Microenterprise
Development Review December 2002, Vol. 5 No. 2
Inter-American Development Bank

Why the Microcredit Crunch?

By Heywood Fleisig and Nuria de la Peña

It is no surprise that microenterprises get credit at worse terms than large firms do. Indeed, they pay higher interest rates, get smaller loans relative to cash flow and must repay their loans more quickly. Less obvious, however, is the fact that Latin American microenterprises pay more for being small than do their North American counterparts.

In Latin America, one well-known and respected microlender charges 28% on solidarity group loans, about 15 percentage points higher than the 12.9% prime rate that commercial banks in the same country charge their best, large borrowers.[1] In contrast, lenders in the United States charge microenterprises 4.3 to 7.3 percentage points more than the prime rate. Moreover, even while paying relatively higher interest rates, the typical Latin American microenterprise gets far less credit than do North American microenterprises: in fact, just one-tenth as much on average.[2]

(continued next page)

In This Issue

Why The Microcredit Crunch?

The Evolving Capital Structure of Microfinance Institutions

Inside:

Microenterprise Borrowing Rates 2

Private Credit in Peru and United States 4

How Deposits Are Becoming Important to MFIs 6

Compartamos: How Formalization Creates New Funding Opportunities 6

Colombian WWBs' Approach to Managing Currency Risk 7

The Evolving Capital Structure of Microfinance Institutions

By Todd Farrington and Julie Abrams

The microfinance industry is changing shape as you read this. In Latin America, where nongovernmental organizations used to dominate microfinance, it is now rapidly evolving into a subsector of the financial services industry. Every year, more microfinance institutions join the ranks of the regulated. Most are growing strongly. Many are profitable. Some are more profitable than leading financial institutions.

What is new in this story? *Competition*. First spotted in Bolivia, competition has risen over the past two years to become a defining force in microfinance. In fact, the forces of competition are shaping microfinance like nothing has before. This is a case where Adam Smith, the famous 18th century British economist, turns out to be right: competition is dri-

(continued on page 5)

	Latin America		United States	
	Low	High	Low	High
Unsecured	15.1%	23.1%	4.3%	7.3%
Secured				
by Real Estate	2.2%	5.1%	0.6%	0.6%
by Movable Property				
Cars	7.5%	7.5%	1.3%	1.3%
Other	15.1%	23.1%	4.3%	9.3%

Microenterprise Borrowing Rates
(Percentage points above prime, by collateral)

Source: United States: Federal Reserve Statistical Release H.15, "Selected Interest Rates," August 2002. Latin America: "Marco Legal e Institucional de Garantías Reales Mobiliarias en Países de la Región", N. de la Peña y H. Fleisig, *Revista de Bancos y Empresas*, No. 3 Ed. Depalma, Argentina, 2001.

Why, relative to their North American counterparts, are Latin American microenterprises paying such high interest rates, and getting such small loans for such short periods of time?

Part of the disparity arises from the greater risks in Latin America – of devaluation, default or imposition of capital controls – as well as inefficiencies in financial markets and differences in reserve requirements. However, the different prime rates of the two regions capture the effect of country risk and intermediation costs, so there must be another explanation for the higher spreads over prime paid by Latin American microenterprises.

The additional premia over prime arise from problems in Latin America's legal framework governing debtors and creditors, which render businesses unable to realize the economic benefits of collateral. They cannot get the benefits directly, by offering equipment and merchandise as collateral for loans, nor can they get the benefits indirectly, by using secured financing as a method for refinancing their unsecured loans.

Private lenders only lend when they think they will be repaid. Over the years, credit markets have developed two successful lending systems: unsecured lending and secured lending. Unsecured lending relies on borrower reputation and the lender's assessment of the borrower's future demand for access to credit. Secured lending relies on the lender's ability to seize and sell property to satisfy an unpaid loan. Both systems reflect sound economic logic and both attempt to address the main features of credit markets: adverse selection, moral hazard, asymmetric information and uninsurable risk.

