
- Payments and cash management
- Mobile and branchless banking
- Micro insurance and micro leasing

“It is important to keep focus on all of the poor and on the clients’ needs first rather than the products.”

Some MFIs have broadened their activities even further, providing non-financial services such as business training, health care, and other social services. These services are now commonly referred to as ‘plus’ activities in the sector. The idea behind the ‘plus’ services is that poor people have more problems than access to finance. Microfinance plus recognizes that clients can only fully utilize the financial services they are provided if they are healthy and educated on how to use the borrowed funds efficiently.² Listed below are many of the non-financial services offered by MFIs.

Non-financial services:³

- Education and awareness (e.g. financial education and literacy)
- Asset building (e.g. retirement savings)
- Business training
- Networking
- Mentoring
- Other social services

New products and services create unexpected side effects...

In addition to the services listed above, MFIs have also attempted to use their relationships with clients to sell products seen to be socially beneficial, such as water filters and mobile phones. See box 1.1 for an example of an MFI’s experience providing mobile phones to its customers.

Box 1.1 The unexpected side effects of providing mobile phones for mobile banking

SKS, currently the largest MFI in India formed a partnership in 2008 with one of the world’s largest mobile phone manufacturers. They developed a plan to sell mobile phones on credit through SKS branches, and also to provide mobile banking services to the poorest people. SKS loan officers acted as sales agents for the mobile phones, promoting them to customers during SKS centre meetings and other interactions.

Initially, the phones sold like hot cakes. The phenomenal spreading of mobile phones to the rural poor (between now and 2012, 120 million new users are expected to adopt wireless telephony in rural areas compared to about 62 million in the metros) acted as a clear and present signal for product demand. With credit factored into the deal, the mobile proposition only became more attractive to the poorest. SKS sold their first 1500 phones in their small scale pilot within the space of a couple of weeks, indicating that the tie-up would be very successful.

Repeated technical problems and user interface difficulties with the phones, however, soon overwhelmed SKS branches and created considerable dissatisfaction among customers, both with the “SKS mobiles” and with the organization’s traditional loans. Since loan officers sold the phones directly to customers, they were in fact the face of the product, and implicitly became liable for its performance in the mind of the customers. Trust among the poorest customers for SKS and their loan officers diminished, threatening the core loan-making business as well.

Source: Courtesy of Monitor Inclusive Markets.

2 Lensink, R. Mersland, R. Nhung, V. (2011). Should Microfinance Institutions Specialize in Financial Services (Working Paper)? Retrieved December 15, 2011, from www.rug.nl

3 Henry, S. (2006). Good Practice in Business Development Services: How Do We Enhance Entrepreneurial Skills in MFI Clients? Toronto, ON.: Alterna Savings, July.

This scheme highlights the risk an MFI takes in expanding its offering and how an organization can become distracted by straying away from what it knows best. It should be noted that highlighting the concerns in the growth of services of MFIs does not imply that MFIs should not consider serving more people in more ways, but that in doing so there may be a risk of the MFI straying from its core product and also a risk that the poorest will be excluded.

...but are not necessarily used in productive ways to alleviate poverty.

Another risk in the expansion of services provided to the poor is that MFIs may stray from providing services the poor need to services that the poor desire. In a recent survey by Monitor Inclusive Markets⁴, they found that 85% of respondents in a focus group of Indian consumers said they would use credit to purchase 'aspirational' or 'non-productive' items such as televisions and kitchen cupboards instead of productive means such as increasing their business or start education. If MFIs are pressured to become fully sustainable or more profitable, there is a risk that they may expand to desired products rather than products that are income generating.

1.1.3 The formal and informal banking sectors converge

As the services offered by MFIs increase and the institutions' clients improve their financial status and require more formal banking products, many MFIs are moving 'up-market'.⁵ Existing customers that have proven to be reliable in paying back loans are attractive for MFIs to retain and are trying to do so by providing larger loans and additional products. This has resulted in some MFIs resembling a more typical consumer bank.

Along with investors, local and international banks have observed the success of these MFIs and want to participate in the sector. It is unclear to what extent they have actually participated in the sector but many are now establishing partnerships with MFIs. This has led to commercial banks offering services to many people that previously would have been excluded.

This convergence leads to MFIs functioning more like traditional banks and traditional banks functioning more like MFIs. While this is promising for improving overall financial inclusion, a question remains that if MFIs are moving 'up-market' and banks are moving 'down market', who is serving those at the bottom of the market? This has implications for the social performance of MFIs, on one hand many MFIs want to focus on clients at the bottom of the market, but on the other hand they need to support clients' needs as they grow.

1.1.4 Adoption of technology

The adoption of technology has increased in the sector and has many potential benefits for MFIs. Technological advances have the potential to reduce the operating expenses of MFIs, both in general administration and the costs involved with servicing small loans. Certain technology advances, such as digital fingerprinting, have been recently proven to reduce costs and risks in lending to poor people.⁶ With this new technology borrowers in Malawi knew that they would be identified in the future and if they would default they would not be able to obtain future loans. This didn't prevent them from taking out loans but did result in borrowers being more cautious and borrowing less money⁷. This resulted in improved loan repayments and compensated MFIs for the costs of implementing the fingerprinting system.

"If MFIs are moving 'up-market' and banks are moving 'down market', who is serving those at the bottom of the market?"

"Many MFIs have now incorporated mobile payment systems that have enabled them to improve their efficiency and extend their outreach."

4 Lalwani, N., & Kubzansky, M. (2009). *Stretching the Fabric of MFI Networks*. Mumbai, India: Monitor Inclusive Markets, December.

5 World Economic Forum (2006). *Blended Value Investing: Capital Opportunities for Social and Environmental Impact*. Geneva, World Economic Forum.

6 Abdul Latif Jameel Poverty Action Lab. (2011). *Fingerprinting to Reduce Risky Borrowing*. J-PAL Briefcase. Massachusetts, USA: Massachusetts Institute of Technology, July.

7 Ibid.



The increased use of mobile banking services has increased the outreach to clients in rural areas that otherwise would be too costly to finance. For this reason, mobile banking (branchless banking) is seen to play a key role in reducing the number of rural poor people that are financially excluded. As an example, M-Pesa is a mobile network operator in Kenya and has had extraordinary success in transforming the financial landscape in Kenya. From 2006 to 2009 access to formal finance increased from 27% to 41%, with 10% of this increase credited to the services provided by M-Pesa.⁸ Many MFIs have now incorporated mobile payment systems that have enabled them to improve their efficiency and extend their outreach. Rather than creating their own mobile banking products, MFIs have utilized those already in place, such as the mobile banking services of M-Pesa. Through this partnership MFIs have benefited, as have the mobile network operators and clients.

1.1.5 Increased need for transparency for all stakeholders

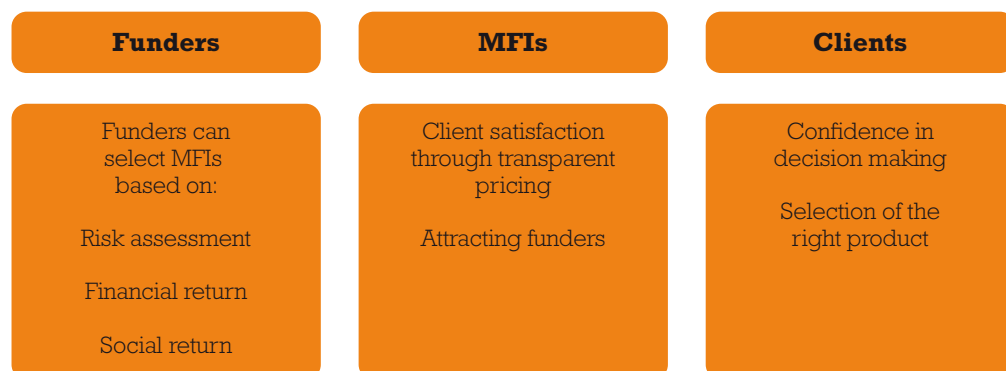
Investors require transparency on financial and social risk and return...

Investors and practitioners in the microfinance sector are increasingly focused on transparency and standardization of MFI practices and performance (figure 1.3).⁹ This focus has developed as more types of investors have been attracted to the sector. Investors want to be able to select MFIs that match their appetite for risk and their desired social and financial return. In the past this required a deep knowledge of the sector and limited opportunities for many.

8 Napier, M. (2011). Including Africa – Beyond Microfinance. No. Ninety Eight. London, U.K.: Centre for the Study of Financial Innovation. February.

9 World Economic Forum (2006). Blended Value Investing: Capital Opportunities for Social and Environmental Impact. Geneva, World Economic Forum.

Figure 1.3 Benefits of improved transparency at different levels in the Microfinance supply chain



Source: ING Economics Department.

...and the MFI's have responded in order to attract more funding.

Only in the past decade has the reporting of MFI's become publicly available and this reporting has been increasing rapidly. One of the underlying reasons for this development is most likely due to the MFI's perceived value that reporting will attract more investments from either donors or more commercially oriented investors.

Clients need transparency to be able to select the product that meets their demands best.

Besides the need for transparency of MFI's for investors, there is a growing demand for transparency in pricing for the clients that MFI's serve. Transparency not only includes the interest rate but also the terms of agreement and commissions earned by the sales people. There is now a widely held view that MFI's should provide clear and complete information about the loans that they provide so that clients fully understand what is expected of them. With this full understanding, clients can be confident in selecting a loan that best suits their needs.

Due to competition and market forces it is hard for a single MFI to increase transparency.

Why would MFI's have unclear pricing if the whole Microfinance supply chain benefits from increased transparency? One possible explanation is competition. As the sector developed, many more MFI's entered the fray (some with a different mission) and competition rose. As competition grew for both clients and funding, some MFI's began to focus on becoming profitable at the expense of the clients. By claiming a lower price than the competition, certain MFI's were able to attract clients even though the real pricing was much higher than advertised. By attracting more clients, these MFI's grew quickly and attracted funding from investors based on their profitability. Unfortunately, this has been the case in many markets and has become the status quo. This development has trapped many MFI's into adopting similar practices and even if MFI's now want to change, the consequences of being the first to change is often too high. This has caused a first mover disadvantage and in a sector where sustainability is already difficult, the loss of clients and the resulting negative effect to profitability is simply too high. This status quo has led to the need for coordinated action on the sector level.

“Many now argue that microfinance has to prove itself and restore credibility to the sector.”

“The SPTF has gained membership consisting of over 1,000 members from all over the world, which represent nearly 600 organizations.”

1.2 Recent initiatives in the microfinance sector

The sector has to restore credibility and initiatives have been created.

In response to the recent developments in the microfinance sector, initiatives have been taken to address the challenges the sector is now facing. Along with a strong focus on preventing over-indebtedness and increasing transparency, microfinance is faced with the challenge of restoring credibility to the sector and restore investor confidence that microfinance is the a viable investment that also provides a social return.

Initiatives have a strong focus on social performance.

Social performance is currently the main focus of these initiatives. Through implementation of social performance initiatives and the reporting of social performance indicators, the sector will be better equipped to prevent the ill effects of rapid growth and commercialization while also providing insight on how MFIs interact with clients.

As the sector continues to grow and reaches more clients and in more ways, social performance will have an important role in the MFIs ability to attract funding as the sector becomes more competitive. Of course, this will only hold if responsible investing is adhered to by all types of funders. The initiatives developed as the sector matures presents an opportunity for funders to lead by example and minimize the negative results and optimize the positive potential of microfinance. The rest of this section describes the main initiatives:

- The Social Performance Task Force
- The Smart Campaign
- MFTransparency
- The Principles for Investors in Inclusive Finance
- The Microfinance Information Exchange

1.2.1 Social Performance Task Force

Mission drift has led to questions whether microfinance is improving the lives of clients.

The original purpose of microfinance was to improve client welfare, but for the last two decades, many MFIs have prioritized the financial sustainability of their organization over the sustainability of the clients they serve.¹⁰ Transparent pricing and preventing over-indebtedness of clients have become important issues in the sector due to cases of excessive and confusing pricing by MFIs and multiple loans to clients that cause more harm than good. This shift in focus, which is commonly referred to as ‘mission drift’, has led investors and the general public to question whether microfinance has drifted away from its mission to improve the lives of clients. Many now argue that microfinance has to prove itself and restore credibility. We believe that to do so, responsible financial inclusion needs to be on the minds of all actors in the sector.

Social performance should be standard business practice.

The vision of the Social Performance Task Force (SPTF) is to ensure that social performance management is standard business practice and considered fundamental to achieving the social promise of microfinance.¹¹ To reach this vision, the SPTF is engaging with microfinance stakeholders to develop and promote standards and good practices for social performance management and reporting. The core of these universal standards is to ensure that microfinance services do in fact benefit clients.

¹⁰ SPTF. (2011). Introduction to the Social Performance Task Force (SPTF)'s Universal Standards for Social Performance Management-Building Client Focused Institutions. Retrieved January 15, 2012, from <http://sptf.info/sp-standards>

¹¹ Source: www.sptf.info (15/12/2011).



The SPTF has grown rapidly...

Since its inception in 2005, the SPTF has gained membership consisting of over 1,000 members from all over the world, which represent nearly 600 organizations. These organizations represent every microfinance stakeholder group: practitioners, donors and investors (multilateral, bilateral, and private), global, national and regional associations, technical assistance providers, rating agencies, academics and researchers, and others.

SPTF membership brings all members together with one definition of social performance and the recognition that financial performance alone is insufficient to achieve the goal of serving and improving the lives of poor and excluded people sustainably. With a shared definition of social performance, all members then commit to improving social performance of microfinance.

...and developed tools to assist their members.

For members to implement improvements in their social performance management, a variety of tools are provided by the SPTF.

- **Client protection tools.**

The Smart Campaign and MFTransparency both are the leading tools promoted by the SPTF to improve client protection.

- **Audit tools.**

There are four audit tools promoted by SPTF that evaluate the MFIs intentions, systems, and actions, in order to determine how well they are achieving their social objectives and to identify areas of particular strength or weakness.

- **Poverty assessment tools.**

SPTF promotes two leading poverty assessment tools for MFIs that have a mission to target poor clients MFIs can use these tools to measure the poverty of incoming clients and track changes over time.

- **Rating tools.**

SPTF promotes four rating agencies as the recommended rating tools. These rating agencies provide an objective opinion on an MFIs success in translating its mission into practice. These ratings can be important for funders in their search for new investment opportunities and therefore are also valuable to the MFIs as well.

“The client protection principles are quickly becoming the basis for how MFIs should treat their clients.”

1.2.2 The Smart Campaign

The smart campaign aims to improve accountability, security and transparency in financial services. This is important to all recipients of financial services, whether in the Western world or in developing countries. Without such measures, people are unable to understand the services that are best suited for them and cannot be confident in the choices that they make. In environments where institutions are not held accountable, the risk of misleading and taking advantage of clients is much greater.

Microfinance has to become more customer centric.

Knowing that the microfinance industry has evolved from its earliest roots as a social movement to a multi-faceted financial services industry, it has become clear that the focus of the future should be on clients first, not the services. Rather than focusing first on the supply side, the industry needs to know their clients' needs and repayment capacities.¹²

The Smart Campaign was formed in 2008 with the vision to bring people together across the microfinance industry to implement a common code of conduct that governs how clients should be treated and to help implement client protection safeguards within the industry's operations.¹³ The Client Protection Principles (CPPs) resulted out of this effort and have been widely accepted in the industry with over 2,300 endorsers from 130 countries, including 700 MFIs (approximately one third of the total number of MFIs reporting on MIX).¹⁴ The CPPs are quickly becoming the basis for how MFIs should treat their clients. Of these principles, the two most important focus on over-indebtedness and transparency.

The focus should shift from endorsement to actual implementation.

Beyond endorsement, the smart campaign is now supporting the development of the tools and resources necessary to implement the CPPs. In addition to the support services, the campaign also is conducting assessments and providing CPPs certification. This has been the more difficult task for the Smart Campaign. Getting endorsements is easy, ensuring implementation from those endorsing is more difficult and ultimately it rests on the endorsee. Donors and social investors can have an important role in the promotion of the CPPs through due diligence and loan agreements. In addition, associations or networks have been important by promoting the Smart Campaign.

1.2.3 MFTransparency

MFTransparency was established to promote the welfare of poor micro-entrepreneurs, and to promote the integrity of microfinance as a poverty alleviation practice.¹⁵ The poor continue to be neglected by commercial banks in developing countries. The poor have had to rely on alternative and informal sources of credit, such as money lenders, family and friends. The original idea of microfinance was to give additional options to those financially excluded and to provide a better quality loan and at a fair price.¹⁶ While microfinance has long been highly transparent in some areas, pricing of loan products has been less transparent due to market conditions and a lack of regulation.

Confusing interest rates, hidden fees and complicated agreements...

As the microfinance sector has developed, many types of MFIs with different objectives have entered in the market. Some of them are believed to only be in the market for a

“The founding purpose of MFTransparency has been to improve transparency one country at a time and have now done so in over 20 countries.”

¹² Source: www.smartcampaign.org (15/12/2011).

¹³ Ibid.

¹⁴ Rozas, D. (2011). Implementing Client Protection in Microfinance: The State of the Practice, 2011. A Report from the Smart Campaign. Publication No. 14. Washington D.C.: Center for Financial Inclusion at ACCION International, November.

¹⁵ Source: www.mftransparency.org/(15/12/2011).

¹⁶ Waterfield, C., Interview held with the Netherlands Platform for Microfinance, Utrecht, NL, 2011.

Box 1.2 How transparency can be increased in practice

Gatsby Shows All

In the microfinance market in Uganda, non-transparent disclosures are the norm. There is no single point of reference that clients can consult to understand their loan pricing structure. Loan repayment schedules often fail to include interest rates, fees, commissions, and other pricing components.

In this market, one MFI, Gatsby, has developed a repayment schedule that truly stands out. On a single sheet of paper, Gatsby has been able to display a wealth of information regarding the loan, and do so in a well-laid-out manner that is clear and understandable. The schedule shows all loan fees and commissions, the interest rate and its calculation method (flat rate), the repayment grace period, a full repayment schedule that breaks out interest and principal installments, including those due and still to be paid, and the total amount of interest to be paid over the life of the loan. The schedule also includes important reference information, such as the loan officer's name, branch contact information, as well as the date the schedule has been generated.

One major benefit to Gatsby is that in a market where a loan officer appropriation of client repayments is not infrequent, clients now have a clear document that lays out exactly what they have paid and what they owe. Similarly, sharing a wealth of loan pricing information allows clients to understand their loan better. Such transparency allows Gatsby to build greater trust with its clients, and thus constitutes an important advantage over its competitors.

Source: Courtesy of MFTransparency.

financial return and have done so by masking their true prices. These different types of MFIs have increasingly come into competition with each other, which has had an adverse effect on the pricing transparency of the loans. As a consequence, nearly all MFIs have a confusing price and are trapped into the practice (see box 1.2 for an example). So what makes a pricing scheme confusing? When MFIs advertise rates per month rather than annual rates, the cost to the borrower may seem to be lower, but often it is not the case. MFIs can also choose to advertise interest rates through different methods, further confusing clients. In addition to confusing interest rates, hidden fees and complicated terms of agreements make clients unable to compare and they must rely on the staff of the MFI to explain what they are agreeing to. Trust in the MFI becomes very important to these clients, but often the staff of an MFI does not fully understand their own pricing schemes.

... make clients unable to fully understand and compare products.

All of these factors have made microfinance prices exceedingly difficult to understand, and as a result, clients often make poor choices. Although governments in some countries have passed legislation to tackle such issues, many markets are left without laws protecting clients. To improve the transparency where the industry falls short and the regulation does not create an enabling environment for transparency, MFTransparency has begun to intervene.

Through competition and transparency the price spread becomes smaller...

