CGAP

BRIEF

How Have Market Challenges Affected Microfinance Investment Funds?

Highlights from the CGAP market scan

Despite the global economic recession, total assets of the 10 largest microfinance investments vehicles (MIVs) grew in 2011, reaching US$4 billion.[1] During the year, MIVs continued to face many challenges, including increased credit risk in several markets and lower returns, but the overall investment market was more active than in 2010, with renewed capital appetite from most microfinance services providers and more focus on underserved markets.

Growth Rate on the Rise for the 10 Largest MIVs

Total assets of the 10 largest MIVs grew by 7.2 percent in 2011, above the 4.1 percent growth rate in 2010, but still below precrisis levels (e.g., 31 percent in 2008 and 23 percent in 2009). This increase in growth rates is mainly driven by the increased microfinance institution (MFI) demand for capital, particularly for local currency loans. The top 10 MIVs remained largely the same as in 2010, with one fund from the top 15 joining the top 10 grouping in 2011 (Triodos Fair Share Fund). Most of the top 10 MIVs are funded by private capital from retail and institutional investors.

Support from Investors Remains Sound

At least five new microfinance funds were created in 2011, including two for US$95 million in assets or more, such as the responAbility Financial Inclusion fund and the Developing World Markets Microfinance Fund-J, the first commercial MIV designed for the Japanese retail market in March 2011.[2] Most of the new funds are managed by existing microfinance investment managers. They are invested mainly in debt instruments, but investors are showing more interest in microfinance equity, with two of the funds targeting equity investments at 25–70 percent of portfolio.[3]

It seems that 2012 is more dynamic than last year, with seven new funds already launched or targeting mid-2012 closings. Of these, Progression Eastern African Microfinance Fund and ISIS are equity funds, and all but one of these funds will include equity as an offering. Some funds are also targeting impact areas beyond microfinance (e.g., agriculture, small enterprises). For example, Symbiotics and Oxfam announced the launch of the Small Enterprise Impact Investment Fund in January 2012, which is targeted to reach US$100 million.[4] Accion launched the Venture Lab, a $10 million fund targeted at innovative start-ups that are expected to open financial access through avenues such as technology, education, energy, and housing.[5]

Although support from investors remained relatively strong, some fund managers interviewed noted that raising private investor capital has become more challenging, mostly due to the negative

1 Interviews with 30 investors and data gathered from asset managers in the first quarter of 2012. Total amounts are based on December 2011 exchange rates.
2 http://www.dwmarkets.com/media/pdf_DWM-Microfinance-Fund-J-Press-Release_March2011.pdf
3 MIVs also made indirect equity investments via holding companies. For example in 2011, Finca formed a US$74 million holding company for equity investments in its partners with capital from several MIVs and DFIs. http://www.finca.org/site/apps/nlnet/content2.aspx?c=6fIGIXMFJnJ0H&b=6088937&ct=10881409
4 For more information, see http://www.symbioticsgroup.com/news/latest-news/seiif-oxfam-and-symbiotics-target-investment-industry-with-new-sme-fund
5 http://www.accion.org/page.aspx?pid=4124

May 2012

Table 1: Ten Largest MIVs (Total Assets, December 2011)*

Name	Total Assets in USD (millions)	Year Established
European Fund for Southeast Europe	1,008	2005
Oikocredit	870	1975
responsAbility Global Microfinance Fund	524	2003
Dexia Micro-Credit Fund—BlueOrchard Debt Sub-Fund	394	1998
ASN-Novib Fonds	301	1999
SNS Institutional Microfinance Fund	229	2007
Microfinance Enhancement Facility	222	2009
SNS Institutional Microfinance Fund II	194	2008
responsAbility SICAV (Lux) Mikrofinanz-Fonds	157	2007
Triodos Fair Share Fund	156	2002
	4,055	

*Total assets of the ten largest MIVs represent between around 60–65 percent of the total market (CGAP estimates based on desk research, including Symbiotics and MicroRate 2010 MIV surveys).

developments and publicity in several microfinance markets,[6] as well as economic weakness in several European economies.

More Focus on Underserved Markets

MIVs are increasingly targeting underserved markets, mostly in sub-Saharan Africa (SSA), Asia, and rural markets. In many cases, these efforts are supported by development finance institutions (DFIs).[7] For example, Fefisol and Rural Impulse Fund-II (approximately US$19 million and US$41 million in assets, respectively, as of December 2011) were created to focus on financial access in rural markets.[8] Oikocredit and FMO plan to structure a euro 10 million fund targeting only low-income countries, while the Microfinance Initiative for Asia driven by IFC and KfW, announced the launch of a US$100 million fund focused on microfinance and capacity building in underserved Asian markets.[9]

Finally, to enhance their ability to identify and execute investments and to better understand local market needs, MIVs are increasing their local presence. For example, several large asset managers have opened offices in SSA in 2011.