The presence of a good legal framework for collateral explains why, compared to Latin America, small businesses in the United States can borrow at terms closer to those of large businesses. Unsecured loans are available for microenterprises that offer no collateral, and whose operators do not own real estate. Of course, microenterprises that offer movable property as collateral can get better terms. And those that can offer real estate as collateral – the house of the owner or the premises of the shop – can get even better credit terms.

Latin American microlenders respond in the same way to the framework for collateral. At the same time that well-known microlender in Bolivia was charging 28% for solidarity group loans with a $3,000 upper limit, it was charging 20.4% for loans up to $30,000 when the borrower offered a car as collateral. It was charging 18% for first mortgages on real estate.

Thus, the power of collateral works in both North American and Latin America. Better collateral produces lower interest rates, longer periods to repay, and larger loans relative to income or cash flow.[3] The problem that arises for Latin American microenterprises, as we shall see, is that Latin American law does not permit much of their property to serve as collateral. This limits microenterprises' access to secured credit, in loans and in sales on credit, and raises the cost of both their secured and their unsecured credit.

Collateral: What can Microenterprises Offer?

Lenders want collateral, property that they can seize and sell if the borrower does not pay; but what can microenterprises offer? Most microenterprises operate businesses where movable property comprises most of their capital stock and assets. It may be in the form of trucks or display cases, inventory or restaurant furnishings. They also have as assets their "accounts receivable" – the money they expect to be paid from past sales.

In addition, such businesses often want to buy equipment on credit from a dealer or wholesaler. Acquisition of this equipment is often central to business development, expansion, and growth. Typically, microenterprises do not own real estate or, if they do, it may already be in use as collateral for financing other movable property. Therefore, microenterprises usually can only offer movable property as collateral or attempt to buy equipment on credit using the equipment itself as collateral.

[1] Interest rates taken from the website of BancoSol in Bolivia (www.bancosol.com); commercial bank prime rate from Banco Central de Bolivia, *Tabla de Cotizaciones*, http://www.bcb.gov.bo.
[2] "Marco Legal e Institucional de Garantías Reales Mobiliarias en Países de la Región", N. de la Peña y H. Fleisig, *Revista de Bancos y Empresas*, No. 3 Ed. Depalma, Argentina, 2001.
[3] "Secured Transactions: The Power of Collateral", H. Fleisig, *Finance and Development*. June 1996.

But private Latin American lenders typically will not take movable property as collateral. Nor will private Latin American equipment dealers sell equipment on credit while using the equipment alone as collateral for the loan. Sometimes exceptions are made for those who demonstrate that they own real estate, but no systematic pattern exists.

Legal Framework for Secured Lending

All the property described above would be acceptable as collateral to formal sector lenders in the United States. What prevents Latin American formal sector lenders from taking collateral in the same way? The answer is simple: while the letter of existing Latin American law might permit taking such property as collateral, the actual economic operation of the law does not. For example, the law might provide that a farmer can pledge a tractor but, at the same time, specify an enforcement procedure for the pledge that is so long and expensive that it actually does not permit the lender to recover any of the value of the tractor if the farmer defaults. The result of such laws? The capital stock of US microenterprises serves as collateral and supports microenterprises' access to credit, while the capital stock of Latin American microenterprises does not.

Several elements of the Latin American legal framework for secured lending combine to make the property of microenterprises useless as collateral.[4] First, the law does not provide an easy or inexpensive method of *creation* for such a security agreement. Instead, gaps in coverage exclude some lenders, some borrowers, and much property and business transactions. Nor does the law give clear or unambiguous ranking of *priority* to lenders, making even otherwise valuable property worthless to lenders as collateral. Primitive registries limit the *publicity* of security interests, making the practical determination of a lender's ranking of priority in collateral either difficult or impossible to ascertain. Finally, *enforcement* is slow and expensive. *Repossession* can take two or three years; lenders know this length of time far exceeds the economic life of much movable property that microenterprises can offer as collateral. Once repossessed, *sale* of collateral often requires complex, judicially-mandated procedures that ultimately put most of the proceeds of a sale into the hands of the auctioneer, appraiser, participating lawyers and officers of the court.[5] Through these features, Latin American law makes the otherwise valuable capital stock of microenterprises useless to lenders as collateral.