MFTransparency's work has been based on the dual approach of educating stakeholders on issues of transparency as well as publishing the true costs of microfinance products in a clear, consistent fashion to create an enabling environment for transparency.¹⁷ The founding purpose of MFTransparency has been to improve transparency one country at a time and is currently active in more than 20 countries. MFTransparency has been successful in its method of working with a majority MFIs per country to make pricing of the competition clear. According to Chuck Waterfield, CEO of MFTransparency, when

¹⁷ Waterfield, C. (2007). The Challenge of Understanding Pricing of Micro-loans. Pennsylvania, USA: MFTransparency, June.



this pricing becomes clear, most MFIs with higher pricing (whether they were previously aware or not) typically adjust their price to those of other MFIs. The end result of this initiative has been that the price spread becomes smaller through price competition, leading to a market that works better.

...and clients can decide better which products are best for them.

Besides the transparency needed for MFIs to set a fair price, clients also need to know the terms of their agreement. When clients have complete information and understand the information, they are fully equipped to decide which products are best for them. This type of practice encourages open communication and a supportive relationship between providers and clients that can give an MFI an advantage over others.

Since MFTransparency's launch in 2008, 889 industry leaders serving 60 million clients worldwide have endorsed MFTransparency. With their continued work, transparent pricing in the microfinance industry can ensure that pricing and profits find an acceptable equilibrium.

1.2.4 Principles for Investors in Inclusive Finance

In 2005 the United Nations Secretary-General invited a group of the world's largest institutional investors to join a process in developing the Principles for Responsible Investment (PRI). Individuals representing 20 institutional investors from 12 countries agreed to par-

“The Principles for Investors in Inclusive Finance were developed in response to growing interest and investments into inclusive finance and demand for investor guidance.”

ticipate in the Investor Group.¹⁸ The Group created six principles that are meant to align investors with broader objectives of society. Since this time, the Principles for Investors in Inclusive Finance (PIIF) were developed in response to growing interest and investments into inclusive finance and demand for investor guidance.¹⁹ These principles are an initiative of investors and Her Royal Highness Princess Máxima of the Netherlands, the UN Secretary-General’s Special Advocate for Inclusive Finance for Development (UNSGSA).

The PIIF are comprised of 7 principles that are all applicable to microfinance.

1. **Range of Services.**

This principle aims to support retail providers to innovate and expand the range of financial services available to low income people in order to help them reduce their vulnerability, build assets, manage cash-flow, and increase incomes.

2. **Client Protection.**

This principle aims at integrating client protection in investment policies and practices.

3. **Fair treatment**

aims to treat investees fairly with appropriate financing that meets demand, clear and balanced contracts, and fair processes for resolving disputes.

4. **Responsible Investment.**

This principle aims to include environmental, social and corporate governance issues in investment policies and reporting.

5. **Transparency.**

This principle actively promotes transparency in all aspects.

6. **Balanced Returns.**

This principle strives for a balanced long-term social and financial risk-adjusted return that recognizes the interests of clients, retail providers, and investors.

7. **Standards.**

This principle aims at collaboration to set harmonized investor standards that support the further development of inclusive finance.

The principles complement other initiatives...

The PIIF have a dual purpose for investors. First, the PIIF can be seen as a way of implementing the Principles for Responsible Investment with regards to investments in inclusive finance. Second, the PIIF are complementary to the Smart Campaign, MFTransparency, SPTF, CGAP MIV Disclosure Guidelines, and standards and tools and Impact Reporting and Investment Standards (IRIS).

...and are currently being implemented.

The PIIF were launched on 27 January 2011 at the Responsible Finance Forum hosted by the Dutch Ministry of Foreign Affairs. On 6 April 2011, a second round of signing was hosted by ING. Total current signatories now stand at 51. Currently investors are implementing the principles into their day to day business.

The PIIF promote all the other initiatives as well

Through the creation of the PIIF, there is now one initiative that promotes all initiatives that focus on responsible investment, while also promoting social performance (SPTF) and responsible finance (Smart Campaign and MFTransparency). The SPTF is the only other initiative that has promoted the other initiatives in the past (e.g. Smart Campaign and MFTransparency).

Prior to the PIIF, each initiative has had to promote itself both to funders and to MFIs. These initiatives have grown, in part, through the endorsement or membership of

¹⁸ www.unpri.org (15/12/2011).

¹⁹ Ibid.

funders. They are now gaining in importance as MFIs have incorporated the initiatives into practice. This is expected to rise even further as MFIs recognize the value of implementing better practices and as more investors become signatories to the PIIF. Through signing the PIIF and implementing the principles, funders will promote the initiatives to the MFIs that they invest in. This has great value to the future of these initiatives as funders will make them more widely used and in a less costly and more efficient manner. In addition, the initiatives are likely to not be as overbearing to an MFI as they currently are. Many MFIs are struggling to stay profitable and each required initiative requires more time and money. This is not sustainable for many MFIs. In the past experiences of some MFIs funded by NPM members, more than one NPM member was funding them and requiring different assessment tools to be used for the same indicator. The promise behind bringing these initiatives closer together is that funders and MFIs will be on the same page. By doing so, responsible investments will be made, responsible finance will be provided to clients and social performance will improve.

1.2.5 Microfinance Information Exchange

MIX provides detailed information on MFIs, especially financial indicators...

The Microfinance Information Exchange (MIX) was founded in 2002 to disseminate information on the microfinance markets and ultimately to encourage standardization and transparency by providing detailed information on MFIs, their partners and investors.²⁰

...but MIX recently started reporting on social performance indicators as well.

The MIX now provides data on approximately 2000 MFIs around the world. The MIX originally reported indicators focused on financial performance of MFIs. As the previously noted initiatives have been successful in motivating MFIs and other parties to report on social performance indicators, the MIX now is able to provide a first glance on the social performance of MFIs. For example, MIX reports now on:

- The poverty level of clients at entry and their movement out of poverty.
- Corporate governance issues such as whether members of the Board of Directors have been trained in social performance and the presence of a formal committee that monitors social performance.
- How the MFI states its interest rate.
- Whether the MFI has policies in place to mitigate the environmental impact of financial enterprises.
- The number of clients reached by product type.
- The number of enterprises financed by an MFI and employment created by these enterprises.

Unfortunately data does not represent the full sector yet.

This unique dataset provided by the group of MFIs reporting on their social performance has already shed new light on MFI social performance management practices but can only be seen as a first glance since they represent only a fraction of all MFIs. For an analysis of social performance to truly reflect the sector, more complete data needs to be provided and by a larger percentage of the MFIs. But further reporting will rely on the participation of all stakeholders in the microfinance sector since the information gathered by the MIX is voluntarily provided by a variety of sources. As MFIs, investments funds and networks increasingly share detailed social and financial performance data, the dataset will improve and provide a unique dataset that will shed further light on the sector. The first group of MFIs has set a trend in the reporting of social performance indicators and it is quite certain to grow. To guarantee that it does catch on, donors and investors can function as an enabling factor in this critical phase.

²⁰ www.mixmarket.org (15/12/2011).



End of Part I: need for simplicity and cost efficiency of initiatives

In this part we have described five major trends that are causing the sector to grow and develop, but unfortunately not without side-effects. Fortunately the sector is addressing these by recent initiatives; however, there are questions of efficiency with so many initiatives promoting responsible investment, responsible finance and better social performance in the sector.

In practice, funders and MFIs find difficulty in managing all the new initiatives and the costs in implementing them are high. Some have expressed their frustration that as soon as one is implemented, a new initiative is created. Often these initiatives have overlapping themes. While auditing agencies and consultants certainly benefit from this, the costs to MFIs and funders in both time and money are significant.

From a supply chain point of view, there is clearly a need for simplicity so that unnecessary costs are avoided. For example, by means of two leading initiatives; one could target both funders and MFIs while the other targets client protection at the bottom of the supply chain. With regard to funders and MFIs, it may be that all the current initiatives can grow more efficiently under one umbrella initiative. By doing so a 'lean and mean' initiative would have potential to be more efficient and be widely accepted in the sector.

Since there is a great deal of discussion among practitioners regarding how best to move forward, we expect this continued discussion to result in future innovation. It is likely that in the process, many hurdles will need to be overcome to find a common ground. Many funders now have due diligence practices based on their own framework and mission. It may be difficult to find a common due diligence that produces measurable results useful for industry-wide comparison. Funders are beginning to focus on such ideas, including the NPM members, and hopefully this will result in more efficient initiatives in the future.

In part II we take a closer look at where and how the Dutch are currently investing in the sector.



Part II: The Dutch Microfinance Offer: a major contributor to the microfinance sector

2.1 Introduction and overview

This part provides an overview of the Dutch Offer as represented by the NPM members. Until now, an extensive overview of the Dutch Offer was lacking. An overview of investments and the amounts is an important first step to better understand the drivers behind the Dutch involvement in the sector. The main conclusions are as follows.

- Cross-border funding has been a key driver of growth in the microfinance sector and it continues to be essential in frontier and remote markets where few private funding sources are available. Total cross-border funding²¹ is estimated to be around \$ 25 billion globally. The 16 NPM members account for 8.4% (2.1 billion as of December 2010).
- The NPM members use direct investments to MFIs (79%) which is very high in comparison to other foreign funders (37%). This is due to the long history of Dutch funders with direct investments (in the early days of microfinance there were limited options for indirect investments), the capability to manage direct investments, the strong focus on the low end of the market that lacks indirect opportunities and the wish to keep a close eye on their investments. NPM members mostly provide debt (76%) although equity funding is expected to increase since there is a need for MFIs to improve their solvency while scaling up investments. Last but not least, the debt market is highly competitive, which puts margins under pressure. The equity market in comparison reflects better margins.
- Despite the crisis, the market for foreign capital has continued to grow, albeit at a much slower rate (from 50% in 2007 to an estimated 4% in 2012). Foreign investors have not strayed away from the sector. In fact, due to the crisis diversification into the broader impact investment class and corporate social responsibility are higher on the management agenda of investors.
- Nevertheless, the outlook is uncertain the market is too optimistic about future growth. We expect moderate growth of 4% in 2012 if Europe is able to handle the economic and political crisis but a sharp decline if the European Monetary Union (EMU) breaks up. Although the probability of this is low, in such a scenario cost cutting measures will shift governments' focus to other priorities and institutional and retail investors will be hit hard.
- The combined portfolio of the 16 NPM members has an overweight on Latin America (31%) in comparison with other foreign funders (22%). The Dutch are active in 68% of the 40 low income countries in the world to which they allocate 24% of their funds, which is considerably higher than other foreign funders (16%). However, as countries move up the income level classification rapidly, 80% of the poor are living in middle income countries nowadays and are still massively being underserved. In that respect, the old way of giving mandates to funders to invest in low income countries is out of date and requires a more balanced approach.

Box 2.1 List of 16 the NPM members



- ASN Bank
- Cordaid
- DOEN Foundation
- FMO
- Hivos
- ICCO
- ING
- Ministry of Foreign Affairs (MoFA)
- Oikocredit
- Oxfam Novib
- Rabobank Foundation
- SNV
- SNS
- Terrafina Microfinance
- Triodos Bank
- Triple Jump

2.2 The Netherlands Platform for Microfinance

The NPM network comprises of 16 members...

Using the lemma 'The Dutch Microfinance Offer' the Dutch donors and investors united in the Netherlands Platform for Microfinance (NPM) in 2003. The members of the NPM stand for a transparent and accountable microfinance sector with both a financial and social return.²² The NPM currently is comprised of sixteen members (see box 2.1)²³. Appendix I provides a short description of each NPM member.

²¹ Total cross-border funding represents total commitments. Commitments represent both current as well as future funding to the microfinance sector. These commitments are commonly used rather than actual investment amounts due to the availability of data in the sector. Source: CGAP

²² www.microfinanceplatform.nl/ (15/12/2011).

²³ SNV is a NPM member but currently does not focus on microfinance and therefore did not provide a CGAP survey.

“NPM members aim to strengthen their expertise, increase efficiency through cooperation and coordination and improve transparency of their activities.”

...and covers Dutch microfinance activities almost completely.

NPM members are not the only Dutch institutions that are active in the field of microfinance. For example, we know of a few pension funds (Shell Pension Fund, FNV Pension Fund and Stork Pension Fund) that are involved in microfinance through their investments in the SNS microfinance fund. These pension funds may also invest in the microfinance sector through other channels beyond the NPM members. In addition, other investment companies (e.g. Goodwell Investments, APG and PGGM) are active in the field of microfinance. Numbers on many of these activities are not available but in comparison to NPM members they are likely to be relatively smaller. It is safe to say that NPM members represent the bulk of Dutch Microfinance activities.

NPM members work together to create synergies.

Many members are actively working together in the sector in a variety of ways. This ranges from the creation of partnership funds to the creation of separate organizations with a specific mission. Triodos Bank, for example, has created two separate partnership funds with NPM members (Hivos and the DOEN Foundation). Each fund has its own goal based on the shared vision of Triodos Bank and Hivos and the DOEN Foundation. Terafina Microfinance is an example of how ICCO, Oikocredit and Rabobank Foundation successfully came together and created a programme with the common goal of promoting rural microfinance. In this cooperation financial resources are shared and invested in the sector. Through cooperation between ING and Oikocredit, Dutch investors are encouraged to invest in microfinance. ING clients can participate in the Oikocredit Nederland Fonds without any transaction costs.

Other forms of cooperation focus on knowledge sharing. For example, MicroNed is a microfinance network created by Cordaid, ICCO, Hivos, Oxfam Novib and Rabobank Foundation. The aim of MicroNed has been to strengthen members' expertise, increase efficiency through cooperation and coordination, improve transparency of member activities, improve national and international positioning and increased involvement in international forums and debates.²⁴

Another way that NPM members create synergy is by recognizing the knowledge and expertise of each other to effectively make the right investment choices. As an example, Oxfam Novib's grant funding is internally managed, whereas all of the debt or equity in-

Box 2.2 Example of NPM members working together

The Impact Investment department of SNS Asset Management created two microfinance funds since 2007. The purpose of these funds is to offer professional investors the opportunity to invest in MFIs that provide loans to micro-entrepreneurs and farmers in developing and transition countries without having to set up their own fund. While SNS acts as fund manager, the investment manager is Developing World Markets (DWM) and the sub-advisor is Triple Jump. With the expertise of DWM and Triple Jump, SNS is provided with a comprehensive due diligence process. The SNS Investment Committee is then easily able to assess potential risks and select investment based on financial and non-financial grounds. In addition, to further evaluate the non-financial risk, SNS and Oikocredit have developed a non-financial scorecard and also look at whether or not the MFIs adhere to the client protection principles.

Source: www.snsam.nl (15/01/2012).

²⁴ MicroNed. (2011). MicroNed Annual Report 2010. Utrecht, NL.

“The idea that improving access to financial services helps the poor increase their standard of living is shared by all NPM members.”

vestments are managed through Triple Jump. In doing so, Oxfam Novib can stay focused on a smaller group of MFIs receiving grants, while also reaching out to a larger group of MFIs without incurring risk beyond what is acceptable to them. See box 2.2 for another example of a Dutch fund that takes advantage of the knowledge of other NPM members.

NPM members share the idea that improving access to financial services can contribute to combating poverty.

The members of the NPM contribute to the sector in many ways and are active in 94 countries throughout the world. While being active in this sector, all of the members endorse the view that improving access to financial services for everyone can genuinely contribute to combating poverty.²⁵

During their involvement in the sector over the past decades, the NPM members have recognized the need for continued improvements as the sector develops. In some cases they have been leaders in the sector, for example, when MFTransparency began in 2008, 100% of the funding came from Dutch institutions.²⁶ Nearly all of the NPM members are members or endorsers of the current initiatives in the sector and a few hold positions on the committees of these initiatives.

In addition to the endorsement of these initiatives, through the NPM position paper of 2011, the NPM members collectively endorse these initiatives. They believe that these initiatives fit well with their position that commercialization will be vital in the future growth, but must develop in a transparent and enabling environment.

2.3 Market size

Based on data from the MIX, we find that MFIs currently hold approximately \$80 billion in total assets. Foreign funders have contributed to these MFIs by providing approximately \$25 billion²⁷ in total commitments (see box 2.3). Of this \$25 billion, \$21.3 billion is captured in the most recent CGAP cross-border survey (table 2.1). The Dutch Offer represents 10% of the total commitments reported, but 8.4% of the total estimated cross-border funding. As seen in table 2.1, there are five categorizations of funders and the NPM members cover four of the five.

Box 2.3 Note on commitments

Funders' commitments represent all active investments and projects supporting microfinance. As the typical tenor is around three to five years, commitments include funds already disbursed, as well as funds not yet disbursed. Therefore, commitments represent both current as well as future funding to the microfinance sector. These commitments are commonly used rather than actual investment amounts due to the availability of data in the sector. Although the use of these commitments have its drawbacks, such as not revealing amounts of funding reaching the microfinance sector within a given year, it is currently the most reliable indicator available for analyzing overall trends in microfinance funding.

Source: CGAP.

25 The Netherlands Platform for Microfinance. Microfinance Today - A Position Paper of NPM. (2011). Utrecht, NL: The Netherlands Platform for Microfinance, October.

26 Waterfield, C., interview held with the Netherlands Platform for Microfinance, Utrecht, NL, 2011.

27 CGAP's best estimate is between 22-25 billion. Table 2.1 states 21.3 billion (December 2009) according to the most recent CGAP cross-border funding survey: El-Zoghbi, M., Gähwiler, B., & Lauer, K. (2011). Cross-Border Funding of Microfinance. Focus Note 70. Washington, D.C., April.

MoFA and FMO contribute 8% of total commitments by bilateral agencies and DFIs.

As previously stated, many of the largest funders in the sector are multilateral or bilateral agencies. The World Bank is an example of one of the largest multilateral agencies that currently funds the sector. MoFA is an example of a bilateral agency, which provides 2% of total commitments of all bilateral agencies, yet it provides 100% of the guarantees of bilateral agencies. There are also many development financial institutions (DFIs) that participate in the sector and they account for 42% of all cross-border funding. FMO is included in this category and provides 6% of total commitments of DFIs. The total share of these funders is nearly 70% of all cross-border funding to the sector in comparison to 24% of the Dutch Offer (figure 2.1).

Dutch foundations and NGOs contribute 14% of total commitments by foundations and NGOs.

When we look at foundations and NGOs, we find the Dutch Offer and total cross-border funding to be more alike (8% versus 5%). Yet, when we look closer we find that the contribution to the sector by Dutch foundations and NGOs is 14% of all foundations and NGOs in the sector.

Dutch institutional investors contribute 25% of total commitments by individual and institutional investors.

We then find a large difference between the Dutch Offer and total cross-border funding in the percentage of commitments from individual and institutional investors (68% versus 26%). This highlights the growth in microfinance funds in the Netherlands and also the large contribution of Oikocredit. We find that Dutch institutional investors contribute 25% of all cross-border funding by individual and institutional investors.

Table 2.1 Total cross-border funding by type of funders and the share of the Dutch Offer (in millions \$)

	Multilateral and UN agencies	Bilateral agencies	DFIs	Foundation and NGOs	Individual and institutional investors	Total cross-border funding
Total cross-border funding	4166 (20%)	1585 (7%)	8852 (42%)	1116 (5%)	5595 (26%)	21,314
Dutch Offer	0	29 (1%)	489 (23%)	159 (8%)	1414 (68%)	2,090
Dutch Offer (% of total cross-border funding)	0%	2%	6%	14%	25%	10%

* Cross-border funding is based on a CGAP surveys (December 2010) of 60 funders and 90 MIVs which represents \$21.3 billion. Total cross-border funding is estimated to be \$25 billion. Based on this estimate, the Dutch Offer represents 8.4% of total cross-border funding.

Future funding needed in the sector is between \$250-300 billion.