Microfinance Fund Returns: Significant Variations While Steady on Average

The SMX Index[10] showed about the same returns in 2011 as in 2010, at 2.5 percent for U.S. dollars and 2.6 percent for euro investments. These are well below that of earlier years when returns of 5 percent were feasible. Nonetheless, the 2011 yields still provide a risk premium above the six-month LIBOR (0.7 percent) and the six-month EURIBOR (1.6 percent).[11]

There were significant differences in fund performance. For example, within the SMX index,

6 For example, some investors are requiring increased information and accountability on MFI social performance and client protection practices to ensure the well-being of the end clients.
7 DFIs are the private sector arms of government-owned bilateral and multilateral development agencies.
8 For more information, see http://www.sidi.fr/fefisol.php and http://www.incofin.com/en/news/incofin-im-launches-rural-impulse-fund-ii.
9 For more information, see http://www.microcapital.org/downloads/monitor_volume7/MicroCapitalMonitorPreview_Mar2012
10 The index for U.S. dollar and euro investments includes a selected group of microfinance funds with majority fixed income assets. For more information, see https://my.syminvest.com/microfinance-investment-vehicle/symbiotics-microfinance-indexes
11 For more information, see http://www.global-rates.com/interest-rates/libor/european-euro/2011.aspx.

Box 1. Progress on Funding in Local Currency

In 2011, we saw notable progress in supplying local currency capital to MFIs. Local currency funding is an important priority for most private asset managers and DFIs interviewed. MFX and TCX, vehicles providing foreign exchange hedges, are doing more business. In 2011, MFX closed foreign exchange hedges for US$145 million, roughly three times its volume in 2010.[a]

In fact, several of the largest MIV managers now have a third of their global portfolios effectively in local currency, and some have significantly higher levels (e.g., Oikocredit at 56 percent). Some MIVs and DFIs have made it a deliberate strategy to provide local currency funding in poorer and less developed regions, such as SSA. For instance, 72 percent of Triodos's debt portfolio in SSA is in local currency, compared to 38 percent of its global portfolio. Some DFIs, such as AfD and IFC, have 100 percent of their SSA debt portfolio effectively in local currency.

Finally, some MIVs (e.g., Triodos, Regmifa, Fefisol) can or are already taking open foreign exchange positions to support MFIs with local currency capital where market hedges don't exist. Generally, such exposures are limited to a small portion of the MIV's assets or have other mitigating protection.

[a]For more information see MFX Solutions (April 2012). It should be noted that 2012 may be a challenging year for employing foreign exchange hedges given unusually high interest rates in particularly in East Africa, driven by high inflation.

Triodos Microfinance Fund-I Euro shares realized a 7.9 percent return in 2011, while Dexia Micro-Credit Fund realized only 0.32 percent and 0.68 percent, respectively, on U.S. dollar and euro returns—below LIBOR and EURIBOR rates.[12] In fact, three of the seven funds had a less than 1 percent return in 2011, in part due to increased provisioning in certain difficult markets.[13] Also, some currency volatility in 2011 may have lowered MIV returns.

Overall, lower fund returns since 2009 reflect lower market interest rates, higher loan loss provisions, and increased competition for placement of funds, especially in several saturated markets.

Table 2: MIV Returns based on SMX-USD and SMX-Euro

SMX-USD Returns		SMX-Euro Returns	
Year	Return (%)	Year	Return (%)
2011	2.51	2011	2.63
2010	2.55	2010	2.55
2009	3.08	2009	2.06
2008	5.95	2008	5.55
2007	6.33	2007	4.15
2006	5.09	2006	2.63
2005	4.30	2005	3.10

NOTE: For more information, see http://www.syminvest.com/

Increased Focus on Social Performance

Fund managers are increasing their focus on social performance and end-client issues, to ensure more responsible placement of their capital. Several industry efforts are underway to promote transparency and accountability, and to avoid contributing to overheated markets. Also, 54 investment organizations, including several leading MIVs, endorsed the Principles for Investors in Inclusive Finance in 2011. Finally, investors are stepping up country-level coordination efforts (e.g., in Bosnia and the Kyrgyz Republic) to help prevent overheating and over-indebtedness.[14]

Outlook: Moderate Growth Projections

Investment managers expect further increase of MFI demand in 2012 and improved growth compared to 2011. They also expect further expansion into underserved markets and more focus on equity investments.

MIV managers project increased diversification of their portfolios into other impact investing fields, such as agricultural finance and small and medium enterprise finance, while recognizing that the expansion into these areas will proceed at a slower pace.

12 http://www.blueorchard.com/jahia/webdav/site/blueorchard/shared/Products/DMCF/Monthly%20updates/2011/BlueOrchard%20Bulletin%20mensuel%20Dec%202011%20FR.pdf and http://www.triodos.com/en/institutional-investors/microfinance/.
13 For example, increased provisioning for investments in Nicaragua and India.
14 For more information, see http://www.sptf.info/sp-task-force/working-groups.

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May 2012

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