For those fortunate few microenterprises whose owners have real estate, existing Latin American legal frameworks present further difficulties. Latin American security devices for real estate do not go beyond the mortgage. The mortgage is an expensive security device. Its costs of creation can represent a large fraction of the value of small properties and make the total cost of funds borrowed on a mortgage prohibitive. Virtually all Latin American mortgage procedures require that land be titled. However, much Latin American land is not titled, although the occupants have legal rights to the title. Therefore, the occupant/owner cannot mortgage that property. Other security devices that may use untitled or future titled land would serve Latin America better. However, these have not been developed under the legal system or under various land titling and reform projects.

Legal Framework for Unsecured Lending

Unsecured lending is the only true substitute for collateral. Latin America has made enormous progress in advancing unsecured lending. An innovative range of ideas pressed forward by those lending to microenterprises has expanded access to credit enormously. However, while unsecured lending can substitute for collateral, it cannot substitute for a legal framework for secured lending. To the contrary, unsecured lending in Latin America could benefit greatly from reform of the current framework for secured lending.

An unsecured loan is, itself, another piece of movable property. In a reformed framework for secured lending, a portfolio of such loans could serve as collateral for a refinancing loan. Were such an operation possible under Latin American law, sound microlenders could tap outside sources of funds at commercial rates. They could lower their costs and greatly expand their operations.

This is not a dream. American Express in the United States, to take one such lender among many in that country, extends credit to thousands of small borrowers daily. It has no deposit-taking bank to refinance these loans. Rather, the company routinely finances its operations by taking commercial paper to private lenders: banks or capital markets. This commercial paper is secured using its portfolio of thousands of small, unsecured loans.

Why can't Latin American microlenders do this? Because the legal frameworks for secured transactions in no Latin American country permit taking security interests in portfolios of unsecured loans in a safe and inexpensive way. Nor is it only microlenders who suffer from this legal problem. Dealers and suppliers can also provide important amounts of credit to microenterprises. Dealers routinely supply 30 days of working capital when they sell merchandise on credit. These sales documents are themselves movable property. Dealers in the United States can use their portfolios of accounts receivable, arising from such sales, as collateral for a low-interest loan from a formal-sector lender. Not only does

[4] See "Marco Legal e Institutional de Garantías ...".
[5] See, for example, "Argentina: Cómo Las Leyes Sobre Prenda Limitan El Acceso al Crédito," N. de la Peña H. Fleisig, La Ley 61 (Marzo 1997); y "Peru: How Problems in the Framework for Secured Transactions Limit Access to Credit," *NAFTA: Law and Business Review of the Americas 3*, 1997, also at "Perfecting Security Interests South of the Border", American Bar Association, *Section of Business Law*, April, 1997.

extending credit become an important merchandising tool for the dealer but it is also a profitable way to avoid the charges of credit card companies.

Dealers and microlenders in Latin America, however, have no such opportunities. While lawyers may assert that the legal device exists, there is in fact no legal feature that permits simple, cheap and safe financing that uses accounts receivable as collateral.[6] This promising channel of credit to microenterprises is choked off.

What Does Reform Require?

Reforming the law of secured transactions, as a technical matter, has a few key ingredients. A new law must be written that satisfies the economic requirements of a modern financial system. The registry must be reformed to conform to the reformed law. Assuming the registry is replaced by a modern Internet-based filing archive, the entire reform would cost less than $500,000. Were real estate included in the reform – advisable from both a technical and financial point of view for Latin America – the entire reform would still cost less than $750,000. While these may seem like large numbers to some readers, they are no more than rounding errors in the programs of international finance institutions and large donors. Of course, the cost of reform is even more insignificant when compared with the oceanic losses sustained by public institutions that lent and guaranteed loans in the absence of a secured-transaction framework.[7]

Unfortunately, it is all too easy to summarize Latin America's record on reforming secured transactions: No country in Latin America has passed an economically effective secured transactions law.