While the funding to the sector has grown in recent years and the Dutch Offer is responsible for a considerable portion, there is still a great demand for additional funding. There are current estimates that 190 million people have gained access to financial services through microfinance. Yet, it is estimated that 2.7 billion people throughout the world still do not have access to formal financial services. So while there has been growth in the assets of MFIs and the cross-border funding, the percentage of those with access to finance is only around 7%. This leaves a large gap and therefore a demand for

additional funding to the sector. We calculate that future funding needed in the sector to be between \$250-300 billion (approx. 0.45% of world GDP).²⁸

Mapping of the Dutch Offer

Figure 2.1 provides a mapping of the Dutch Offer that presents the capital flows of the 16 NPM members to the microfinance sector. Note that the graph includes all funds of the NPM members. Since a member can have multiple funds there are more than 16 names in the graph. Funds are classified as:

Microfinance Investment Vehicles (MIVs, see box A in figure 2.1)

MIVs are independent investment entities that have microfinance as one of their core investment objectives and mandates, with more than 50% of their non-cash assets invested in microfinance. MIVs allow institutions to participate in the sector and reach many MFIs without the need for time and monetary costs involved in due diligence requirements when investing in an MFI.

Donors and investors (see box B in figure 2.1)

We grouped donors and investors according:

1. Motive and intent.

Both donors and investors use microfinance as a tool to achieve development goals, such as poverty reduction, economic and social development, and financial inclusion. Both have to balance social return with financial return, but in doing so donors and investors make different choices. Donors focus mainly on the social return. Investors usually work within tighter financial constraints and also use microfinance as an opportunity to diversify their investment portfolios while also 'doing good'.

2. Use of funding instruments.

In general, donors use more grants and guarantees whereas investors use more debt and equity. When donors use equity this is used for more risky activities such as capacity building whereas investors typically provide it to mature MFIs.

3. Classification by Consultative Group to Assist the Poor (CGAP).

CGAP distinguishes donors and investors in their yearly funder surveys.

4. Literature review.

We had a close look at literature that categorizes funders in different peer groups such as donors and investors.

Although it is difficult to give clear definitions since in practice donors can often behave like investors, our classification is broadly in line with industry standards such as CGAP. More importantly, interviewees affirmed the categorization. In part III we will go more in depth concerning the differences between donors and investors.

Development Financial Institutions (see box B in figure 2.1)

DFIs are financial institutions that make investments in regions, sectors and segments in developing countries that would otherwise not be financed sufficiently by the private sector.²⁹ They do so by providing higher risk loans, equity positions and guarantees to the private sector. DFIs can be either public or private institutions, or a mix between the two.

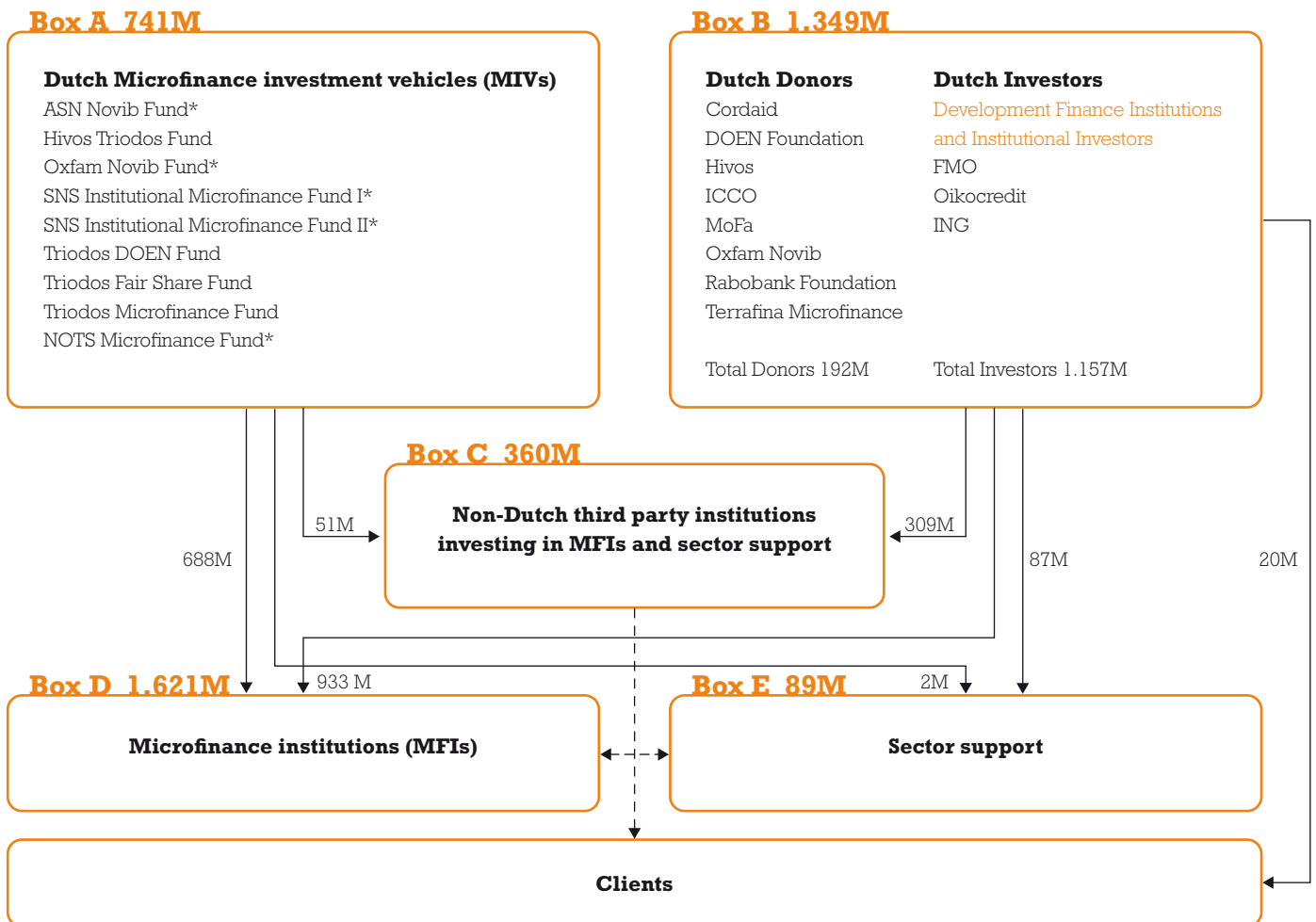
Institutional investors (see box B in figure 2.1)

This group includes a broad range of institutions and funds, including international banks, private equity funds, pension funds and insurance companies.

²⁸ This estimate is similar to other estimates in the sector.

²⁹ Dalberg Global Development Advisors. (2010). *The Growing Role of the Development Finance Institutions in International Development Policy*. Copenhagen, Denmark: Dalberg Global Development Advisors, July.

Figure 2.1 Capital flows of the NPM members in the Microfinance sector total 2.1 billion



Since members can have multiple funds there are more than 16 names in the figure.

* Triple Jump is a service provider and manages 5 funds The Dutch funds are ASN Novib Fund, Oxfam Novib Fund, SNS Institutional Microfinance Fund I and II, NOTS Microfinance Fund. The contributions to microfinance of these funds are reported under Triple Jump instead of their parent companies. Numbers are taken from the CGAP survey filled in by Triple Jump.

Source: CGAP investor, donor and MIV-surveys of individual NPM members as of December 2010. Edited by ING Economics Department.

Non Dutch third party institutions (see box C in figure 2.1)

- Apexes: these organizations are often created and funded by governments. Apexes typically have been created to fund MFIs in countries where funding opportunities are limited. Some apex organizations also have been created to provide loans to clients. See box 2.4 for an example of Dutch funding to an APEX that provides loans to clients.
- Development finance institutions (DFIs).
- Holding companies: institutions that provide financing and technical assistance to MFIs. They usually hold a majority stake in their investees and are generally investible only by private invitation.
- Service providers: organisations that improve the capabilities of MFIs.
- Microfinance funds and other funds that invest in microfinance.

Box 2.4 Dutch example of an APEX

In 2008, The Ministry of Foreign Affairs (MoFA) has agreed to provide funding to the Surinam Ministry for Planning and Development to establish a Micro Credit Programme (MCP) in Surinam. The objective of this programme is to establish a facility for the disbursement of commercial micro credit without collateral to low income entrepreneurs on the lowest level of existence in society. This new wholesale (APEX) lending institution provides access to credit where there is a relatively underdeveloped microfinance sector.

Source: www.triodosfacet.nl (5/01/2012).

Sector support organisations (see box E in figure 2.1)

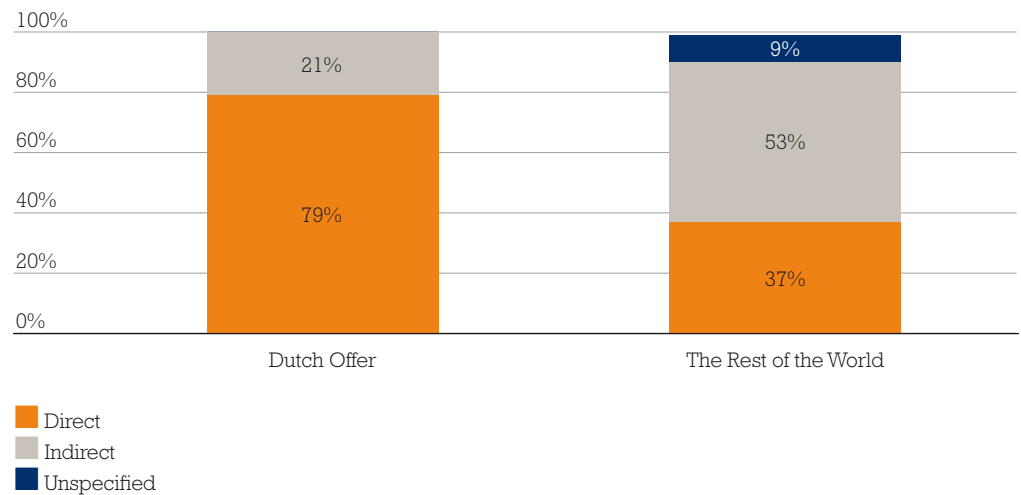
Networks and nongovernmental organizations (NGOs) provide local or regional support to the microfinance sector. This can take on many forms. Many networks provide technology assistance to an MFI that improves the internal processes making an MFI more efficient and effective. These networks also provide funding to MFIs or train the staff of MFIs in a variety of ways. The type of support that these networks provide is extensive, ranging from improvements in financial performance to the improvement of social performance. NGOs can also improve the sector by empowering clients through improving their ability to read and understand financial decisions or on how to become entrepreneurs.

From analysing the money flow of the Dutch Offer we conclude as follows.

- The NPM members have committed **\$ 2.1 billion** to the sector. Since the total amount of foreign capital is estimated by CGAP at \$ 25 billion, **the Dutch account for 8.4% of cross-border funding** to the microfinance industry.
- **Dutch Investors are the largest funders** providing \$ 1.157 billion (55% of the total funding). See figure 2.1 box B. This is mainly attributed to FMO and Oikocredit, which are the two largest microfinance funders in the Netherlands. **The role of institutional investors is still rather limited.**
- Dutch **MIVs** provide \$ 741 million or 35% of Dutch funding whereas Dutch donors provide \$ 192 million (9%). See figure 2.1 box A and B.
- **Only \$ 20 million (1%) is lent out directly to clients.** ING is the only NPM member that provides loans directly to clients via ING Vysya Bank in India.
- Besides giving loans directly to clients, **the Dutch prefer to be as close to the clients in the developing countries as possible** since 79% of the funding goes directly to MFIs (\$ 1.621 billion)³⁰. Only \$ 360 million (18%) flows via non-Dutch third parties to MFIs or via sector support (\$ 89 million or 3%). With this respect, the Dutch are quite unique in comparison to the aggregate funding choices of all other foreign funders (figure 2.2).

³⁰ Section 1.1.1 gives definitions of direct and indirect investing.

Figure 2.2 The Dutch have a strong preference for direct investments to MFIs (% of total \$ committed)



Source: CGAP & MIX (December 2010).

The reasons are manifold.

1. Since the Dutch are the early pioneers in the microfinance industry they have a history of direct funding to MFIs. In the early days there simply were no institutions that could act as an intermediary.
2. As a result, the Dutch built up their own organisations that are very capable in managing direct investments. They have the resources, such as staff in the front and back offices, relationships, information systems, etc.
3. With the resources and knowledge in place, the Dutch prefer face to face contact with MFIs. This gives additional information that is unavailable via indirect funds, making these insights very valuable in the selection process of investments. In addition, once the investments are made the Dutch want to track the progress of their investments.
4. There are Dutch social, ethical and regulatory requirements in place for certain funders to directly invest in MFIs without intermediaries. Therefore, some Dutch institutions have a mandate to invest directly in MFIs whereas many foreign funders lack such mandates.
5. The Dutch are active in 94 countries. In most countries they know the investments opportunities well. Most other foreign funders have a much smaller geographical scope and less managerial resources. Indirect investments provide them the opportunity to build a diversified portfolio.
6. A considerable share of the Dutch Offer is allocated to the low income countries. In general these markets provide less investment opportunities since there often are only a few MFIs to invest in. These markets often are not covered by indirect funds and the only way to invest is through direct investments to MFIs or in an APEX.

The reasons given above explain why the Dutch have a strong preference for direct investments in MFIs over other foreign funders. This does not imply that foreign funders do not have good reasoning for indirect investment. In fact, indirect investments can be

important in countries where options are limited (often due to regulation) or if an investor lacks the resources to manage a portfolio of direct investments. An example of an indirect investment is ProCredit Holding. ProCredit Holding is a holding company that consists of 21 banks operating in transition economies and developing countries in Eastern Europe, Latin America and Africa. By investing in such a company, a funder can easily gain access to the microfinance sector and effectively expand its geographic reach of investments.

2.4 Growth in the market for foreign capital funding

Growth has decreased considerably since the financial crisis.

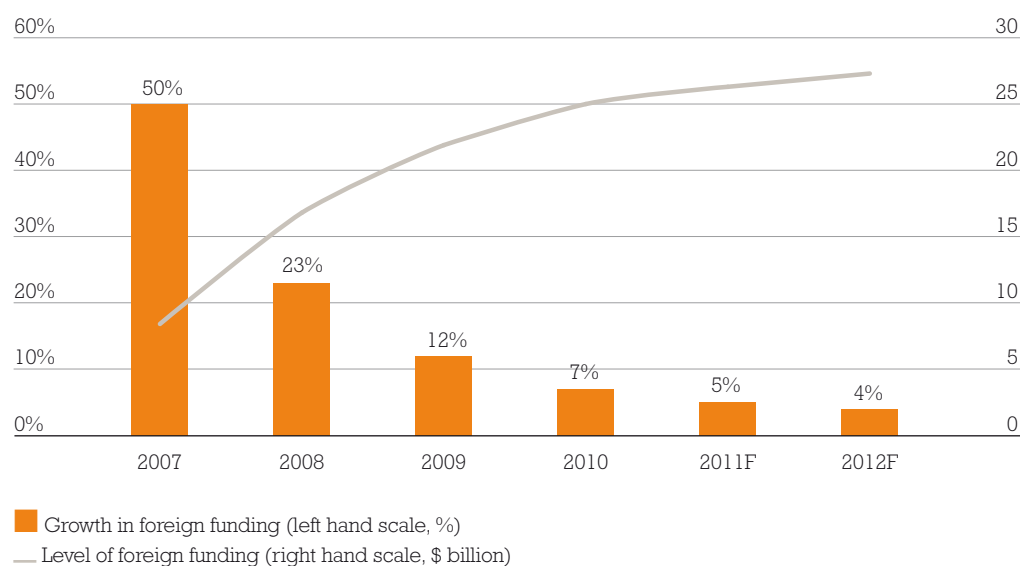
The Microfinance sector lacks accurate data on growth rates for foreign capital (box 2.5). Figure 2.3 plots the best available data. In the years before the financial crisis foreign capital was growing 50% or more annually. Since the crisis, growth has slowed down considerably to an estimated 4% in 2012.

Box 2.5 a lack of accurate data on growth rates

The sector lacks accurate data on growth rates. Since this is the first time that we have constructed this extensive database, we are not able to calculate growth rates from previous years for the Dutch sector. We hope that we will be able to do so in the future.

The best estimate for total cross-border funding in the microfinance industry comes from CGAP. They conduct a yearly survey among the 20 largest MFIs. APG and FMO are the only two Dutch companies included but APG is not a NPM member and therefore not included in our database. So CGAP only covers one institution from our database. Nevertheless, the CGAP data is assumed to represent the growth rate in the sector and it is certainly the best estimate currently available. Growth rates are available for 2007 to 2010.

Figure 2.3 Growth rate of global cross-border Microfinance funding, 2007-2011



Source: ING Economics Department, based on CGAP.



“Foreign investors were initially attracted to invest in microfinance because of its social value and this has not changed since the crisis.”

Despite the crisis foreign capital has continued to grow.

Despite the financial crisis, foreign investors have not withdrawn from the sector. A plausible explanation for this is an increasing number of investors in the developed world with a motivation for 'doing good'. Foreign investors were initially attracted to invest in microfinance because of its social value and this has not changed since the crisis. In fact, the financial crisis has put corporate responsibility higher on the management agenda of many investors. This is an underlying reason why investors are diversifying their portfolios into the broader impact investment asset class. Over the past few years, microfinance investing has become the flagship of this rapidly growing impact investment movement. So far this trend of 'doing good' has been stronger than withdrawals from the sector as a result of financial panic among private investors or austerity measures by governments. We note this with reservation, as the prospects of the global economy continue to trouble investors.

Governments are looking for savings and politics is less focused on developing aid.

Most public funders use microfinance as a tool to achieve development goals, such as poverty reduction, economic and social development and financial inclusion. But the financial crisis has had a severe negative impact on public finances in Europe and the US, who are the main providers of cross-border funding. The need for budget cuts can put development aid under pressure. Since public funders provide the majority of foreign capital (58% in 2010) this could have a severe impact on public funding of MFIs in the coming years, especially if the Eurozone's debt crisis leads to an EMU break-up, as we will discuss later.

Institutional investors need to reduce their balance sheet but also want to increase their corporate responsibility.

Institutional investors such as commercial banks, pension funds and insurance companies provide on average 30% of foreign funding and they have been hit hard by the crisis. Derisking, balance sheet reduction and the funding gap of Dutch financial institutions will continue to be a major theme in the foreseeable future, in which less capital might be allocated to microfinance. On the other hand, these companies are socially under pressure and society demands more socially responsible investments from these companies.

So far, retail investors are hit hardest by the crisis.

The share of retail investments in foreign capital to the microfinance sector has decreased from 18% in 2007 to 15% in 2010³¹. Since the financial crisis, support from retail investors is under pressure due to negative wealth effects from falling equity and house prices. And in some countries fiscal stimulation of socially orientated investments have become austere.

Funders are not the only cause, since many MFIs have become more risky...

Apart from the troubles that public, institutional and retail investors in microfinance face, they also see problems for MFIs. Some MFIs have already made significant loan loss provisions against possible defaults in markets troubled by over-indebtedness or few investment opportunities causing over liquidity. In some countries, too much funding is chasing too few MFIs. This is causing the adjusted risk return profile to be out of balance.

...and demand has decreased.

Demand for foreign capital has decreased as MFIs look for more domestic funding opportunities like local debt and savings. This is especially the case in markets where MFIs are allowed to offer more products to clients and collect retail savings or deposits from small and medium enterprises (SMEs).

We expect moderate growth at best...

Despite fears that funding for the poor would decline as a result of the financial crisis and austerity measures by governments in the developed world, foreign capital has continued to increase in 2007-2011, albeit at an ever slower pace. Looking forward, everything depends critically on the developments in the world economy and Europe in particular. If Europe is able to handle the economic and political crisis by fiscal discipline, economic reform and European Central Bank (ECB) action to aid the funding of banks and peripheral governments, we expect cross border funding on average to grow by a moderate 5% annually in the coming years. In that case, cross-border funding will continue to play a pivotal role in the growth of the microfinance sector.

