

**Financing Micro, Small, and Medium Enterprises:  
An Independent Evaluation of IFC's Experience in Frontier Countries**

**SUPPLEMENTAL APPENDIXES**

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## ABBREVIATIONS & ACRONYMS

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AEPR	Annual Environmental Performance Report
BRI	Bank Rakyat Indonesia
CES	Environment and Social Development Department of IFC
CGAP	Consultative Group to Assist the Poor
CITES	Convention on International Trade in Endangered Species of Wild Fauna and Flora
CODE	Committee on Development Effectiveness of the Board
EBRD	European Bank for Reconstruction and Development
EMS	Environmental management system
ESHS	Environment, Social and Health & Safety
ESRP	Environmental and Social Review Procedure
ESRR	Environmental and Social Risk Rating
EU	European Union
FI	Financial Intermediary
FY	Fiscal Year
GFM	Global Financial Markets Department of IFC
IADB	Inter-American Development Bank
IEG-IFC	Independent Evaluation Group-IFC, formerly, OEG
IEG-WB	Independent Evaluation Group-World Bank, formerly OED
IFC	International Finance Corporation
IFI	International Financing Institution
IICC	Institutional Investor Country Credit
LOC	Line of Credit
MDB	Multilateral Development Bank
MFI	Microfinance Intermediary
MSME	Micro, Small and Medium-sized Enterprise
MSME-FI	MSME (oriented) Financial Intermediary
NBFI	Nonbank Financial Institution (not deposit-taking)
NGO	Nongovernmental Organization
NPL	Non-Performing loan
PEP	Private Enterprise Partnership
ROAE	Return on Average Equity (annual basis)
ROE	Return on Equity
SDP	Strategic Directions Paper (IFC)
SME	Small and Medium Size Enterprise
SME-FI	SME (oriented) Financial Intermediary
TA	Technical Assistance
TAAS	Technical Assistance & Advisory Services
XPSR	Expanded Project Supervision Report

## Appendix F: Summary of IFC's MSME and Frontier Strategies, FY94–FY06

Document	IFC Strategic Priorities	MSME Investment Support	MSME TAAS Support
Fiscal 1995–97 Three-Year Plan	n/a	<ul style="list-style-type: none"> <li>• Providing credit lines to existing FIs</li> <li>• Creating local FIs</li> <li>• Direct SME financing in selected cases</li> <li>• Financing through AEF (limitations already recognized)</li> </ul>	PDFs
Fiscal 1997–99 Three-Year Plan	<ul style="list-style-type: none"> <li>• SME development is a focal point of IFC operations</li> </ul>	<ul style="list-style-type: none"> <li>• Providing credit lines to existing FIs</li> <li>• Creating local FIs</li> <li>• Direct SME financing in selected cases under "Extending IFC's Reach" initiative</li> <li>• Initial work in the microenterprise sector</li> </ul>	PDFs
IFC 2000 Strategic Directions Paper	<p>Five sectors:</p> <ul style="list-style-type: none"> <li>• Financial markets</li> <li>• SMEs</li> <li>• Infrastructure</li> <li>• Information and telecommunications</li> <li>• Health and education</li> </ul> <p>MSME support is a vital element of World Bank Group's private sector development strategy.</p>	<ul style="list-style-type: none"> <li>• Providing credit lines to existing FIs (conduit financing)</li> <li>• Creating local FIs</li> <li>• Direct SME financing in selected cases (increasingly de-emphasized)</li> <li>• Increasing support for microenterprise financing</li> </ul>	<p>PDFs</p> <p>New SME Department created to:</p> <ul style="list-style-type: none"> <li>• Help frame and deliver regional department SME programs</li> <li>• Draw out best practices for SME support</li> <li>• Provide TA to SMEs</li> <li>• Assess impacts</li> <li>• Build capacity, etc.</li> </ul>

<b>Document</b>	<b>IFC Strategic Priorities</b>	<b>MSME Investment Support</b>	<b>MSME TAAS Support</b>
IFC 2001 Strategic Directions Paper	<ul style="list-style-type: none"> <li>Increasing interventions in frontier countries</li> </ul> <p>Sectors:</p> <ul style="list-style-type: none"> <li>Financial markets</li> <li>SME</li> <li>Infrastructure</li> <li>Information and telecommunications</li> <li>Health and education</li> </ul>	<ul style="list-style-type: none"> <li>Working through and with existing FIs (frontier environments will also call for innovations, risk sharing arrangements, and securitizations)</li> <li>Creating local FIs (MFIs, venture capital funds, leasing companies, etc.)</li> <li>Direct SME financing in selected cases (increasingly de-emphasized)</li> <li>Increasing support for microenterprise financing</li> </ul>	<ul style="list-style-type: none"> <li>PDFs (broadening product range and scope)</li> <li>SME Department</li> <li>SME Capacity Building Facility</li> </ul>
IFC 2002 Strategic Directions Paper	<ul style="list-style-type: none"> <li>Frontier markets</li> <li>Emphasis on high-impact sectors, such as financial markets, infrastructure, information and telecommunications, and social sectors</li> <li>Support for SMEs and sustainable development</li> </ul>	<ul style="list-style-type: none"> <li>Working through and with existing FIs</li> <li>Creating local FIs including MFIs</li> <li>Discontinuation of direct SME financing</li> </ul>	<ul style="list-style-type: none"> <li>PDFs (broadening product range and scope)</li> <li>SME Department</li> <li>SME Capacity Building Facility</li> </ul>
IFC 2003 Strategic Directions Paper	<ul style="list-style-type: none"> <li>Frontier markets</li> <li>High-impact sectors, such as financial markets, infrastructure, health, and education</li> <li>SMEs and sustainability</li> </ul>	<ul style="list-style-type: none"> <li>Working through and with existing FIs</li> <li>Creating local FIs, including MFIs</li> <li>Major build-up in microlending</li> <li>Initial discussions with International Development Agency (IDA) regarding a joint initiative for MSME operations in African countries</li> </ul>	<ul style="list-style-type: none"> <li>Significantly expanded noninvestment support</li> <li>SME Department (focus of expertise)</li> <li>Development of multiple partnerships with donors and executing agencies</li> <li>Creating linkages between SMEs and major IFC investments</li> </ul>