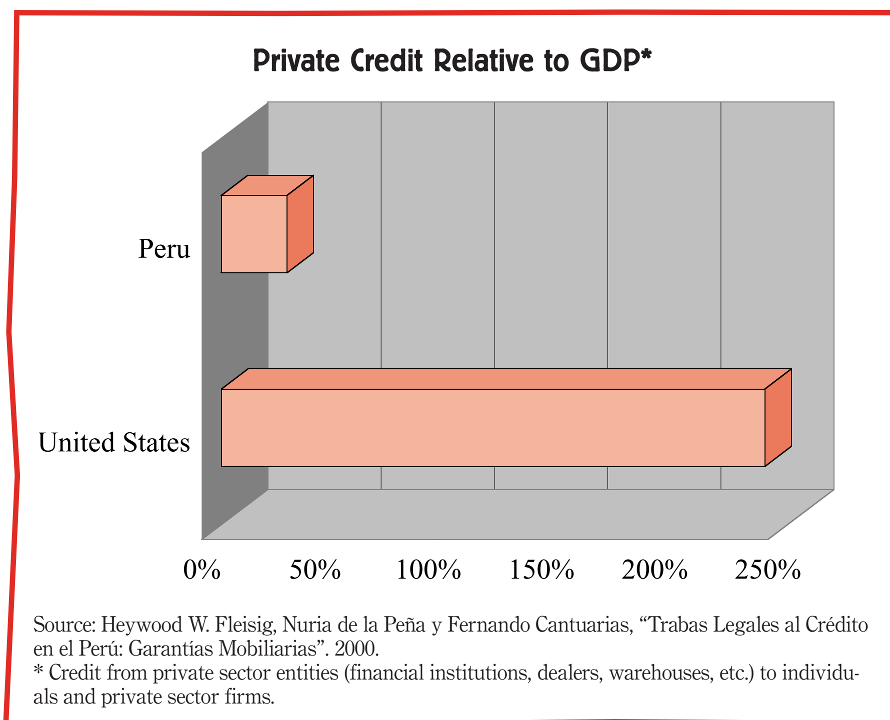
For example, about ten years ago Bolivia received a World Bank study detailing the links between problems in its legal framework for secured transactions and limits to credit access.[8] That report explained how, as a result of Bolivian law, private lenders found no movable property economically useful as collateral. Instead lenders frequently refused loans or used the post-dated check as a guarantee, a device that permitted them to imprison non-paying debtors. The study surveyed jail inmates in La Paz and found that 25% of the inmates were in jail for debt default.

Despite the well-documented problems with the legal framework, a donor-supported draft law of secured transactions submitted to the Bolivian Congress nearly six years ago still remains to be passed. Moreover, in its present form, weakened by amendments and redrafting, it would make little economic difference if it were passed. Private lenders in Bolivia, including many microlenders, continue to use the post-dated check as a guarantee and continue to threaten their non-paying clients with jail.

Reform efforts in other Latin American countries have not fared better. Though most of Latin America long ago abandoned imprisonment for debt, few countries have passed new laws for secured transactions. Moreover, where they have passed such laws, they have stripped them of their economically effective features.

Reform of secured transactions has not been enforced as a condition on any Latin American adjustment lending operation of the World Bank, Inter-American Development Bank or International Monetary Fund. Usually, it has not been a loan condition at all. Some international financial institutions, as a general approach, do not link lending operations to legal reforms since difficulties in achieving such reforms might delay loan disbursement. This strategy obviously limits the chances of success of any legal reform.

Private Credit Relative to GDP*



Source: Heywood W. Fleisig, Nuria de la Peña y Fernando Cantuarias, "Trabas Legales al Crédito en el Perú: Garantías Mobiliarias". 2000.
* Credit from private sector entities (financial institutions, dealers, warehouses, etc.) to individuals and private sector firms.