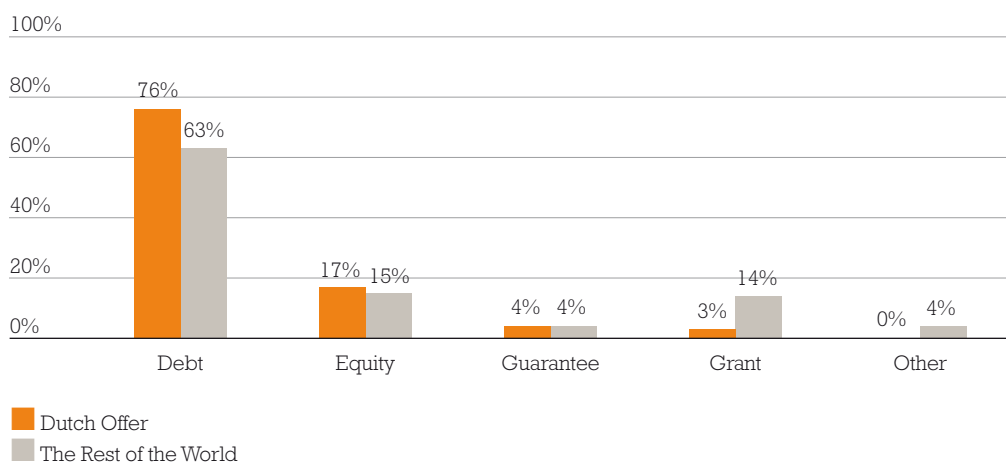
...but a sharp decline if the Eurozone falls apart.

An EMU break-up will lead to development-fatigue as cost cutting measures shift governments' focus to other priorities. They are wrong in the long term. First, simply too many people in the world are living in poverty. Secondly, many people in the developed world deeply desire more equality between the rich and poor, even if many of them do not wish to pay for it. Nevertheless, in the case of an EMU break-up followed by investor panic, a global recession and protectionist measures, we expect cross border funding to fall sharply for two years in a row³². Although this is still a small probability, the consequences are high if it materializes. In the case of a Greece exit, we expect a decrease of approximately 5% for two consecutive years. If the EMU falls apart due to multiple countries leaving, we expect foreign capital for microfinance to shrink by 15% in the first year and 10% in the second. Both scenarios would be extremely detrimental to frontier and remote markets, where MFIs have few domestic funding sources available.

31 Reille, X., Forster, S., & Rozas, D. (2011). Foreign Capital Investment in Microfinance: Reassessing Financial and Social Returns. Focus Note 71. Washington, D.C.: CGAP, May.

32 Cliffe, M. (2011). EMU Break-up: Pay Now, Pay Later. Amsterdam, NL: ING Global Economics Strategy Team, December.

Figure 2.4 Funding instruments (% of total \$ committed)



Source: CGAP (December 2010).

2.5 Funding instruments

The Dutch prefer debt instruments.

The Dutch Offer has a clear preference for debt and equity instruments over grants and guarantees when investing in the microfinance sector. Debt and Equity represent 93% of the Dutch portfolio in comparison to 78% for the rest of the world (see figure 2.4). The difference can be explained by the use of debt instruments which is exceptionally high for the Dutch Offer (76%). Again, historical reasons can explain why. Grants were initially used in the early days of microfinance but since there are limits to their availability, debt financing is now the most viable option for funders that want to increase their investments in this growing sector. This is especially true for investors looking for a social return while also requiring a financial return. All of the Dutch funds created in the past decade explicitly state that their goal is to invest in MFIs and do so predominantly with debt instruments.

Many of the largest funders in the sector are public funders (multilateral or bilateral agencies) that do not require the same financial return as MIVs or other types of investors. These agencies account for 27% of all funding to the microfinance sector (CGAP Cross-Border Funding Survey, 2011). Bilateral agencies are found to provide the largest percentage of grants to the sector (50%) and these grants account for 86% of their microfinance portfolio.³³

Equity funding is expected to increase.

The Dutch have a long history in providing funding directly to MFIs and have the knowledge of what type of financing MFIs need. Many know that equity is becoming a more important tool in the sector and are keen to discuss the future possibilities of equity investment. Although the importance of equity finance is increasing, interviewees mentioned that equity is more risky while it is not clear yet whether the social impact is higher than debt financing. For the Dutch, debt financing in many cases has the optimal balance between risk and the social and financial return. This is especially true if it is provided through close contact with MFIs (direct investments).

“All of the Dutch funds created in the past decade explicitly state that their goal is to invest in MFIs and do so predominantly with debt instruments.”

“Many know that equity is becoming a more important tool in the sector and are keen to discuss the future possibilities.”

³³ El-Zoghbi, M., Gähwiler, B., & Lauer, K. (2011). Cross-Border Funding of Microfinance. Focus Note 70. Washington, D.C.: CGAP, April.

Although equity financing is considerably larger than grant and guarantees, it is still considered a niche market that is in a young state in comparison to debt finance. Yet the equity provided by foreign investors is rising rapidly. Equity finance is typically used for seed-capital investments in start-up MFIs. Or it is provided for additional capital to let MFIs grow to the maturity stage. Some Dutch funders do opt for equity investment to attain a board seat in an MFI. This investment typically requires over 10% of total equity and for some Dutch funders it is above the investment size they are willing to make in any one MFI. For those that can make a large investment in equity, they benefit by having the ability to keep the MFIs future goals in line with their own.

Increased competition in debt financing has made equity investments more appealing to foreign funders. As more funders are involved in the sector, many successful MFIs are now able to bargain for the best rates possible. In some cases, this prevents a funder from investing in certain MFIs because the funder's return requirements are not met. Last but not least, there is an increasing need for equity among MFIs to keep their solvency at the desired levels. This holds especially for the fast growing MFIs that are scaling up their activities. Due to these reasons, we expect the share of equity finance to increase for the Dutch funders.

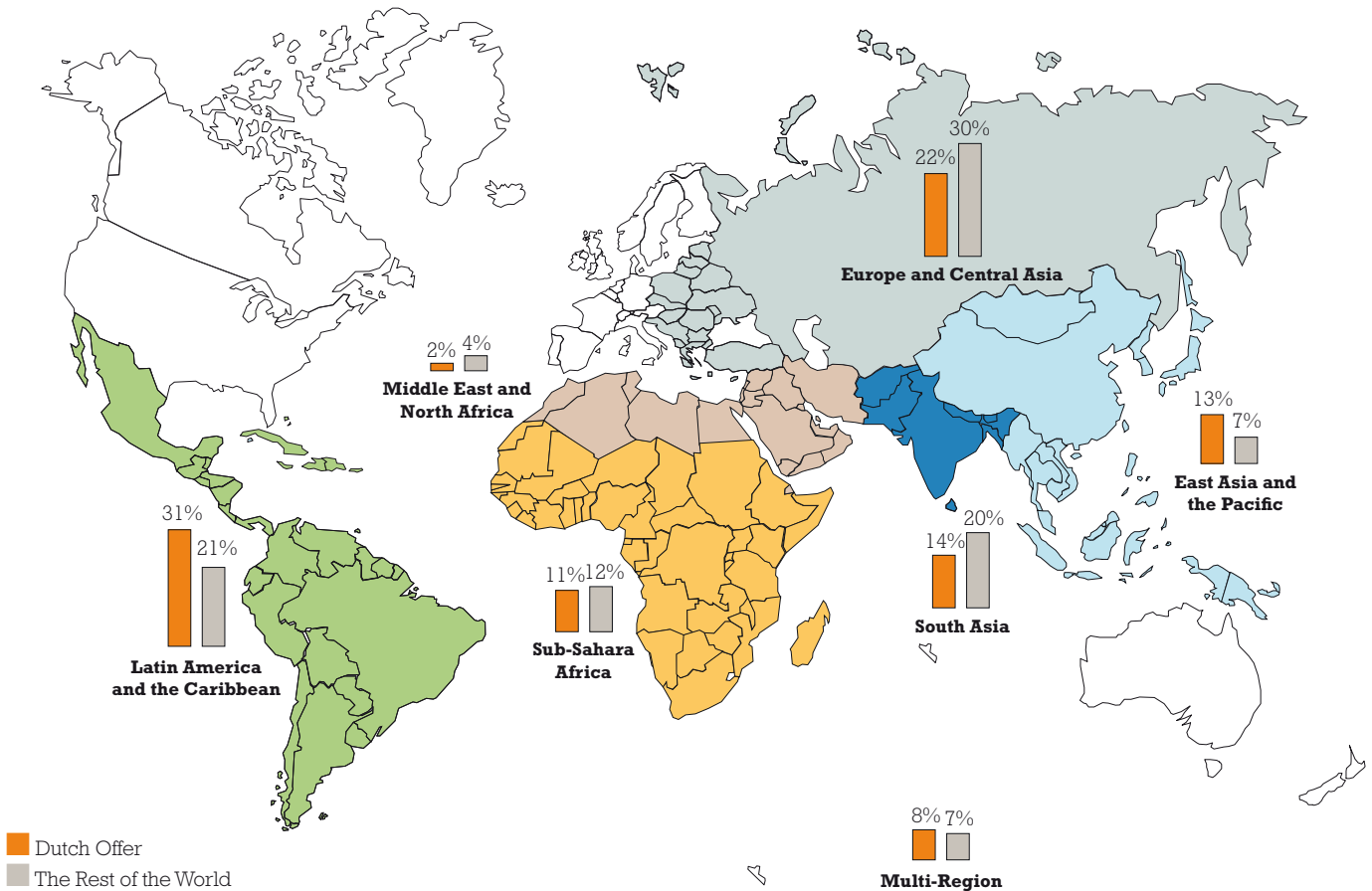
2.6 Regions

80% of Dutch investments go to Latin America, Europe and Asia

Both Dutch and other foreign investors have more than 50% of their investments in Latin America and Europe and Central Asia. However the distribution between these regions differs. The Dutch invest 31% of their total portfolio in Latin America and the Caribbean, making it the number one region for the Netherlands (figure 2.5). This is relatively large in comparison to other foreign investors who invest only 21% in the region. We see the opposite picture for Europe and Central Asia, where the rest of the world invests nearly one third of their funds. We also find some differences in other regions such as the African and Middle Eastern regions (SSA and MENA), which only attract 13% of Dutch investments in comparison to 16% for foreign investors. Yet overall, approximately 80% of the Dutch Offer and the rest of the world's funding is found to be in Latin America, Europe and Asia.



Figure 2.5 Regional allocation of Dutch investments (% of \$ committed)



Projects that involve multiple regions are named Multi-Region.

Source: CGAP surveys of individual NPM members for Dutch Offer and CGAP sample survey for other foreign investors (December 2010).

Differences in portfolio allocation over regions are of course also visible in the share of foreign capital the NPM members have within a given region (figure 2.6). On average, the Dutch Offer provides 8.4% of the foreign capital to the microfinance sector. This share is higher in regions where the Dutch have an overweight in comparison to the rest of the world. For example, the Dutch invest \$ 646 million in Latin America and the Caribbean which gives them a 14% share in foreign capital for the region. At the other end of the spectrum the Dutch invest \$ 34 million in the Middle East and North Africa which gives them a market share of only 4%.

Latin America and the Caribbean (LAC): leading the way

The focus of microfinance funders in this region is reflective of the development of microfinance over time. During the 1980s many international donors and networks played a role in the development of MFIs in Latin America. Through the involvement of foreign actors, professionalism improved the industry in Latin America and over time attracted more types of investors. The region is now one of the most developed microfinance region in the world, with many MFIs reaching large scale. Figure 2.7 shows that the region accounts for 42% of the global assets in microfinance but with only 24% of the worldwide number of MFIs. This is in sharp contrast to the least developed regions of SSA and the MENA. These regions together have a share of 11% of the worldwide assets but constitute 26% of all MFIs.

Figure 2.6 Share of Dutch Offer in foreign investments per region (\$ committed)



Source: CGAP surveys of individual NPM members for Dutch Offer and CGAP survey for other foreign investors (December 2010).

Europe and Central Asia (ECA): supporting transitions to market economies

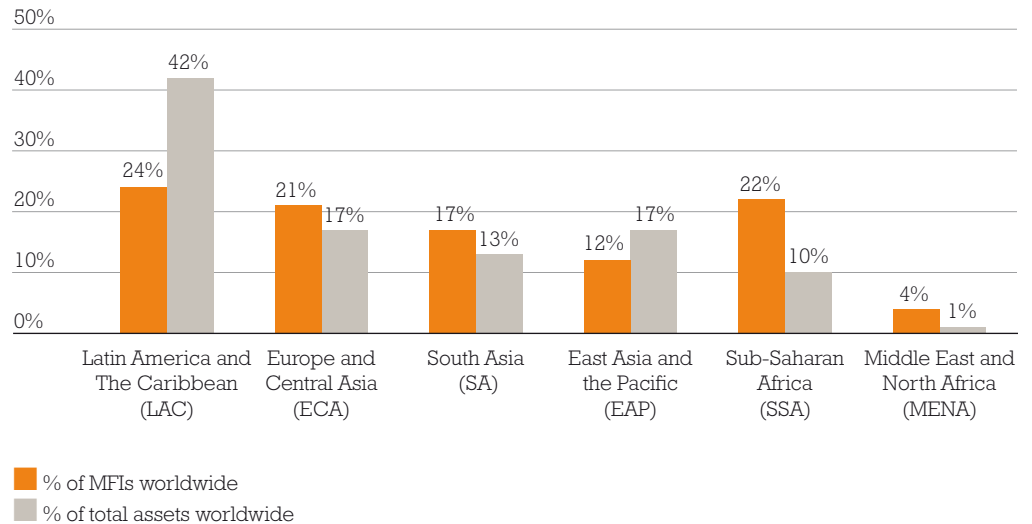
In the former communist countries of Europe and Central Asia, microfinance became a tool for donors and DFIs to assist countries in their transition to a market economy.³⁴ Just as in Latin America, microfinance benefited from these efforts and as a result became more professional.

South Asia (SA): making microfinance known to the world

Bangladesh and India account for the majority of investments in this region by both the Dutch and the rest of the world. This is not surprising considering the pioneering work in Bangladesh by Muhammad Yunus. Yunus and the bank he founded, Grameen Bank, grabbed the world's attention especially when he won the Nobel Peace Prize in 2006. The business model of Yunus focused on providing small loans to the poor through the use of group lending, in which social cohesion is an important element in loan repayment. This method gave proof to many that microfinance can be a commercially viable investment and an instrument that is sustainable in the struggle against poverty. The excitement of microfinance as a profitable tool to improve access to finance led to high amounts of funding from all sorts of funders. While this was precisely the goal of many,

³⁴ Reille, Xavier, Sarah Forster, and Daniel Rozas. 2011. "Foreign Capital Investment in Microfinance: Reassessing Financial and Social Returns." Focus Note 71. Washington, D.C.: CGAP, May.

Figure 2.7 Worldwide assets and number of MFIs per region.



Source: MIX (December 2010).

in recent years this rapid flow of capital led to dramatic growth of MFIs but not without side-effects. In some regions, the growth led to the over-indebtedness of clients. Andhra Pradesh has been an example of this and has made funders question future investments. Unfortunately these questions are not limited to over indebted regions alone, as investors question microfinance in general.

East Asia and the Pacific (EAP): market with many challenges

Funding to the EAP is complicated by a number of factors such as heavily subsidized markets and the restrictive regulatory and institutional framework. These factors can make investment choices limited. Vietnam is a good example of the difficulties currently facing potential funders to MFIs. Much of the market is served by the Vietnam Bank for Social Policy, which disburses heavily subsidized loans and accounts for 98% of all microfinance loans. This results in a 'crowding out' of other MFIs and limits possibilities for investments by foreign funders. In addition, of the few MFIs that operate in the country, most are prohibited from accepting foreign investment. For other countries the situation is similar. While certain countries in East Asia and the Pacific are increasingly attracting funding from international donors and investors, commercial investors are currently underrepresented in the region.

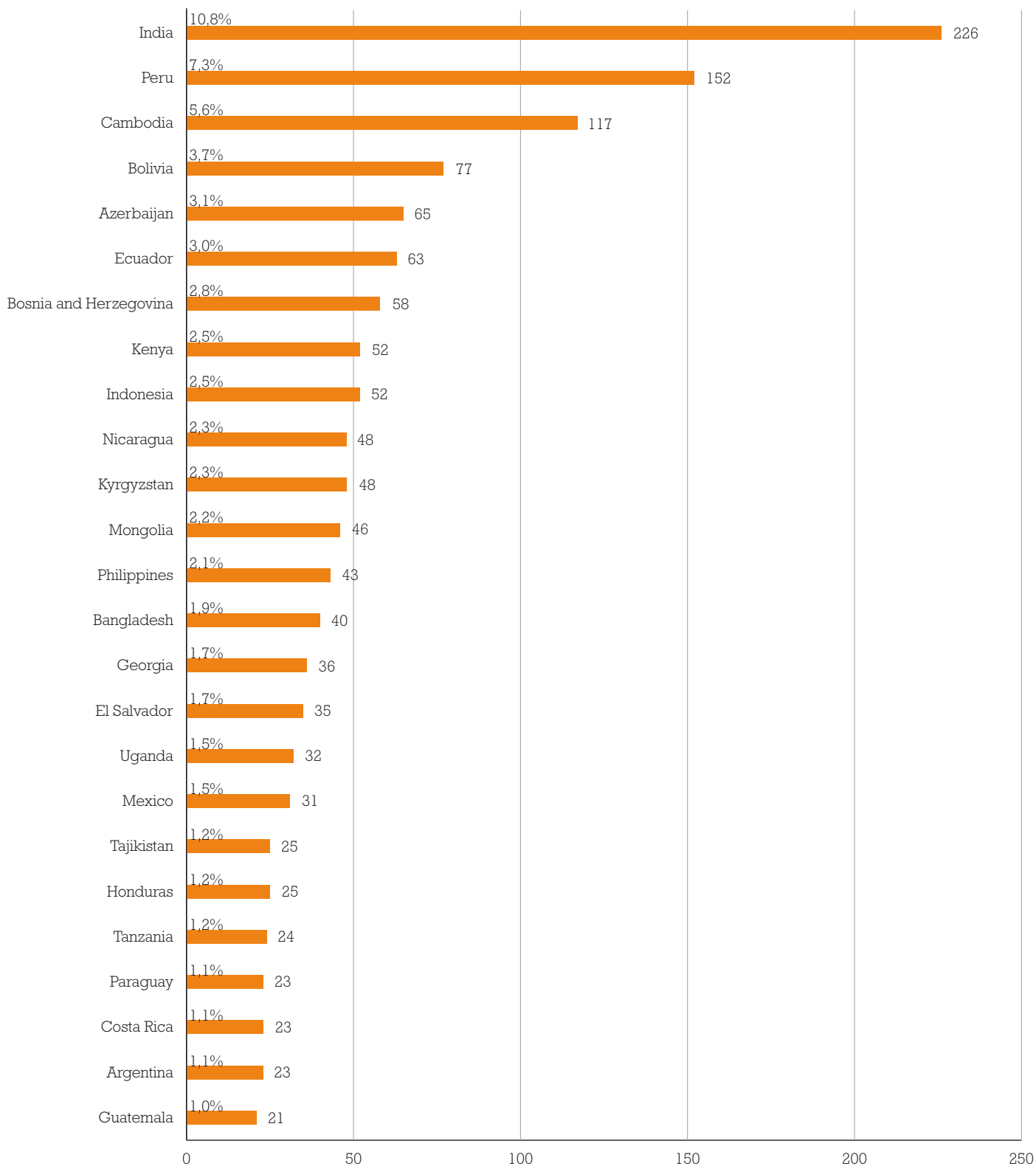
This being said, the country that stands out is Cambodia. The government understands that the rural areas are dependent on microfinance (see box 2.6). As a result, it has cre-

Box 2.6 The importance of microfinance for Cambodia

In Cambodia, economic activities are dominated by micro, small and medium enterprises (MSMEs) which are largely based in rural areas. These MSMEs are beyond the reach of the banking sector, which tends to concentrate on serving businesses in urban areas. Thus, MFIs are principally the main providers of financial services to the rural economy.

Source: MIX. (2009). Microfinance in Cambodia: Taking the Sector to the Next Level. MicroBanking Bulletin, Issue 16. Washington D.C.: Microfinance Information Exchange, Inc., June.

Figure 2.8 Top-25 countries funded by the Dutch (\$ millions committed and % of Dutch portfolio)



Source: CGAP surveys of individual NPM members (December 2010).

ated the most attractive enabling environment in the region. This explains why 42% of Dutch investments in the region flow to Cambodia.

Middle East and Northern Africa (MENA): limited microfinance activities

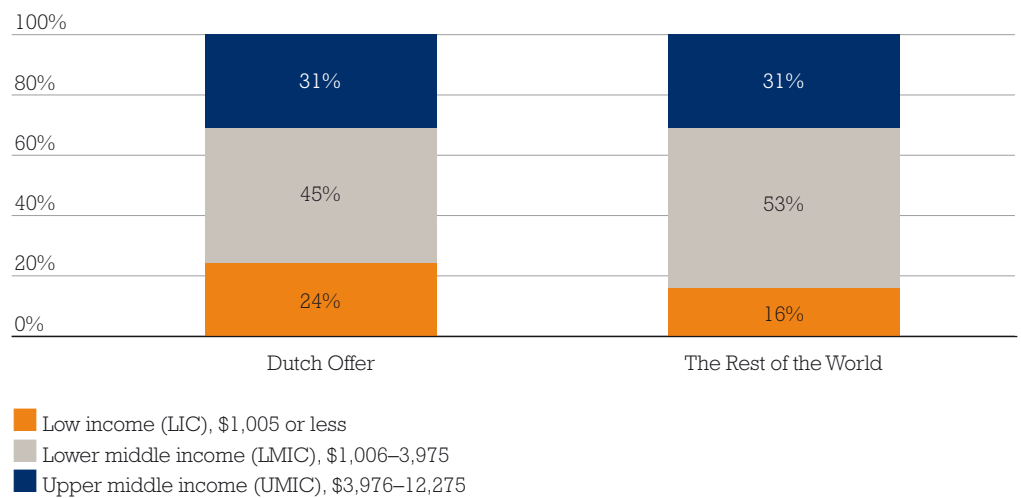
The MENA represents a small portion of the Dutch Offer and this also holds true for the rest of the world. This is mainly explained by the infancy of the microfinance sector in the MENA region. While Morocco has experienced dramatic growth in the past decade, many other countries in the region barely have any microfinance activities. Of those countries that do have microfinance activities, they are mostly very immature markets. While some countries are making attempts to improve the microfinance environment, the region still lags behind more mature regions and political instability only intensifies the hesitation of potential funders, whether donors or commercial investors.

Sub-Saharan Africa (SSA): lagging behind

Investments by the Dutch Offer and the rest of the world to SSA are relatively small in comparison to other regions. In the past, expanding microfinance in SSA was a challenge due to many remote rural areas and the inability to reach the poor. Through mobile banking, this has improved and access to these populations is improving. As a result, over the last five years the Sub-Saharan Africa microfinance sector has evolved rapidly in several countries such as Kenya and Tanzania. With this development, MFIs are now increasingly achieving the scale needed to attract foreign capital, but there is still more progress needed. This can be seen in the high percentage of MFIs in the world (22%) but the low share of total assets in microfinance (10%, see figure 2.7).

Along with MFIs achieving greater scale, the governments of many African countries are actively promoting regulations to create a more enabling environment. All of this is rather promising for donor funding towards capacity building in smaller MFIs and investments in larger scale MFIs, but there are several risks for funders to consider. Besides political instability in certain countries, operating expenses are high and portfolio at risk (PAR) is out of control in many countries.³⁵

Figure 2.9 Investments by income level (% of total \$ committed)



Source: CGAP Cross-border Funder Survey 2011 and the World Bank.

³⁵ MIX & CGAP. (2011). MIX Microfinance World: Sub-Saharan Africa Microfinance Analysis and Benchmarking Report 2010. Washington, D.C.: CGAP & Microfinance Information Exchange, Inc., April.

Most of the Dutch funding flows to India

Figure 2.8 ranks the top 25 countries that are funded by the NPM members. India ranks at the top of the list with \$ 226 million committed, which equals 11% of the Dutch Offer. Note that the top 25 countries cover each region except for the MENA region and accounts for 66% of the total committed by the Dutch Offer. 11 out of the 25 countries are in the Latin America and Caribbean region. This is not surprisingly as we just discussed this region represents the most mature markets for microfinance.

2.7 Income levels

NPM members focus on the poorest countries

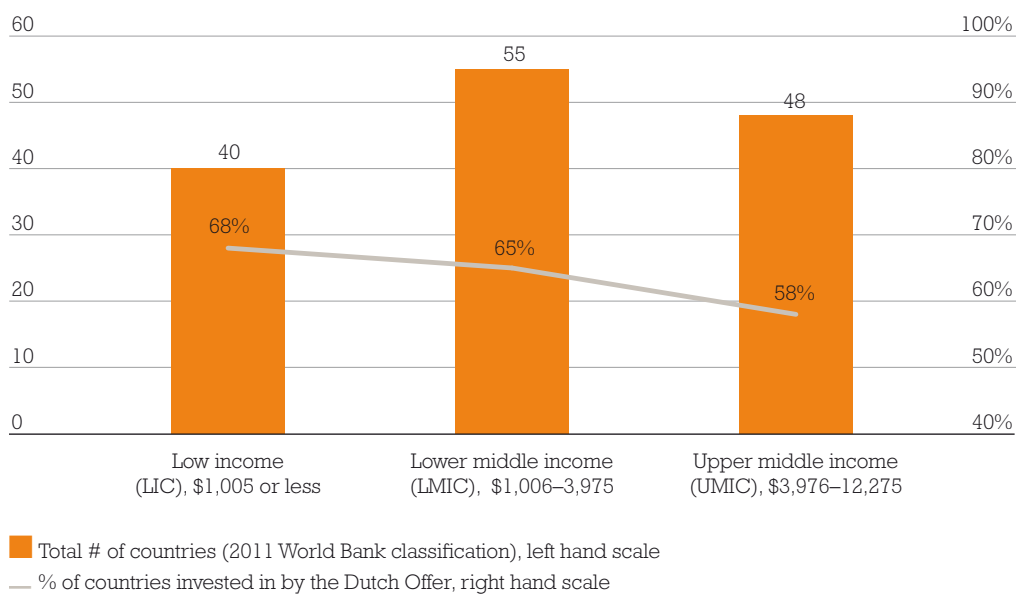
The NPM members have a higher focus on the poorest countries in comparison to the rest of the world (figure 2.9). 24% of the committed \$ 2,1 billion is funded to low income countries (LICs) with an average income of less than \$1,005 a year per capita. An explanation for a focus on LICs may be that donors, and any institutions receiving public funding, may very well have a mandate to function in specified LICs. This focus on the LICs is found to be at the expense of lower middle income countries (LMICs). We find that the NPM members invest 45% of investments in LMICs and the rest of the world invests 53%.

“As countries grow and move from one income level to the next, it is not guaranteed that this progress results in greater financial inclusion.”

The high focus on the LICs does not mean that the NPM members invest in every poor country. From the 40 poorest countries in the world they reach 68% whereas they reach 58% of the upper middle income countries (UMICs) (figure 2.10).

Over the last decade, the number of LICs has fallen from 60 to 40. This has significantly changed the global distribution of poverty when defined by country income levels. Much of this is due to the reclassification of countries such as India, Indonesia, Nigeria, Pakistan and China to higher income levels. What should be kept in mind is that as these countries have grown and moved from one income level to the next, it is not guaranteed that this progress resulted in greater financial inclusion or the end of poverty.

Figure 2.10 Number of countries reached per income level



Source: CGAP Cross-border Funder Survey 2011 and the World Bank.



Box 2.7 John Hatch not only focuses on the poorest of the poor

John Hatch, founder of FINCA and co-founder of the Microcredit Summit Campaign, puts it this way: “If you look at it from a big tent point of view of total people reached instead of just looking at the poorest of the poor, I think the estimates now are roughly [190] million clients worldwide. Multiply that by 4 or 5 people per family and you are close to a billion people impacted by this movement. That is just a huge accomplishment. We have started building little rungs on the credit ladder, and now it is hard to find a country that doesn’t have a ladder in place that allows poor people, if they can get on the bottom rung, to have a place to climb.”

Source: Reed, L. (2011). State of the Microcredit Summit Campaign Report 2011. Washington D.C.: Microcredit Summit Campaign.

Table 2.2 Number of people living in poverty per country

Country	# of people living under 1.25\$ (millions)	# of poor reached by microfinance	Dutch market share
India	456	8,8%	1,9%
China, People's Republic of	208	0,7%	0,0%
Nigeria	89	0,9%	0,9%
Bangladesh	76	23,9%	2,0%
Indonesia	66	1,3%	12,3%
Congo, Democratic Republic of the	36	0,3%	0,2%
Pakistan	35	4,8%	0,2%
Tanzania	30	1,6%	8,7%
Ethiopia	29	na	na
Philippines	20	11,7%	6,2%
Vietnam	18	66,1%	0,1%
Mozambique	15	0,3%	10,3%
Uganda	15	3,4%	11,9%
Nepal	15	8,2%	0,0%
Madagascar	12	0,5%	14,2%
South Africa	11	na	na
Uzbekistan	11	na	na
Brazil	10	2,3%	2,0%
Total	1152	6,9%	

Source: Global Microscope on the Microfinance Business Environment, 2011, Institute of Development Studies, CGAP. Please note that these 25 countries account for 1,1 billion poor people or 89% of the estimated 1,3 poor people in the world. Na means not available.

We take India as an example. India has experienced high growth and recently graduated from a LIC to a MIC. While this growth may have improved the lives of many, India still has 456 million people living on less than \$1.25 per day (table 2.2). Of these 456 million people only 8.8% are reached by microfinance. Of the poor people reached, the NPM-members have a market share of only 1.9%.

These numbers show the poor are still massively underserved and that poverty remains a major issue in countries that have outgrown the LIC status. In this respect: absolute figures still matter. Countries may move up in income level classification but it is of no relevance to the poor people that continue to live under \$1.25 a day.

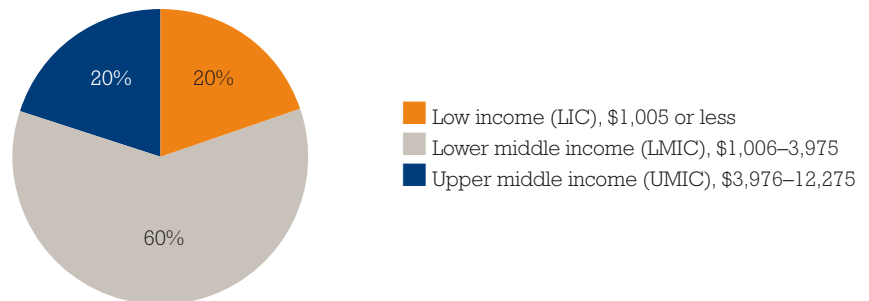
In this respect, it is a very good thing that the NPM members have a well balanced focus when investing in different country income levels. By not only focusing on the low income countries but also the poor people in the lower and upper middle income countries, greater overall financial inclusion can be achieved (see box 2.7).

“Of the estimated 1.3 billion poor people throughout the world, there is a new ‘bottom billion’ living in the MICs.”

As a result of these reclassifications, of the estimated 1.3 billion poor people throughout the world, there is a new ‘bottom billion’ living in the MICs.³⁶ This is a very different picture than in 1990, where it is estimated that 93% of the world’s poor people lived in

³⁶ Sumner, A. (2010). Global Poverty and the New Bottom Billion: What if Three-quarters of the World’s Poor Live in Middle-income Countries (Working Paper No. 349)? Retrieved from Institute of Development Studies website: <http://www.ids.ac.uk>

Figure 2.11 Number of people living under \$1.25 a day



Source: Global Microscope on the Microfinance Business Environment, 2011 & Institute of Development Studies, CGAP.

LICs.³⁷ We now find that only 20% of the poor live in LICs, and they are mostly found in Sub-Saharan Africa (figure 2.11).

In the past, poverty has been viewed mainly as a LIC issue and has laid the foundation for where developmental aid should and should not go. Concerning microfinance, such simplistic assumptions can be misleading because 80% of the poor now live in countries that have the middle income status.

End of part II

Beyond any country specific mandates that a funder may have, other factors such as political stability, regulatory and institutional framework, the strength of sector support services, MFI characteristics and clients all factor into where and how a funder will invest. In part III we will have a close look at the different types of funders among the NPM-members. In particular we will distinguish between donors, MIVs and investors. We will investigate if these types of funders differ significantly in terms of MFIs they invest in and the social return on these investments. In practice this can be important in benchmarking against peer groups. It also provides insight for funders regarding future investment choices.

³⁷ Ibid.

Part III: Donors and investors: different motives in investment choices

3.1 Introduction and overview

In this part we investigate whether Dutch donors, MIVs and investors differ significantly in the MFIs they fund and the resulting social performance of these MFIs (figure 3.1). We did so by analyzing 1314 projects that reach 496 MFIs reporting to the MIX. Together the projects account for \$ 1.3 billion (80%) of the total committed to MFIs by the Dutch Offer. We find that these investments reach over 2.7 million clients worldwide (see box 3.1).

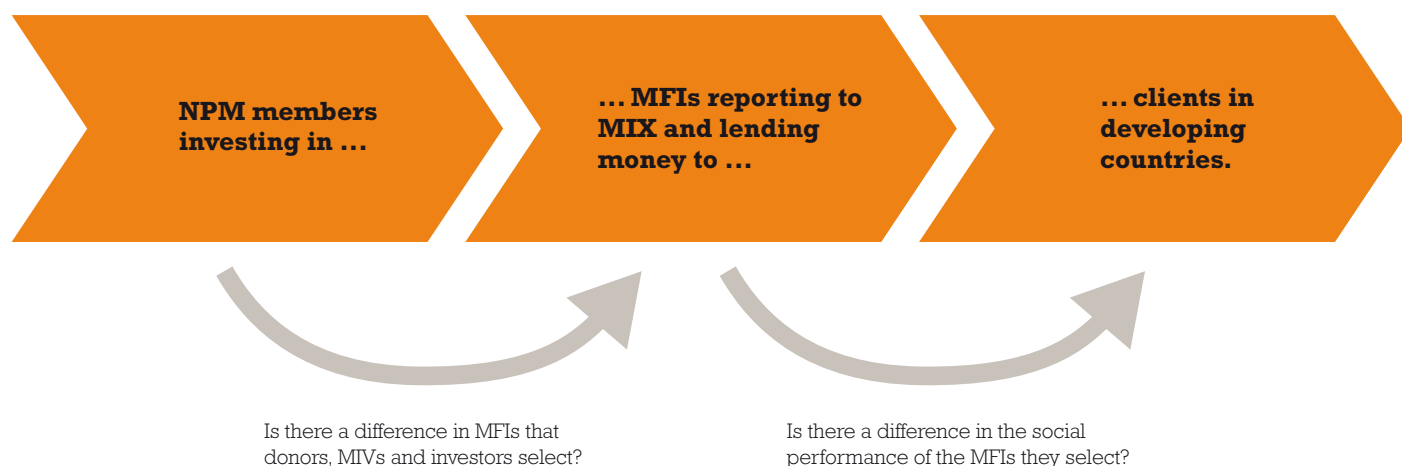
Box 3.1 Number of clients reached

The 496 MFIs invested in by the Dutch Offer reaches approximately 50 million clients. The investments of the Dutch Offer account for 2.7 million of these clients. Assuming that each client has a family of four, the MFIs reach out to approximately 200 million people and the Dutch Offer reaches out to approximately 10.8 million people.

Source: CGAP surveys of individual NPM members and MIX

We choose to focus on social performance since it has become the goal for many to discover if their investments are achieving their mission. Social performance indicators can give insight to whether there has been an effective translation of investments put into practice. The results allow for an insight on whether the mission of investments has become a reality. For reasons of data availability we have chosen to use the depth and breadth of outreach to see if there are differences in the social performance of the MFI portfolios of donors, MIVs and investors. In section 3.3.2 we provide more details on both of these indicators and the other indicators that could be used if data becomes available in the future.

Figure 3.1 Overview of research questions part III



We conclude that donors, MIVs and investors differ significantly.

- **Donors invest in MFIs that are in comparison smaller, younger, less regulated and often nonprofits, such as NGOs.** This is in line with expectations since donor funding often focuses on the start-up phase of an MFI, which is too risky for commercial investors.
- On the other end of the spectrum, **MIVs focus on larger, mature, regulated MFIs with a for-profit status.** Dutch investors are in between these categories.
- **MIVs reach more clients** since they fund MFIs that are found to have a greater **breadth of outreach.**
- **Donors and investor have greater outreach to poorer clients** since they fund MFIs that provide smaller loans (**depth of outreach**).

3. 2 Definition and characteristics of Dutch peer groups

The NPM is composed of a variety of funders. In chapter 2.2 we categorised the 16 NPM-members and their funds as donors, MIVs and investors. Investors we further categorised as DFIs and institutional investors. For convenience the definitions are reintroduced below.

3.2.1 Donors

Donors are institutions that participate in microfinance activities with a primary focus on social performance rather than financial performance. These are often non-profit organisations such as foundations and NGOs that provide grants for activities with a high perceived social impact.

Many MFIs have started off as non-profit organizations with a social objective and have been able to do so thanks to donor support. Donors have supported these organizations in reaching their social goals when they would otherwise be unable to do so while being financially sustainable. This support has usually come in the form of grants and has been an important source of funding for microfinance.

Many donors go beyond grant giving by providing equity, debt or guarantees to MFIs and do so at different growth stages of the MFI. No matter the funding instrument being used, donors' objectives are the same. They look for a social impact and understand that MFIs' needs may go beyond what grant funding can provide and what more commercial investors are willing to provide. Donors are able to fill this gap and in doing so behave in a similar way to investors in the instruments used but differ in the expected return.

The use of debt instruments by donors does complicate the classification of funders when thinking of donors or investors but it becomes less complicated when the objectives of the funder are clarified. The donor objectives are to have a social impact by assisting an MFI in a specific area, such as increasing the size of the MFI's portfolio, capacity building or the development of experimental services. The investor objectives are focused on getting a financial return while also 'doing good' by investing in the sector.

In addition, donors often have a role in the sector beyond MFI funding. They often provide support to the market infrastructure, such as rating agencies, credit bureaus, and audit capacity; and fostering an enabling policy environment.³⁸

38 CGAP. (2006). Good Practice Guidelines for Funders of Microfinance. Microfinance Consensus Guidelines. 2nd edition. Washington D.C.: CGAP, October.

3.2.2 Microfinance Investment Vehicles (MIVs)

MIVs are independent investment entities that have microfinance as one of their core investment objectives and mandates and with more than 50% of their non-cash assets invested in microfinance. MIVs collect money from all kinds of investors which they invest in microfinance. MIVs allow these investors to participate in the sector and reach many MFIs without the need for close relations on their part.

3.2.3 Investors: Development Financial Institutions (DFIs)

DFIs are financial institutions that make investments in regions, sectors and segments in developing countries that would otherwise not be financed sufficiently by the private sector.³⁹ They do so by providing higher risk loans, equity positions and guarantees to the private sector. DFIs can be either public or private institutions, or a mix between the two.

The rationale behind the DFI business model is to be 'additional' and 'catalytic'. DFIs are additional in the sense that they seek to invest in regions, sectors and segments that would not otherwise have had access to finance for the private sector. They seek to bring in expertise and provide the support needed to ensure real commercial development of their investments rather than taking a buy-and-sell orientation. DFIs are catalytic by partnering with co-investors. In sharing risk and return among the partners according to core competences they enable other private sector investors to follow in areas and places that DFIs have proven to offer sustainable investment opportunities.