[6] "Reforming the Legal Framework for Security Interests in Mobile Property," Nuria de la Peña, *Uniform Law Review 4* (1999-2): 347, and "Financiamiento de Cuentas de Crédito", *Estudios de Derecho Comercial*, Nuria de la Peña, Lance Girton y Heywood W. Fleisig. Buenos Aires, April, 1997.
[7] "Costo Económico de los Defectos en el Marco Legal Argentino para los Créditos con Garantía de Bienes Muebles", Nuria de la Peña, Heywood W. Fleisig, Alejandro M. Garro, y Roberto Muguillo: Poder Judicial, *Desarrollo Económico y Competitividad en la Argentina, Volumen II*, Editorial Depalma, Marzo 2001.
[8] "How Legal Restrictions on Collateral Limit Access to Credit in Bolivia," by Heywood W. Fleisig, Juan Carlos Aguilar, Nuria de la Peña, The World Bank: December 1994; and "Legal Restrictions on Security Interests Limit Access to Credit in Bolivia" by Heywood W. Fleisig, Juan Carlos Aguilar y Nuria de la Peña, *The International Lawyer*, Spring 1997.

Reform Prospects

However, prospects for reform may be better now than in the past. The G-7, G-10 and G-22 finance ministers have signed statements exhorting the finance ministers of developing countries to support the reform of secured transactions. These statements further instruct the international financial institutions to support and promote these efforts.[9]

Support from donors and other international financial institutions for the reform of secured transactions law appears to have been increasing. Their financial market operations now often include some support for inputs to the reform of secured transactions, such as studies, draft laws or computerization of registries. Much of this support, unfortunately, focuses on inputs rather than on the desired output, a comprehensive legal reform that has the real, economic effect of improving access to credit. The "input" approach may help lawyers and consulting firms but it has done little to improve access to credit for Latin American microenterprises.

Let us hope the approach changes going forward. For a variety of technological and market reasons, microenterprises in industrial countries have been expanding rapidly. For Latin America, these promising trends can best support growth and fight poverty if they are adequately funded. There is no way donors can satisfy the demand for financing in the microenterprise sector, which amounts to several hundred billion dollars, so private funding is needed. Private funding, in turn, requires a modern legal framework for debtor-creditor relations in general and for secured lending in particular. Only governments can pass laws, so the sooner Latin American governments take this issue seriously, the sooner Latin American microenterprises can get the financing they need.

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[9] Report of the Working Group on International Financial Crises, October 1998 (report of the G22, working group 3).

The Evolving Capital Structure of Microfinance Institutions

(continued from page1)

ving lending rates down, inspiring new products and precipitating a general scramble by microfinance institutions, or MFIs, to become more efficient. In Bolivia, profit margins that once were generous have become razor-thin.

Amid this atmosphere of heightened competition, as growing numbers of MFIs decide to submit to government regulation and reap its rewards, the financing of microfinance is undergoing profound change. The rise in competition and the spread of regulation are virtually remaking the capital structure of the industry. Three key trends have emerged: a tendency toward increased leveraging of capital, a rise in the practice of accepting public deposits and a shift away from subsidized donor money and toward commercial funding.

Each of these three trends can be observed under way in a sample group of 29 Latin American MFIs tracked by MicroRate, which has conducted some 117 evaluations of 67 companies since 1997. The 29 MFIs included in the sample are institutions that have been tracked over time, some for five years. The group includes some of the most impressive MFIs in Latin America and therefore serves as a bellwether of what is to come in microfinance.

Trends in Microfinance Capital Structure

Most MFIs start out as nongovernmental organizations (NGOs) with a social mission. Since the mid 1990s, however, a growing number of MFIs have "formalized," becoming subject to banking regulation and therefore, in some cases, allowed to accept and manage public deposits. Among the sample group, 20 out of 29 MFIs are now regulated. As more MFIs undergo this evolution, there has been general shift toward capital structures more typical of commercial financial institutions.

One of the key trends to emerge has been a drive toward greater leveraging of capital, a drive that has continued to accelerate in recent years. Microfinance NGOs, being unregulated, typically find it difficult to borrow more than the equivalent of their equity. Obviously, this constrains their ability to grow. But as MFIs become regulated, commercial funding sources are far more willing to lend to them. In 2001, the 20 regulated MFIs among the sample group of 29 had borrowed 4.5 times the value of their equity, on average. In contrast, the nine unregulated MFIs had only a 1.3 debt-to-equity ratio.