DFIs offer a particular value added to development policy in three areas:

- Investing in under-served project types and settings (SMEs, agribusiness, post-conflict settings, etc.)
- Investing in undercapitalized sectors (specialization in financial services, energy, infrastructure, etc.)
- Mobilizing other investors (by sharing knowledge, setting standards, etc.)⁴⁰

They do so by providing higher risk loans, equity positions and guarantees to the private sector to promote the development in regions, sector and segments that would otherwise not be financed sufficiently by the private sector.⁴¹

3.2.4 Investors: Institutional investors

This group includes a broad range of institutions and funds, including international banks, private equity funds, pension funds and insurance companies. These are often commercial organisations to which microfinance is not a core activity. Microfinance therefore often is limited in comparison to total assets of the company or the number of employees within the company. Microfinance is an opportunity to diversify into the broader asset class of impact investing or a way of promoting financial inclusion. It is widely believed that institutional investors' participation is very important for the maturity and sustainability of microfinance.

How we categorised institutions: a four-step approach

We distinguish donors, MIVs and investors from each other according to four factors:

1. Motive and intent.

All institutions use microfinance as a tool to achieve development goals, such as poverty reduction, economic and social development, and financial inclusion. All have to find an acceptable balance between social and financial return; in doing so

³⁹ Dalberg Global Development Advisors. (2010). The Growing Role of the Development Finance Institutions in International Development Policy. Copenhagen, Denmark: Dalberg Global Development Advisors, July.

⁴⁰ Ibid.

⁴¹ Ibid.

donors and investors make different choices. Donors focus mainly on the social return. Investors and MIVs usually work within tighter financial constraints and also use microfinance as an opportunity to diversify their investment portfolios while also 'doing good'.

2. Use of funding instruments.

In general donors make more use of grants and guarantees whereas investors and MIVs make more use of debt and equity. In the case that donors do use equity this is used for more risky activities such as capacity building whereas investors typically provide it to mature MFIs.

3. Classification by CGAP.

CGAP distinguishes donors, MIVs and investors in their yearly funder surveys.

4. Literature review.

We had a close look at literature that categorizes funders in different peer groups such as donors and investors.

In following this four-step approach we categorised the funds as shown in table 3.1. Of course every categorisation has its drawbacks. So has ours. In practice donors can behave like investors and vice versa. After taking the four factors into consideration, our classification is broadly in line with industry standards such as CGAP. More importantly, experts from the sector affirmed our categorisation with discussions focussing on small details rather than the reclassification of peer groups.

3.3 Differences between Dutch donors, MIVs and investors

In this section we look at the differences between the peer groups according to a set of characteristics. We then look further to see if there are differences in investments according to regions and country income levels.

We find that donors, MIVs and investors differ in their main focus, activities, and instruments used. Table 3.2 highlights the main differences between the peer groups.

A further look into the data reveals how these differences play out in practice (see figures 3.2 till 3.5).

Table 3.1 Categorization of Dutch peer groups

Donors	MIVs	Investors
Cordaid	ASN Novib Fund**	<i>Development financial institutions and Institutional Investors</i>
DOEN Foundation	Hivos Triodos Fund	
Hivos	Oxfam Novib Fund**	
ICCO	SNS Microfinance Fund I*	FMO
Ministry of Foreign Affairs (MoFA)	SNS Microfinance Fund II*	Oikocredit
Oxfam Novib	Triodos DOEN Fund	ING
Rabobank Foundation	Triodos Fairshare Fund	
Terrafina Microfinance	Triodos Microfinance Fund	
	NOTS Microfinance Fund**	

* Partly managed by service provider Triple Jump. Data on the part that is managed by Triple Jump is reported in the CGAP survey filled in by Triple Jump. Data from the funds that are managed by SNS are taken from the CGAP survey filled in by SNS.

** Fully managed by service provider Triple Jump. Data taken from the CGAP survey filled in by Triple Jump since the individual funds do not report to CGAP.



Table 3.2 Main characteristics of peer groups

	Donors	MIVs	Investors
Number of funds	8	9	3
\$ committed	\$ 192 million	\$ 741 million	\$ 1.157 million
Main focus	Social return	Financial return by 'doing good'	Balanced financial and social return
Conditionality	In principle money is provided as a gift for specific projects	Money has to be returned + interest	Money has to be returned + interest
Main activities	Capacity building, sector support & MFI funding	MFI funding	MFI funding & sector support
Main instruments	Grants & guarantees	Debt & equity	Debt & equity instruments, often by partnering with professional co-investors

Source: ING Economics Department

Figure 3.2 Investments in MFIs (% of \$ committed)

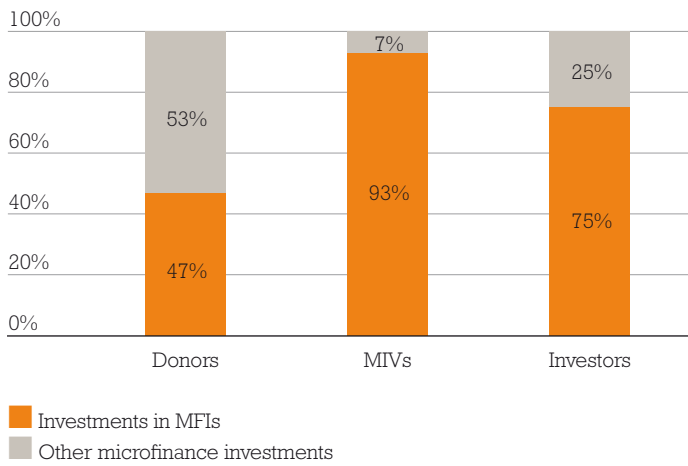
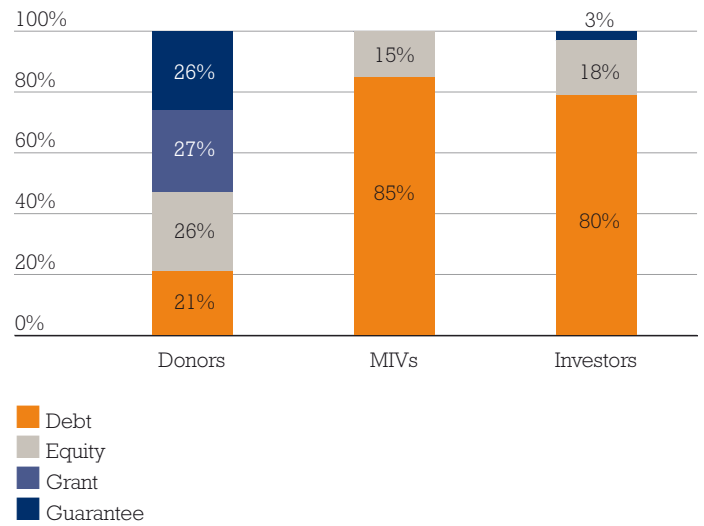


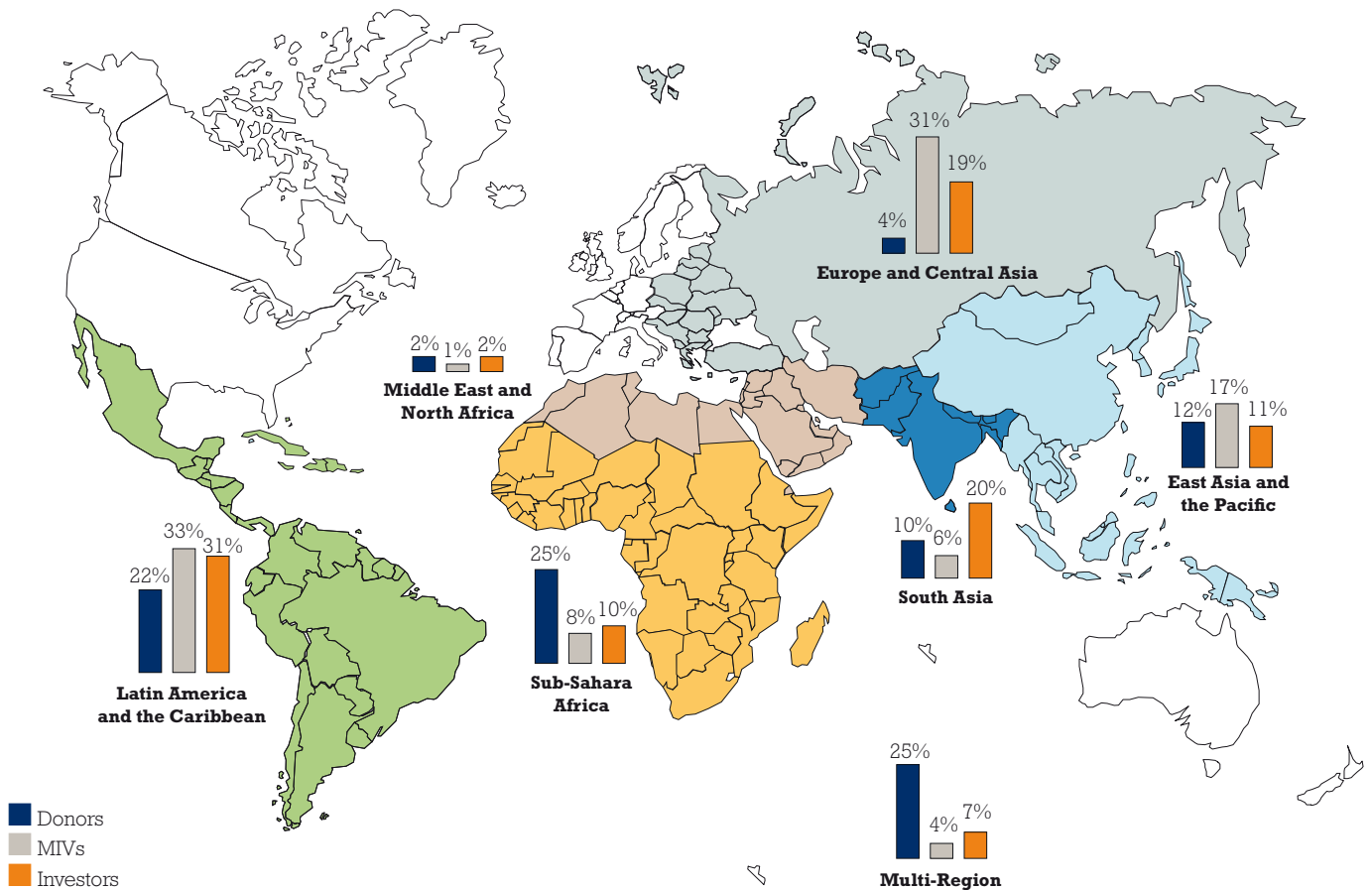
Figure 3.3 Funding instruments (% of \$ committed)



Source: Individual CGAP surveys (December 2010).

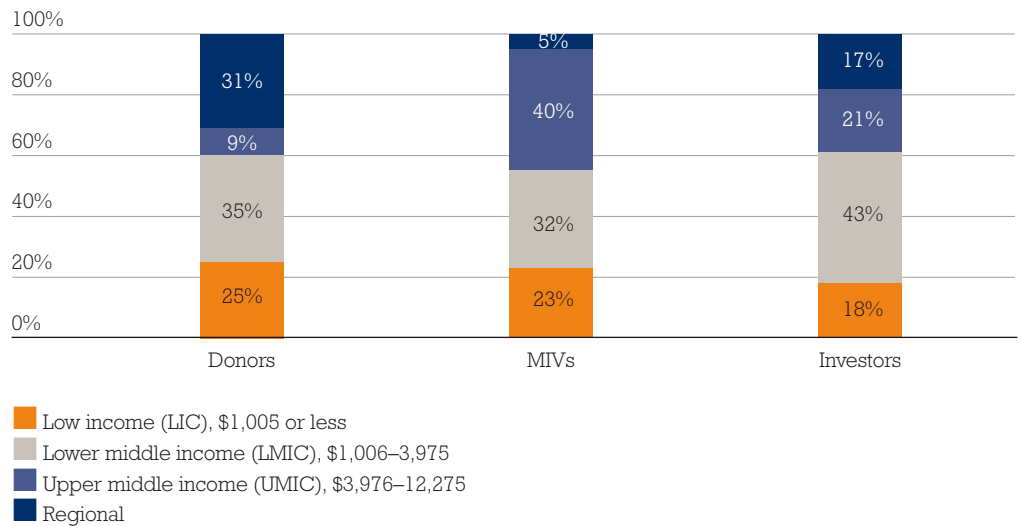
Source: Individual CGAP surveys (December 2010).

Figure 3.4 Regions



Source: Individual CGAP surveys (December 2010).

Figure 3.5 Income levels (% of \$ committed)



Source: Individual CGAP surveys (December 2010).

Donors focus on the low end of the market providing a variety of funding instruments both to MFIs as well as sector support.

Dutch donors invest about half of their portfolio in MFIs and the other half in other activities such as financing holding companies, providing sector support or setting up networks that benefit the sector. While doing so, they make use of a variety of funding instruments. On average grants, guarantees, debt and equity are almost equally used thus accounting for about a quarter of the portfolio each. In comparison to the other peer groups, donors invest most in low income countries with a focus on Sub-Saharan Africa. Donors are found to invest a great deal more than MIVs and investors in the ‘multi-region’. We find this is represented mainly through equity investments in holding companies and grants or guarantees to international networks.

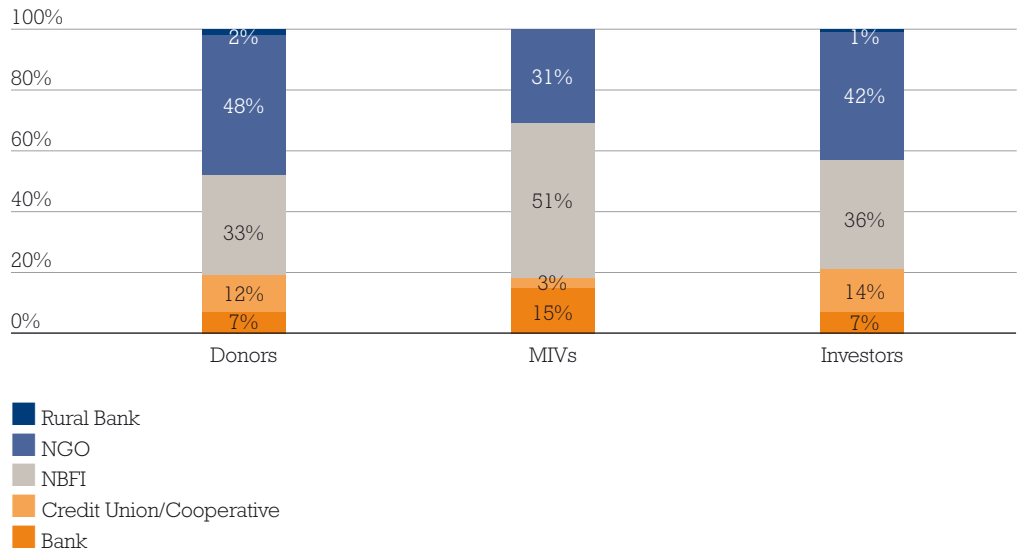
Investors and MIVs focus more on the higher end of the market with debt being their main funding instrument.

Dutch MIVs and investors both have a high focus on investments directly to MFIs. MIVs only invest 7% of their resources in other investments such as funds and holding companies, whereas investors allocate 25% of their resources to these activities. Both use debt as their main funding instrument (85% for MIVs and 80% for investors). The rest is solely allocated to equity by MIVs while investors also provide guarantees albeit at a very small scale of 2% of the total portfolio. Investors have the lowest share of their portfolio allocated to the low income countries (18% versus 23% for MIVs). Instead they focus more on the lower middle income countries than MIVs (43% versus 32%). Of all the three peer groups, MIVs focus most on the upper middle income countries. This is reflected in the regional allocation of their portfolios. MIVs have the highest share allocated to Latin America, Europe and Central Asia, which in many countries you find mature markets for microfinance. Investors have a larger focus on South Asia, notably India.

3.3.1 Differences in the investments in MFIs between donors, MIVs and investors

In the previous section we presented differences between the peer groups according to how and where they invest in the microfinance sector. In this section we investigate if there are differences between donors, MIVs and investors in the MFIs they invest in. Note that from this point forward we will only look at the investments in MFIs. Recall that

Figure 3.6 MFIs by charter type (% of total MFIs per peer group)



Source: ING Economics Department based on CGAP and MIX (December 2010).

this represents 47% of the investments by donors, 75% of total investments for investors and 93% of the investments to the sector by MIVs (figure 3.2). In order to investigate if there are any differences, we have constructed an extensive database that can be found in Appendix II.

By constructing the database we find that more MFIs are reporting to the MIX, indicating higher transparency

The reporting of MFIs to the MIX has increased significantly in recent years. In 2007, a report by Triodos Facet found that only 21% of NPM-supported MFIs reported to the MIX.⁴² We now find that this has increased to 62% of MFIs invested in by the Dutch Offer.⁴³ In terms of total committed the numbers are even higher. The NPM members invest \$ 1.6 billion in MFIs of which \$ 1.3 billion is related to MFIs that report to the MIX (82%). This highlights the progress made by MFIs in reporting their performance in the micro-finance sector and may also confirm that the sector is maturing through better transparency. The percentage of the Dutch Offer invested in MFIs listed on the MIX also confirms a widely held view that MFIs understand the importance of being listed on MIX to gain access to foreign funding.

MIVs focus on MFIs that are non-bank financial institutions, donors focus on NGOs

We first look at the charter type of MFIs, which can be a bank, credit union/cooperative, non-bank financial institution, NGO or a rural bank. We find that MIVs focus on non-bank financial institutions (NBFIs) much more than either donors or investors (figure 3.6).⁴⁴ NBFIs provide similar services to those of a Bank, but are licensed under a separate category. The separate license may be due to lower capital requirements, to limitations

“MFI data found on the MIX provides funders with additional information to make better investment choices.”

42 Triodos Facet BV. (2007). Additionality of Public Funding in Microfinance. Zeist, NL: Commissioned by the Netherlands Platform for Microfinance, October.

43 Refer to Appendix II for further insight.

44 We find that these results are statistically highly significant, meaning that the probability that the findings are a result of chance is less than 1%.

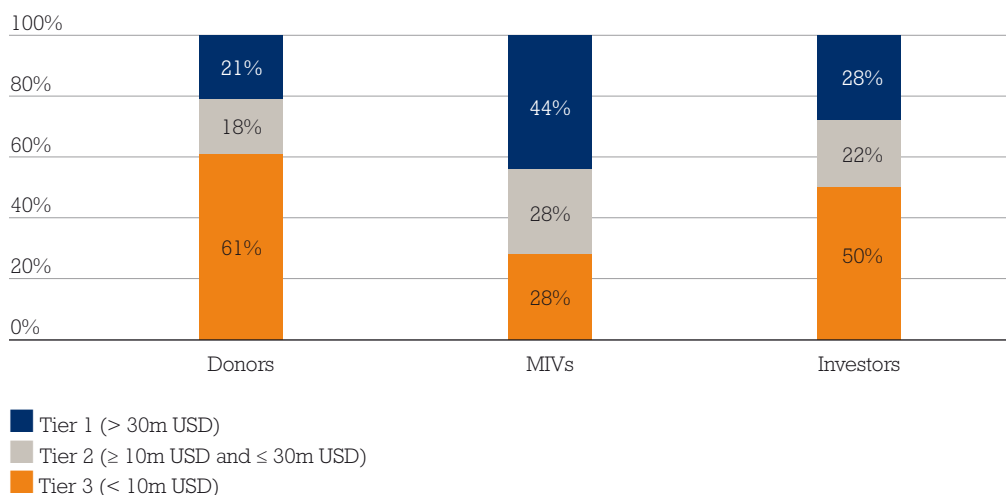
on financial service offerings or to supervision under a different state agency. In some countries this corresponds to a special category created for MFIs.⁴⁵

An explanation for this is that MIVs that select NBFIs for their investments can be more certain of a financial return, since NBFIs are generally more formal and more profitable than NGOs. Recent research has confirmed that NBFIs have greater financial performance over NGOs. These NBFIs provide similar services to a formal bank and often fill a gap between the limited services of NGOs and the full services of a formal bank. The larger amount of services that can reach more clients, coupled with greater financial performance, makes for an attractive investment for MIVs that wish to receive both a financial and social return.