Not surprisingly, higher leverage tends to be correlated with larger portfolio size. The average portfolio size of regulated MFIs in the sample was over three times that of their unregulated peers: $22.4 million versus only $6.6 million. The Mexican MFI Compartamos had almost no debt until it formalized in 2001, but once it did, its debt-to-equity ratio rapidly jumped to 1.6 and its portfolio more than doubled in size from $10 million to $25 million.

In some instances, both leverage and portfolio size are also correlated with profitability, as seen among Peruvian MFIs last year. Yet, leverage is no guarantee of profitability because the profit-dampening impact of a competitive environment often can outweigh the potential profit-enhancing benefits of leverage. For example, in 2001, highly leveraged Bolivian MFIs, operating in a fiercely competitive urban microfinance market, were less profitable than Compartamos, which was barely leveraged but was operating mainly in rural areas free of competition.

A second key trend has been the steady increase in deposit-taking, a privilege allowed only to regulated MFIs. Those that have been managing deposits all along have taken in ever larger sums, while at the same time newly regulated MFIs have joined in the drive to mobilize deposits. Note that these deposits do not always fit the quaint image of microentrepreneurs' maintaining tiny savings accounts. More often, deposits held by MFIs come from large institutional investors.

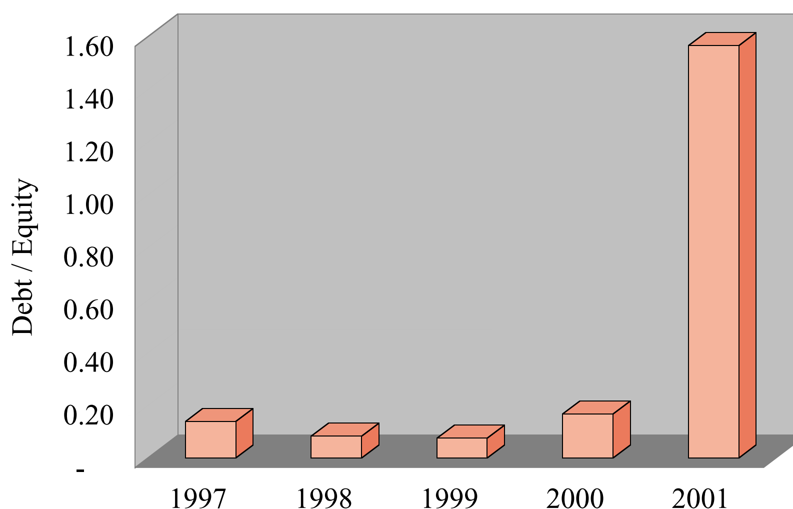
Thirteen of the 29 MFIs in the sample group currently accept deposits. Among these, deposits have risen steadily from 54 percent of portfolio in 1997 to 77% (or $276 million) in 2001. Savings from the public constitute an excellent and cheap source of funds, but mobilizing such savings also costs money, adding 15% to 20% to an MFI's operating expenses. At the same time, the average cost of capital in 2001 for the deposit-taking MFIs was nearly three percentage points lower than that for the MFIs not taking deposits: 10.3% of operating expenses versus 13.1%. This three-point spread would likely have been even greater if funding liabilities were sourced solely from the private sector; many MFIs not taking deposits are still receiving some amount of donor-subsidized funding at below-market rates.

However, that pattern is on the decline. Increasingly, the capital structure of microfinance is shifting away from sources of subsidized funds and toward commercial funding. By the end of 2001, 10 of the 29 MFIs had no subsidized funding at all. An additional nine had an immaterial amount below 5 percent. It is not surprising to find that the four most profitable MFIs in the sample had no concessionary funding. Another five highly profitable MFIs had immaterial levels of subsidized money. The typical pattern is that the more market-driven MFIs are among the most profitable.

Subsidies play a role in helping new MFIs get off the ground, but in many cases they hold back the development of the institutions they is supposed to help. Subsidies very quickly turn into a handicap by reducing the need to cut costs and maximize efficiency. Of course, the MFIs themselves cannot be blamed for accepting gifts, but some of them have in fact learned to say no to overeager aid agencies.

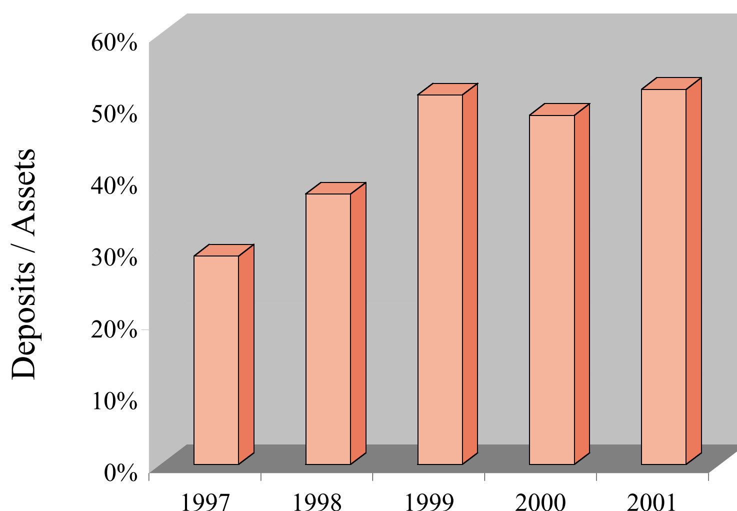
The list of donor agencies that cause harm, albeit often with the best of intentions, is long. But the microfinance programs of the European Community and Spain, due to their size, stand out in this regard. Microfinance would benefit

Compartamos: How Formalization Creates New Funding Opportunities



Source: Microrate data.

How Deposits Are Becoming Important to MFIs



Source: Microrate data for Caja los Andes, FIE, Financiera Calpia, Financiera Visión, CMAC Trujillo, CMAC Arequipa, CMAC Sullana, CMAC Ica.

greatly if donors in general, and these two in particular, took a hard look at the way they go about supporting MFIs.

One consequence of subsidized funding is that many MFIs persist in depending on long-term debt to finance their operations. Often, the borrowing may be at commercial rates even though the funds are sourced from government-sponsored "second-tier" development funds: that is, funds that serve as wholesale mechanisms to channel financing to retail microfinance institutions. Examples of second-tier funds include COFIDE in Peru, IFI in Colombia or NAFIBO in Bolivia. Much MFI dependence on long-term financing stems from the fact that these second-tier funding sources themselves usually receive their funding from international development institutions (such as the IDB or CAF). As MFIs outgrow these semi-official funding sources, their liabilities are likely to become shorter-term and better match their assets, which primarily consist of shorter-term loans.

At the same time, however, those MFIs that begin to take on more commercial financing from overseas are likely to become increasingly exposed to foreign exchange risk. Since their loans to microentrepreneurs typically are in local currency, any substantial devaluation of that currency could render the MFI unable to repay its own debt. Effective management of such risk often eludes MFIs. The problem has not received the attention it deserves, in part because two of Latin America's most active microfinance markets, Bolivia and Ecuador, are dollarized.

Various approaches to currency risk management have been adopted by MFIs in different countries. One example is a loan-exchange arrangement between MFIs and banks in Colombia, whereby the MFIs deposit their dollar-denominated funds and then, using the deposit as collateral, secure a bank loan in local currency, thus transferring the currency risk to the banks.

In Nicaragua, MFIs' foreign currency obligations used to take the form of highly subsidized loans from donor agencies. These loans carried an implicit protection against foreign exchange risk, since the donors were likely to assume any loss caused by a severe devaluation. In the last couple of years, however, Nicaraguan MFIs have started to borrow on commercial terms. For example, Finde's percentage of subsidized funding liabilities declined from 59 percent in 1998 to 14 percent in 2001. Nicaraguan MFIs now use an index system that passes foreign exchange risk on to clients through the lending rate. However, this system, operated by the Central Bank and used by the entire financial sector, only works as long as devaluations remain small. It would not work in extreme circumstances such as those prevailing in Mexico in 1995 or in Argentina today.