Donors invest in small MFIs while investors and particular MIVs invest in the larger and more mature ones

We categorize MFIs according to total assets and place them in three tier groups (figure 3.7).⁴⁶ We find highly significant differences between the peer groups.⁴⁷ Donors focus more on small MFIs. We are not surprised with this finding since it follows the donor objective to support MFIs as they grow and reach scale or sustainability. However, investing in smaller MFIs involves higher risk which makes them less attractive for investors and especially MIVs. Since the larger MFIs are often the most mature and profitable, these MFIs are viewed as the most investable for MIVs.

Figure 3.7 MFIs by total assets (% of total MFIs per peer group)



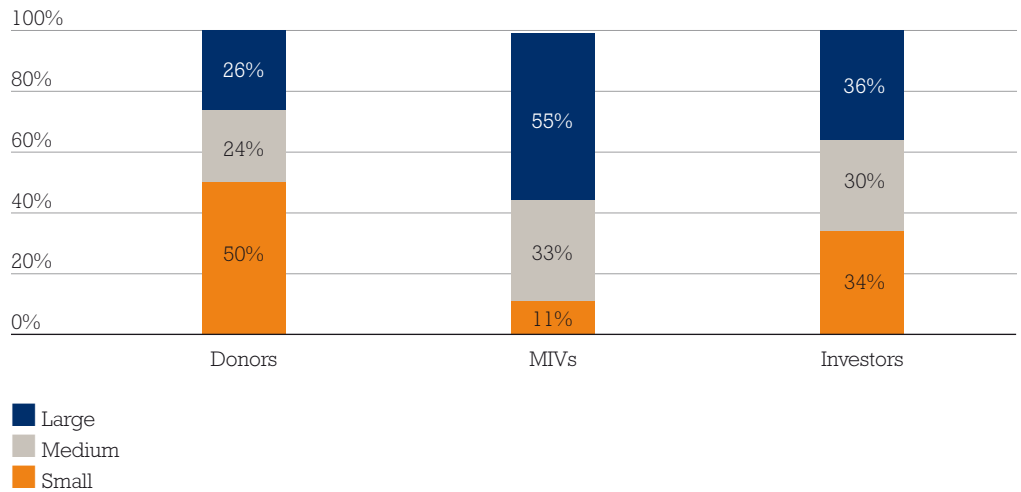
Source: ING Economics Department based on CGAP and MIX (December 2010).

45 Rozas, D. (2011). Implementing Client Protection in Microfinance: The State of the Practice, 2011. A Report from the Smart Campaign. Publication No. 14. Washington D.C.: Center for Financial Inclusion at ACCION International, November.

46 Classification according to Wiesner, S., & Quien, D. (2010). Can "Bad" Microfinance Practices Be the Consequence of Too Much Funding Chasing Too Few Microfinance Institutions? ADA Discussion Paper No. 2. Luxembourg: ADA, December.

47 We find that these results are highly significant meaning that the probability that these findings are a result of chance is less than 1%.

Figure 3.8 MFIs by scale of gross loan portfolio (% of total MFIs per peer group)



Source: ING Economics Department based on CGAP and MIX (December 2010).

MFIs can have a large amount of assets but it is possible that they are not related to loans. That's why we also looked at the gross loan portfolios (figure 3.8). In categorizing the gross loan portfolios of MFIs, MIX distinguishes between the mature markets of Latin America Countries (LAC) and other regions.

- Small: LAC < \$ 4 million, others < \$ 2 million.
- Medium: LAC > \$ 4 million < \$ 15 million, others > \$ 2 million < \$ 8 million.
- Large: LAC > \$ 15 million, others > \$ 8 million.

The conclusions are the same.⁴⁸ Donors focus on the MFIs with smaller loan portfolios whereas MIVs focus on the larger ones. MFIs that have achieved scale can take on larger loans and become more attractive to MIVs since the cost involved with a smaller loan is the same as large loan, making larger loans more profitable.

Note that in terms of gross loan portfolio, the picture for investors becomes more balanced than in terms of total assets. Investors fund small, medium and large loan portfolios in an equal way.

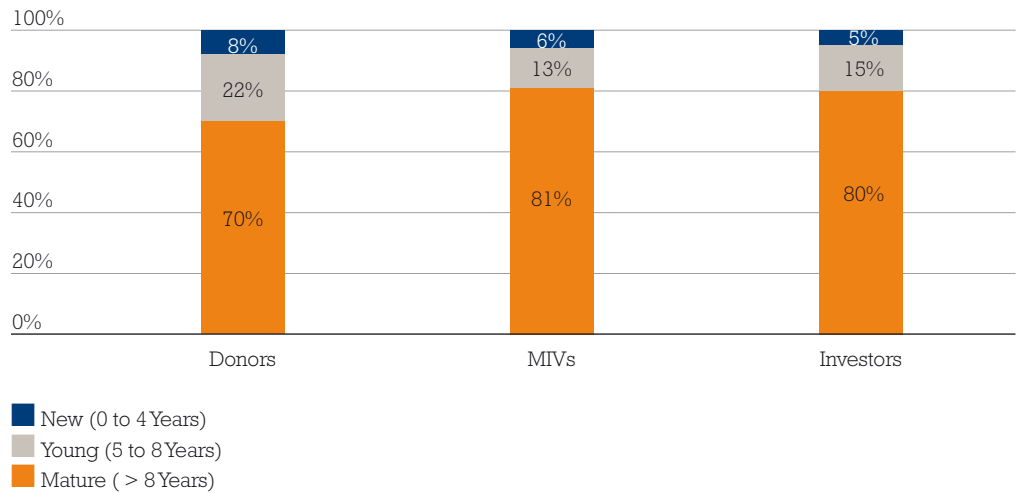
Donors invest more in young MFIs whereas MIVs and investor focus more on the mature ones.

Donors are found to significantly differ from both MIVs and investors in the age of MFIs that they invest in.⁴⁹ 30% of the MFIs invested in by donors are young or new, whereas the average for both MIVs and investors is 20% (figure 3.9). These differences are explained by the need of MFIs for start-up funding and the difficulties many new or young MFIs encounter when attempting to obtain such funding. Many investors do not wish to invest in new or young MFIs that are both more risky and costly than mature MFIs. They are risky since they are unproven and costly since they typically need smaller loans that still require the same time and money for the investors. New and young MFIs therefore

⁴⁸ These findings are statistically highly significant meaning that the probability that these findings are a result of chance is less than 1%.

⁴⁹ These findings are statistically significant meaning that the probability that these findings are a result of chance is less than 5%.

Figure 3.9 MFIs by age (% of total MFIs per peer group)



Source: ING Economics Department based on CGAP and MIX (December 2010).

are in greater need for donor funding as they attempt to achieve scale to access other sources of funding.

MIVs invest most in MFIs that are regulated

MIVs have a strong focus on regulated MFIs in comparison to both donors and investors (table 3.3).⁵⁰ MFIs that are regulated often have gone through a transformation process necessary to fulfil the home countries requirements. In some cases this may require the transformation from an NGO to NBF. As we have just presented results on MIVs' preference for NBFs, it therefore makes sense that MIVs also are found to invest more in regulated MFIs. In addition to this, being regulated implies that the organization is more formal and is often required to adhere to rigorous reporting standards. This is especially important for MIVs since their funders have a high demand for transparency regarding the investments of the MIV. While being regulated does increase costs for the MFI, many regulated MFIs are allowed to collect savings which gives MFIs access to low cost depositor funding.

Donors and investors focus more on non-profit MFIs whereas MIVs prefer for-profit MFIs. Donors focus heavily on non-profit MFIs and MIVs focus more heavily on for-profit MFIs (table 3.3).⁵¹ This is in alignment with the return requirements of donors and MIVs and is not a surprising result. A recent report by Global Impact Investing Network (GIIN) finds that impact investors have higher expected returns in for-profits than that of non-profits.⁵² According to the report debt investments in non-profits are expected to yield 4% and 3% on average, for concessionary and competitive investments, respectively, while debt investments into for-profits were expected to yield almost twice as much: 7% or 8%. The expected return on debt investments in for-profits is greater than that of non-profits. Since MIVs have

⁵⁰ These findings are statistically significant meaning that the probability that these findings are a result of chance is less than 5%.

⁵¹ These findings are statistically highly significant meaning that the probability that these findings are a result of chance is less than 1%.

⁵² Saltuk, Y., Bouri, A., & Leung, G. (2011). Insight into the Impact Investment Market. An in-depth analysis of investor perspectives and over 2,200 transactions. J.P. Morgan Social Finance and Global Impact Investing Network, December.

Table 3.3 MFIs by Regulation and Profit status (% of total MFIs per peer group)

	% of MFIs that are Regulated	% of MFIs that have For-profit status
Donors	53%	33%
MIVs	62%	51%
Investors	51%	37%

Source: ING Economics Department based on CGAP and MIX (December 2010).

a high amount of debt investments and higher financial return requirements, our findings are not surprising. It is revealing of what MIVs expect from their investments in MFIs. In comparison to donors and investors, MIVs have a stronger focus on financial return.

An increasing number of MFIs are now organized as for-profit entities. Often this is due to requirements from banking authorities for MFIs that wish to offer savings services. For-profit MFIs may be organized as NBFIs, commercial banks that specialize in microfinance, or microfinance departments of full-service banks.

In this section we looked at 6 characteristics of MFIs. We found that for each characteristic, donors, MIVs and investors differ significantly in the MFIs they fund. Appendix III provides an overview of the statistical methods used to test for significant differences. In the next section we will investigate whether there is also a difference in social performance of the MFIs that the peer groups fund.

3.3.2 Differences in social performance

Definition of social performance

Social performance is defined as “the effective translation of an institution's mission into practice in line with accepted social values.”⁵³ In other words, social performance is about making an organization's social mission a reality, whatever that mission is. Some of the more commonly promoted social values in microfinance are as follows.

- Providing financial and/or non-financial services to a greater number of poor and excluded people.
- Improving the quality and appropriateness of services already being offered.
- Increasing revenue from clients' businesses.
- Building clients' sense of empowerment.
- Reducing vulnerability.
- Alleviating poverty.
- Improving an MFI's impact on the environment or the community.

There is a concern that there could be a drift away from the social aspect of microfinance

The double bottom line of social and financial performance is a constant talking point in microfinance. It is what has attracted many types of funders to the microfinance sector. Many actors in microfinance are concerned that with the influx of more commercially oriented funders (some perceived to only be in it for its financial value) there will be a drift away from the social aspect so that microfinance will simply be on par with a variety of institutions that have taken advantage of the poor. This concern has been a catalyst for many of the initiatives that were mentioned in part I of this report. It seems that a majority of funders

“Social performance is at the core of responsible investing and responsible finance.”

⁵³ <http://sptf.info/what-is-social-performance> (15/01/2012).

(as measured by the growing numbers of signatories to initiatives) support responsible investing. Social performance is at the core of responsible investing and responsible finance, with both promoting better reporting standards to track social performance.

Measuring social performance: a lack of indicators

While the initiatives are raising awareness and social performance indicators are beginning to become more standardized in the sector, it is still in the early stages and indicators on social performance are limited. It would be ideal to have numbers on indicators such as poverty levels as clients' entry into microfinance and their movement out of poverty over time, the way that MFIs state the interest rates of their loans or the types of lending methodologies applied by an MFI. There has been recent progress in gathering such data and it is expected to improve as the MIX has begun reporting results on MFIs that have provided data on social performance indicators. Of these eleven indicators, seven provide results indicators that are time bound. Since some of them are tied to a specific reporting period, this will allow for insight on how MFIs develop in the coming years. Figure 3.10 lists some of the measurements that will hopefully be available for a broader set of MFIs, so the sector can gain valuable insight on how MFIs operate and how they interact with clients.

Currently we have two consensual social performance indicators with sufficient data to test for differences between Dutch donors, MIVs and investors. These indicators are the breadth and depth of outreach.

Breadth of Outreach: number of active borrowers

The breadth of outreach refers to the number of active borrowers that an MFI reaches with its loan portfolio. Since there are an estimated 2.7 billion poor people throughout the world, expanding access to the largest amount of people possible is considered an admirable goal and has been a main driver in the growth of the microfinance sector. The indicator should be interpreted thus: the higher the number of borrowers an MFI reaches the better in terms of social performance.

Figure 3.10: Time bound social performance indicators

Time bound social performance indicators	
<p>MFIs</p> <ul style="list-style-type: none"> - Number of board members - Number of employees - Number of loan officers - Number of managers - Staff rotation rate - Type of lending methodology 	<p>Clients</p> <ul style="list-style-type: none"> - Female - Rural - People less than 18 years old - Microenterprise training - Educational courses - Women's empowerment training - Number of microenterprises financed - Number of start-up microenterprises financed - Number of people employed in the financed enterprises - Client retention rate - Poverty level of clients

Source: MIX



Depth of Outreach: loan size in relation to average income

The depth of outreach refers to the target market of the MFI. The target market of MFIs can differ based on the mission of the MFI. Is the MFI attempting to reach the poorest of the poor or serve the missing middle? The missing middle refers to high end clients that are too 'rich' for MFIs but too poor for formal banks. This often happens to clients that outgrow the MFIs but still do not qualify for SME financing.

While the breadth of outreach tells something about the number of poor people reached, the depth of outreach is a rough indicator for the type of client being reached. Technically the indicator is defined as the average loan balance of an MFI divided by the Gross National Income per capita in the country. The last step is necessary since a \$ 1,000 loan can be large in a low income country but rather small in a high income country (box 3.2). A lower outcome on this indicator means that an MFI is serving the poorest clients.

Box 3.2 an example of depth of outreach

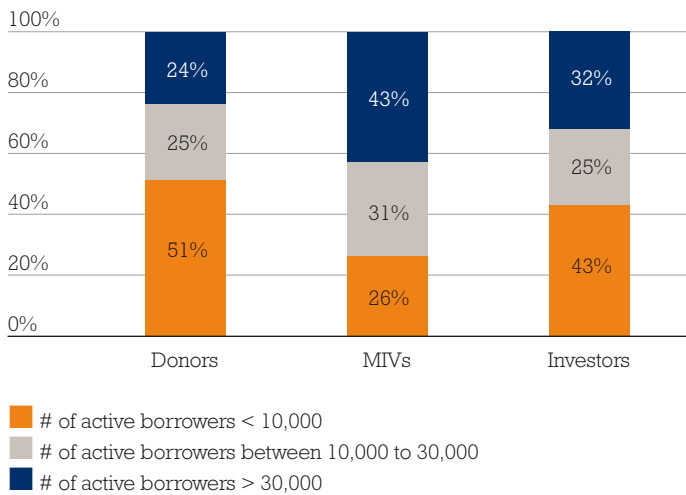
Although a rough estimate, the average loan balance per borrower/GNI per capita is an indicator used to assess if MFIs are reaching the poorest. As an example, a \$1,000 loan in India (GNI of \$1,340) is a rather large loan in comparison to a \$1,000 loan in Mexico (GNI of \$8,930)

To reach the poorest in each of these countries (low end <20%), the loan balance should be less than \$268 (India) and \$1,786 (Mexico)

87% of Dutch investments are in MFIs with an average loan balance of less than 150% GNI per capita.

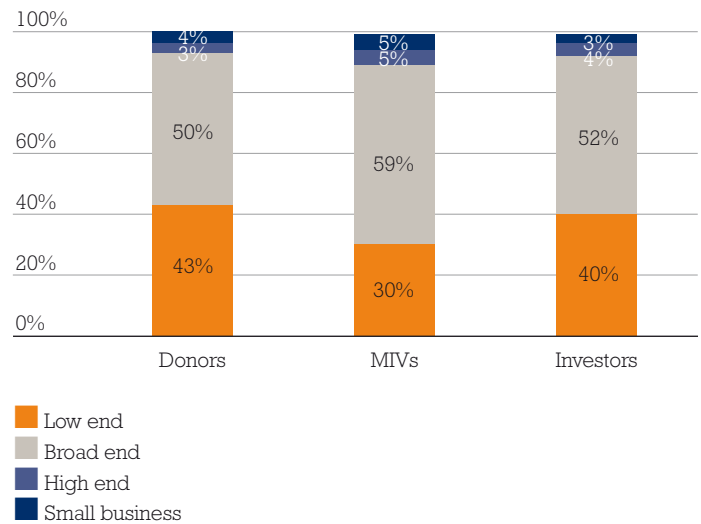
Source: ING Economics Department based on World Bank data (2011).

Figure 3.11 Breadth of outreach (% of total MFIs)



Source: Individual CGAP surveys (December 2010).

Figure 3.12 Depth of outreach (% of total MFIs)



Source: Individual CGAP surveys (December 2010).

Whereas a higher outcome means that an MFI is focused on clients able to handle or need larger loans, such as those starting or expanding their own business. These types of clients may end up employing the poorest in the community and therefore the loan does end up reaching the poorest. Both approaches can be beneficial to clients and communities so we do not say that one is better than the other.

We use this indicator with a bit of reservation due to common critiques in the sector. Many point out that there are potential distortions in international comparisons due to differing levels of income inequality within countries and the selection of appropriate exchange rates. However, in the absence of detailed client information, many analysts and others continue to use this indicator as the best simple proxy measurement for the depth of outreach to the poor. A publication by the MIX in 2008 analyzed two alternatives to this standard method and found that the standard method could not be overturned since all resulted in the same relative rankings.⁵⁴ Therefore, until better reporting is provided on clients, this method continues to be the most widely used in the sector to compare MFI outreach.

MIX has classified MFIs into four categories based on the average balance of loans served:

- **low-end:** average loan balance / GNI per capita < 20%
- **broad-end:** average loan balance / GNI per capita > 20% and < 150%
- **high-end:** average loan balance / GNI per capita > 150% and < 250%
- **Small and Medium Enterprises (SMEs):** average loan balance / GNI per capita > 250%

In this section we look at the differences between the peer groups in their social performance according to the depth and breadth of outreach. We find that donors, MIVs and investors have some significant differences. See Figures 3.11 and 3.12.

⁵⁴ Gonzalez, A., & Researcher, L. (2008). International Comparisons of Loan Balances per Borrower. Bulletin Highlights. MicroBanking Bulletin, Issue 16, Spring 2008.

MIVs have a higher breadth of outreach since they fund MFIs that reach out to a large number of clients

We find that donors and investors differ significantly from MIVs in terms of breadth of outreach. 43% of the MFIs that MIVs fund reach out to more than 30,000 clients. Whereas 24% and 32% of MFIs invested in by donors and investors reach as many clients. This is in line with what is expected since MIVs focus on the larger, more mature, older, regulated and for-profit MFIs that usually reach out to more clients.

Further testing reveals that only the difference between MIVs versus donors and investors is statistically highly significant.⁵⁵ The differences between donors and investors are statistically insignificant which means that the difference may be the result of chance. Details on the findings can be found in Appendix III.

Donors and investors have greater depth of outreach since they fund MFIs that provide smaller loans

We find that the MFIs funded by donors and investors provide significant lower loans than those funded by MIVs. The differences between the peer groups are surprisingly small at the high end of the market and the SME market. However, MIVs only focus less on the low end of the market and more on the broad end of the market. This is in line with what we expected since providing smaller loans is much costlier than providing larger loans.

Again further testing reveals that only the difference between MIVs versus donors and investors is statistically significant.⁵⁶ The differences between donors and investors are statistically insignificant. Details on the findings can be found in Appendix III.

Differences between peer groups has policy implications

In this report we have found that donors, MIVs and investors differ in the MFIs they invest in and that there are differences in the depth and breadth of outreach. This has important policy implications. For example, an individual investor that wants to reach the poorest people has a higher probability in doing so when investing in a Dutch donor. On the other hand, if the individual investor wants to reach as many poor people as possible, he has a higher probability to do so via a MIV. We do not claim that one is better than the other; rather we believe that each group has a role in the improvement of the sector. Through the different approaches, these peer groups have gained knowledge from different experiences that can be valuable to share with each other. Donors can communicate with MIVs or investors on MFIs that are ready to move to the next stage. Through this coordination, donors have a way to exit and MIVs or investors have an opportunity to enter into the picture.

Making responsible investments means knowing your investments. This demands that MFIs become more transparent in both their financial performance and social performance. Since social performance indicators are still in the early stages, input from peer groups on experiences with certain MFIs is invaluable to all Dutch funders. This is especially valuable for funders that wish to ramp up their investments in MFIs that provide SME financing. SME financing is becoming more important in microfinance but it also has its risks. MFIs do not always have the expertise for such lending and the loan size is much larger, this requires more assistance from funders in time or capital, or both.

As funders demand more transparency from MFIs, funders also should be transparent in how they fund the sector. In doing so, responsible investments and responsible financing can be showcased and provide others with a benchmark. The NPM members have shown an initiative towards transparency in their willingness to share their CGAP

⁵⁵ The probability that these findings are a result of chance is less than 1%.

⁵⁶ The probability that these findings are a result of chance is less than 5%.

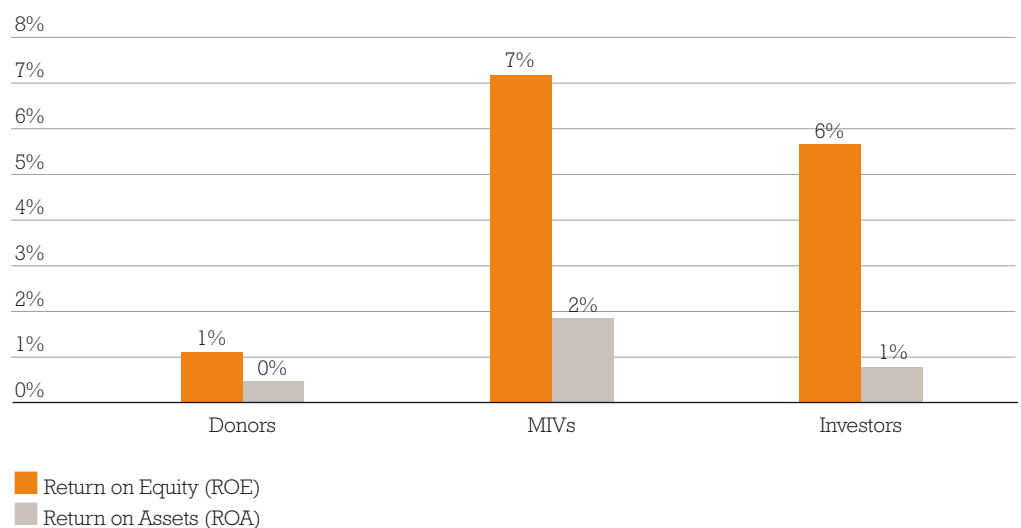


surveys. By continuing to do so, they will provide insight of the Dutch Offer over time and a benchmark for others in the sector.

3.3.3 Differences in financial performance

In the previous section we found differences in the outreach of Dutch peer groups. While we understand that they are rough indicators, they have confirmed common held assumptions that donors have an affinity to MFIs that focus on greater depth of outreach and MIVs have a greater affinity to MFIs that focus on greater breadth of outreach. We now want to see if the assumption holds that MIVs and investors focus on MFIs with a greater financial return in comparison to donors. We observe that the aggregate portfolio of MIVs has an average ROE of 7%, whereas donors have an average ROE of 1% (figure 3.13).

Figure 3.13 Financial performance



Source: Individual CGAP surveys (December 2010).

End of part III

This report has attempted to be a catalyst for the ongoing discussion of how to improve social performance through responsible investments. Recent initiatives make it clear that responsibility lies not only with MFIs but also to those funding the sector. Until better social performance indicators are available, the measurement of social performance will continue to be a challenge. This does not mean that actors should stay idle, instead continued discussions and the sharing of best practices can help the sector develop in a variety of ways. There are many initiatives in the sector that require commitments of both time and money. By working together, actors can develop ways to streamline the initiatives to implement all the principles in the most efficient way. The seminars scheduled at the launch of this report are intended to be the first step in this direction. The outcomes will be shared and discussed with the NPM members. It is our hope that the outcome of the seminars results in a shared vision for the NPM members in improving contributions to the microfinance sector.

Appendix I: Overview of NPM members and their funds

This appendix gives a short description of the NPM members, its funds and initiative participation.



The ASN Bank is one of the leading sustainable banks in the Netherlands. ASN Bank participates in the microfinance sector together with Oxfam Novib through the ASN Novib Fund. This fund was established in 1997 and a description of the fund is given at the end of this appendix.

Initiative

SPTF	✓
Smart Campaign	✓
MFTransparency	-
PIIF	✓



Established in 1999, Cordaid believes in a just and inclusive world. They see inequality as the root cause of poverty and exclusion. Cordaid funds microfinance to improve the lives of the world's poorest and most marginalized people and communities: the 'bottom billion'.

Initiative

SPTF	✓
Smart Campaign	✓
MFTransparency	✓
PIIF	✓



Established in 1991, the DOEN Foundation's ambition is to help create a more livable world in which everyone can make a contribution. To do this, DOEN promotes sustainable, cultural and socially-minded business pioneers. Moreover, DOEN aims to discover, financially support, connect and inspire these pioneers to create impact. In addition to the microfinance activities that the DOEN Foundation is directly involved in, the DOEN Foundation has partnered with Triodos Bank through the Triodos DOEN Fund. A description of the fund is given at the end of this appendix.

Initiative

SPTF	✓
Smart Campaign	✓
MFTransparency	✓
PIIF	✓



Established in 1970, FMO is a development bank that finances entrepreneurs from developing countries with the belief that a thriving private sector fuels both economic and social progress. FMO specializes in sectors where its contribution can have the highest long-term impact such as financial institutions; energy & housing and agribusiness, food & water.

Initiative

SPTF	✓
Smart Campaign	✓
MFTransparency	-
PIIF	✓



Established in 1968, Hivos, the Humanist Institute for Development Cooperation, mission is to contribute to society for a fair, free and sustainable world. Hivos firmly believes that people are well capable of shaping their own futures if they are given the resources to do so. For this reason, Hivos supports MFIs providing facilities to save as well as to take loans to millions of people in developing countries, allowing them to earn their own livings. With business development, Hivos takes this one step further. By offering training and advice Hivos contributes to increasing employment by encouraging professional entrepreneurship. Influencing national policies of developing countries to improve access to financial services, particularly for the poor and marginalized, is another goal.

In addition to the microfinance activities that Hivos is directly involved in, Hivos has partnered with Triodos Bank through the Hivos Triodos Fund. A description of the fund is given at the end of this appendix.

Initiative

SPTF	✓
Smart Campaign	✓
MFTransparency	✓
PIIF	✓



Established in 1964, ICCO's mission is to work towards a world in which people live in dignity and prosperity, a world where poverty and injustice are no longer present. ICCO's work consists of financing activities which stimulate and enable people, in their own ways, to organize dignified housing and living conditions. Based on the biblical principles of 'charity, justice and the purity of creation' ICCO works towards sustainable poverty alleviation. Human rights also constitute a fundamental principle in their work.

Initiative

SPTF	✓
Smart Campaign	✓
MFTransparency	✓
PIIF	✓



Established in 2004, ING created two departments to contribute to the microfinance sector, ING Microfinance Investments and ING Microfinance Support. Microfinance Support was created to raise awareness of microfinance and to give employees working in the Netherlands the opportunity to participate in the development of microfinance. Furthermore, through partnerships, ING offers MFIs the opportunity to engage ING employees as advisors on microfinance projects all over the world. They contribute their individual expertise to assist MFIs in improving their operations and expanding their services.

Initiative

SPTF	✓
Smart Campaign	✓
MFTransparency	-
PIIF	✓

ING Microfinance Investments started end of 2004 with direct loans to MFIs. The current portfolio is almost entirely distributed through ING's subsidiary ING Vysya Bank Ltd. (IVBL) in India. IVBL also provides savings products and loans via its branch network to people in the country-side. This includes microfinance for individuals and self-help groups. For her microfinance activities ING uses her subsidiaries in developing countries (like IVBL), interbank relations of ING Financial Institutions and partners such as Oikocredit. A portion of the profit margin is used for development of additional services in the sector such as the biometric card and education programs.



Ministry of Foreign Affairs (MoFA)

The directorate-general for International Cooperation (DGIS) of the Dutch ministry of Foreign Affairs (MoFA) has been involved in microfinance since its early days. This goes back to the registration in the Netherlands as a 'stichting' of Women's World Banking in 1979. Other lines of approach include projects supported by embassies, relations with Dutch development NGO's in the run-up to the establishment of NPM in 2003, and membership of the Consultative Group to Assist the Poor, the donor consortium and knowledge center hosted by the World Bank that was established in 1995. After the International Year of Microcredit, Her Royal Highness Princess Máxima became a member of a UN Advisers Group, since 2009 she is the UN SC's Special Advocate for Inclusive Finance for Development, and in 2011 she became honorary patron of the G20's Global Partnership for Financial Inclusion.

Current Dutch policy follows developments in the industry as well as national priorities. This implies renewed interest for the demand side (with regard to financial education, product design and responsible finance), continued emphasis on sustainable outreach (in part supported by branchless banking), diversification of financial services, as well as appropriate regulation and supervision. Two of the national development priorities focus on food security and water, respectively, complemented by development of the private sector in partner countries and engagement of the Dutch private sector.

Initiative

SPTF	√
Smart Campaign	√
MFTransparency	-
PIIF	-



Oikocredit is an International Development Finance Institution established in 1975 at the initiative of the World Council of Churches. The main objective of Oikocredit is to mobilize resources from members as well as from third parties, mainly in developed countries, and to channel the proceeds thereof to development projects in order to raise standards of living in the developing countries.

Initiative

SPTF	√
Smart Campaign	√
MFTransparency	√
PIIF	√

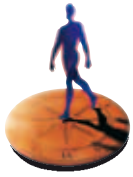


Established in 1958, Oxfam Novib stands up for the rights of poor people, knowing that poor people cannot build independent livelihoods when their rights are not respected. Oxfam Novib's activities all contribute to the improvement of: resources for a sustainable livelihood, basic social services, life and security, social and political participation and identity.

In addition to the microfinance activities that Oxfam Novib is directly involved in, Oxfam Novib established the Oxfam Novib Fund in 1997. A description of the fund is given at the end of this appendix.

Initiative

SPTF	√
Smart Campaign	√
MFTransparency	√
PIIF	-



Rabobank

Established in 1973, the Rabobank Foundation works to improve the lives of disadvantaged people worldwide. Since its establishment, the Rabobank Foundation has supported projects that promote economic participation and self-sufficiency. The foundation is in the Netherlands and internationally, providing both financial aid and technical support. In the Netherlands, Rabobank focuses on projects promoting social inclusion and empowerment, irrespective of people's background or ability. Internationally, the foundation helps small-scale farmers and entrepreneurs to become economically independent, particularly in developing countries. They do this through microfinance loans and by sharing our expertise with small cooperatives to promote cooperative savings and loan schemes.

Initiative

SPTF	√
Smart Campaign	-
MFTransparency	-
PIIF	-



SNS Asset Management is an asset manager for institutional investors and is a part of SNS REAAL, a large financial service provider in the Netherlands. SNS Asset Management is a pioneer in the area of responsible institutional asset management of which investing in developing countries through microfinance is an important part. Since 2007, two microfinance funds have been established to provide investors a good expected return while serving the needs of the developing world's economically active poor. A description of the two funds is given at the end of this appendix.

Initiative

SPTF	√
Smart Campaign	√
MFTransparency	√
PIIF	√



Established in 1965, SNV is dedicated to a society in which all people enjoy the freedom to pursue their own sustainable development. SNV contributes to this by strengthening the capacity of local organizations. SNV helps to alleviate poverty by focusing on increasing people's income and employment opportunities in specific productive sectors, as well as improving their access to basic services including water, sanitation and hygiene, and renewable energy. SNV currently has a high focus on three sectors: (1) Agriculture, (2) Water, Sanitation & Hygiene, and (3) Renewable Energy.

Initiative

SPTF	-
Smart Campaign	-
MFTransparency	√
PIIF	√



Terrafina Microfinance was founded in 2005 as a joint microfinance programme of ICCO, Oikocredit International, and Rabobank Foundation. Terrafina offers more than simply the sum of the individual instruments of each of the partners. It offers African MFIs access to a complete package of financial and technical support that is required to promote microfinance in rural areas. Its motto is: Energizing African roots! Terrafina Microfinance achieves its goals by strengthening young MFIs, through cooperation with mature MFIs and banks, and by stimulating innovation, social responsibility and transparency.

Initiative

SPTF	√
Smart Campaign	√
MFTransparency	√
PIIF	-



1971, the Triodos Foundation was established by a small group of people to support innovative projects and companies. Since this time it has become a leading sustainable bank. Triodos Bank believes that microfinance has a valuable role to play in lifting people out of poverty, and helping to create a fairer, more sustainable world. On the basis of this strongly held belief, Triodos Bank began investing in the microfinance sector in 1994. Triodos Investment Management handles all of the microfinance investment of Triodos Bank. There are now four microfinance funds that are under the management of Triodos Investment Management: Hivos Triodos Fund, Triodos DOEN Fund, Triodos Fair Share Fund and the Triodos Microfinance Fund. A description of the funds is given at the end of this appendix.

Initiative

SPTF	✓
Smart Campaign	✓
MFTransparency	✓
PIIF	✓



Established in 2006, Triple Jump's mission is to contribute to the sustainable development of emerging market economies by facilitating investment in micro and small enterprises. Triple Jump seeks to support the expansion of viable MFIs in all three stages of their development (emerging, expanding and mature) by providing capital and advisory services. Triple Jump's objective is to work towards effective social impact in emerging markets by harnessing entrepreneurial spirit.

Triple Jump currently manages or provides advisory services for 5 funds: ASN-Novib Fund, Oxfam Novib Fund, SNS IM Fund, NOTS Microfinance Fund and the Calvert Social Investment Foundation.

Initiative

SPTF	✓
Smart Campaign	✓
MFTransparency	✓
PIIF	✓



Microfinance Funds of NPM members

ASN Novib Fund

Established in 1999, The ASN-Novib Microcredit Fund (ANF) was the first mutual retail fund for MFIs in the Netherlands. Triple Jump is the investment manager of the ANF, which is regulated and organized as a semi-open-ended fund. The fund enables private individuals to invest in MFIs by purchasing shares sold by ASN Bank. The goal of the fund is to encourage broader participation by all types of entrepreneurs in the market economies of developing countries.

Hivos Triodos Fund

A joint initiative of Hivos and Triodos Bank, started in 1994. This fund assumes more risk and focuses on young, innovative MFIs that are active in underdeveloped markets.

Oxfam Novib Fund

Established in 1997, the Oxfam Novib Fund is owned and funded by Oxfam Novib. In 2007 fund management was transferred to Triple Jump. The Oxfam Novib Fund mainly finances Tier 3 MFIs that show significant potential to grow. Generally, the Oxfam Novib Fund finances MFIs with a higher risk profile, that have the potential to 'jump' to other more commercially oriented funds with a lower risk profile once a certain scale has been achieved.

SNS Institutional Microfinance Funds

SNS Asset Management, by way of its Impact Investing department, has established two institutional microfinance funds: SNS Institutional Microfinance Fund I (2007) and SNS Institutional Microfinance Fund II (2008). The funds are closed-end mutual funds, solely open for professional investors. Investors in the Fund include pension funds such as the Shell Pension Fund, FNV Pension Fund and Stork Pension Fund.

Through investments in MFIs the funds contribute to the provision of loans to micro-entrepreneurs and farmers in developing and transition countries. Both funds aim to include small self-employed entrepreneurs and farmers in developing countries in economic activity, while generating a market based return.

Triodos DOEN Fund

The Triodos DOEN Foundation started in 1994 at the initiative of the DOEN Foundation and Triodos Bank. Based on its funding structure, Triodos DOEN is able to assume more risk and focuses on smaller, newly established MFIs in higher risk countries.

Triodos Fair Share Fund

At its launch in 2002, this was one of the first funds for retail investors in the Netherlands to invest in the microfinance sector worldwide. Focusing on well-established MFIs with a proven track record, the Fair Share Fund allows private individuals to invest in the micro-finance sector in developing countries.

Triodos Microfinance Fund (Triodos SICAV II)

This fund was launched in 2009, with share classes available for institutional investors and private banking clients. The main focus of this fund is on well-established MFIs with a proven track record. The fund aims to increase access to financial services for the working poor in developing countries by providing loans and equity to MFIs while achieving an attractive financial return for investors.

Appendix II: Description of the dataset

The individual CGAP surveys of the 16 NPM members from spring 2011 provided us with 2,062 projects. Of these projects 1,713 are related to investments in MFIs instead of sector support, holding companies etc. These projects reach 801 MFIs and 496 of these are found to be listed on the MIX, which totals 1,314 projects. The MIX provides us with information on these MFIs regarding charter type, tier groups, scale, age, regulation and profit status as well as breadth and depth of outreach.

We constructed a database with **1,314 projects** that reach **496 MFIs** that report to MIX. Together they account for **\$ 1.3 billion** of the total committed by the Dutch Offer.

Number of MFIs invested in by peer groups

	Total MFIs	# of MFIs on MIX	% of MFIs on MIX
Dutch Offer	801	496	62%
Donors	210	120	57%
MIVs	221	201	91%
Investors	563	356	63%

Note that the total MFIs that donors, MIVs and investors invest in are more than 801 since donors, MIVs and investors can invest in the same MFIs.

Source: ING Economics Department based on CGAP and MIX (December 2010).



Appendix III: Overview of statistical findings

Overview of statistical findings on MFI characteristics

MFI characteristic	Statistical test performed	Significance	Probability
Charter Type	Chi-Squared test of Independence	Highly	0.0%
Tier Groups	Kruskal-Wallis Test	Highly	0.0%
Scale	Kruskal-Wallis Test	Highly	0.0%
Age	Kruskal-Wallis Test	High	3.8%
Regulated	Chi-Squared test of Independence	High	3.1%
Profit Status	Chi-Squared test of Independence	Highly	0.1%

Source: ING Economics Department based on CGAP and MIX.

Overview of statistical findings on social performance

Social performance indicators	Significance	Follow up testing: Mann-Whitney U			
		1-2	1-3	2-3	
Breadth of Outreach	Kruskal-Wallis Test	0.0%	0.0%	8.4%	0.0%
Depth of outreach	Kruskal-Wallis Test	1.8%	1.5%	5.4%	1.4%

1 = Donors, 2 = MIVs, 3 = investors.

1-2 refers to the testing in the differences between donors and MIVs, etc.

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Appendix V: List of abbreviations

CGAP	Consultative Group to Assist the Poor
CPPs	Client Protection Principles
DFI	Development financial institution
EMU	European Monetary Union
ECB	European Central Bank
EAP	East Asia and the Pacific
ECA	Europe and Central Asia
GIIN	Global Impact Investing Network
IRIS	Impact Reporting and Investment Standards
LAC	Latin America and the Caribbean
LICs	Low income countries
MENA	Middle East and North Africa
MFI	Microfinance institutions
MSMEs	Micro, small and medium enterprises
MICs	Middle income countries
MIVs	Microfinance investment vehicles
MIX	Microfinance Information Exchange
NBFIs	Non-bank financial institutions
NGO	Nongovernmental organization
NPM	Netherlands Platform for Microfinance
PAR	Portfolio at risk
PIIF	Principles for Investors in Inclusive Finance
PRI	Principles for Responsible Investment
SA	South Asia
SMEs	Small and medium enterprises
SPTF	Social Performance Task Force
SSA	Sub-Saharan Africa
UMICs	Upper middle income countries
UNSGSA	UN Secretary General's Special Advocate for Inclusive Finance for Development

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