In too many cases, however, MFIs still are unaware of the risks posed by foreign exchange exposure. Market-savvy development institutions like the International Finance Corporation could do far more for microfinance by turning their creativity to the problem of foreign exchange risk, rather than continuing their comparatively ineffectual practice of funding MFIs directly. Foreign exchange risk will only increase as MFIs grow and increasingly turn to foreign funding to sustain their growth.

Indeed, recent years have seen the development of new channels for foreign investment to flow into Latin American microfinance, ranging from the issuance of bonds by some MFIs to the emergence of investment funds dedicated to microfinance. To date, at least four Latin American MFIs have secured funding by issuing bonds. Banco Sol led the way with a $5 million bond issue in 1996. Since then, Colombia's FinAmérica has introduced a $5 million convertible obligatory bond. In 2002, Compartamos sponsored a 2-part $15 million bond issue. And Mibanco in Peru was preparing a bond issue as this article went to press.

There has also been a small but significant movement toward the development of a capital market dedicated to microfinance. One fund created in 1998 by the Dexia Banque Internationale á Luxembourg (DexiaBIL) is now called the Dexia Fund, owned by Dexia Asset Management. In 1999, another fund called LA-CIF was founded by a group of development organizations to provide commercial loans to Latin American MFIs. Both Dexia and LA-CIF make purely commercial investments.

The emergence of funds like Dexia and LA-CIF reflects investors' increasing recognition of the financial opportunity to be found in microfinance. Though their lending rates are comparatively high and their loans are short-term, they have been able to compete against subsidized donor funding by knowing

Colombian WWBs' Approach To Managing Currency Risk

Though many Colombian MFIs have prudently shied away from foreign-currency-denominated borrowing, others have not. Colombia's Women's World Banking (WWB) affiliates, which do take out dollar-denominated loans to support their operations, are examples of MFIs that have adopted a simple and effective coping mechanism.

The MFI deposits its dollar-denominated loan in a bank, and then uses that deposit as collateral to secure a bank loan in local currency. In some countries, a single bank may both receive the dollar deposit and make the local-currency loan. In others, including Colombia, a foreign bank affiliate is needed to take the U.S. dollar deposit, while a local bank issues the loan in local currency.

Either way, the foreign exchange risk is transferred from the MFI to a bank, which, being a larger institution, is better able to absorb the risk and thus can offer the local-currency loan to the MFI at reasonable cost. Meanwhile, such deals also serve to help MFIs overcome one of their key challenges: establishing relationships with the local financial sector.

their client's business and moving fast when funding is needed.

The Dexia fund has grown to $16.5 million in assets and hopes to attract as much as $25 million by the end of 2002. By requiring only a minimum investment of $10,000, it is attracting a wide audience of investors. It yielded 7.8% in 2000 and 6.8% in 2001. As of September 2002, LA-CIF held assets of $11.6 million, with another $7 million in funding committed by investors. Yield was 9% in 2000 and 10.7% in 2001.

Capital Restructuring Driven By Competition

It would be no exaggeration to say that heightened competition, a natural outgrowth of vibrant and mature markets, is causing a transformation of Latin American microfinance. In urban Bolivia, competition has played a greater role than any other factor in the reduction of portfolio yields and profit margins. Yet at the same time, Bolivian supervisory authorities have allowed regulated MFIs to capture deposits and thus create more opportunity for growth despite their shrinking yields.

The pressure is on. As microfinance industries grow and mature, and as their clients become more sophisticated and discriminating, competition will challenge MFIs as they strive for increased market share, along with high portfolio quality and profitability. Many MFIs – inspired by the desire to continue growing, to offer a broader range of products and obtain more inexpensive funding through captured deposits – are submitting to the additional costs of regulation and the discipline of the market.

Only by shifting away from subsidized funding sources to leveraged commercial funding, including deposits and local and international bond issues, can MFIs compete in maturing markets and continue adapting to their clients' needs. More and more MFIs are seeing the advantage in restructuring their balance sheets along these lines. This bodes well for the sector.

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In Future Issues...

Microleasing – myth or reality?

Can the cluster model work for microenterprises?

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Microenterprise Development Review

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