<b>Document</b>	<b>IFC Strategic Priorities</b>	<b>MSME Investment Support</b>	<b>MSME TAAS Support</b>
IFC 2004 Strategic Directions Paper	<ul style="list-style-type: none"> <li>• Strengthen focus on frontier markets with emphasis on SME sector</li> <li>• Build long-term partnerships with emerging global players in developing countries</li> <li>• Differentiate through sustainability</li> <li>• Address constraints to private sector investment in infrastructure, health, and education</li> <li>• Continue to focus on the development of domestic financial markets</li> <li>• Corporate scorecard introduced to track execution of priorities</li> </ul>	<ul style="list-style-type: none"> <li>• Strengthen capacity of local FIs to provide MSME financing, including helping banks downscale into SME lending</li> <li>• Significant increase in microfinance operations</li> <li>• IDA-IFC MSME initiative in African countries</li> </ul>	<ul style="list-style-type: none"> <li>• Reorientation of SME support from direct assistance to individual firms toward capacity building</li> <li>• PDFs (reorganized into regional Private Enterprise Partnership (PEP) units)</li> <li>• PDF/PEP reporting lines changed from SME dept. to regional departments</li> <li>• SME Capacity Building Facility</li> </ul>
IFC 2005 Strategic Directions Paper	<ul style="list-style-type: none"> <li>• Strengthen focus on frontier markets with emphasis on SME sector</li> <li>• Build long-term partnerships with emerging global players in developing countries</li> <li>• Differentiate through sustainability</li> <li>• Address constraints to private sector investment in infrastructure, health, and education</li> <li>• Continue to focus on the development of domestic financial markets</li> <li>• Corporate scorecard expanded to include measurable indicators</li> </ul>	<ul style="list-style-type: none"> <li>• Increasing SME access to finance by helping banks downscale into SME lending</li> <li>• New model: credit facilities to banks for SME on-lending combined with TA and incentive schemes rewarding banks for achieving volume and portfolio quality targets</li> <li>• Four-pronged microfinance approach: greenfield plus NGO transformation plus downscaling plus investment vehicles (combined with TA)</li> <li>• Expanding IDA-IFC MSME initiative in African countries</li> </ul>	<ul style="list-style-type: none"> <li>• Regional PEP facilities</li> <li>• SME Department</li> <li>• SME Capacity Building Facility</li> <li>• Developing linkages between SMEs and major IFC investments</li> </ul>



## Appendix G: MFI Study Population: Project Evaluations and Success Drivers

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### Introduction

1. This appendix provides the project-level evaluations for the MFI study population that form the bases for answering the evaluative questions listed in chapter 1 of the main report. The appendix fully describes and evaluates the operating results and development outcomes of the MFI projects that have reached operating maturity (i.e., those with at least two years of reported financial results by the end of 2005, or projects approved in FY96–FY02) and the main drivers of successful project outcomes. The environmental performance of the projects that form part of the development outcomes of the projects are described separately in appendix I and in chapter 5 of the main report.

### **IFC used several types of vehicles or business models to channel financing to microenterprises, and settled on one MFI vehicle for most of its microfinance operations. The projects in the MFI study population are all based on this one business model**

2. IFC approved its first MFI project in a frontier country in FY96<sup>1</sup> and, since then, has utilized five different vehicles or business models to channel financing to microenterprises in developing countries. During FY94–FY02 when the MFI projects that had reached operating maturity were approved, IFC undertook 37 microfinance funding operations in 33 countries (most with TA support and in frontier countries) through these five types of vehicles, as follows:

- (i) For-profit special purpose vehicle (SPV) to help finance a (nonprofit) NGO-sponsored microcredit program:<sup>2</sup> IFC and a nonprofit NGO from a developed country together cofinanced a for-profit special purpose vehicle (SPV) with a limited life (originally 3 years, extended to 4 years) to channel funds (as commercial loans) to the nonprofit NGO's microcredit program in a frontier country. Bilateral aid agency grant funds and donations from private philanthropies and corporations were then combined with the loan funds from the SPV to support the microcredit program operated by the NGO. At the end of 2005, the NGOs' microcredit portfolio reached about \$11.8 million involving about 25,000 borrowers (village groups and individuals) with an average loan amount of \$500 per borrower. The average return on assets for 2004 and 2005 of the SPV was satisfactory. The SPV was a transition entity and was intended to be replaced or transformed into a deposit-taking commercial bank specializing in microfinance (i.e., an MFI) as soon as the country issued regulations allowing and regulating MFIs. Following the issuance of regulations for MFIs to operate in the country, the SPV was dissolved in mid-2006 and its assets and liabilities were transferred to a new MFI with an initial equity capital of about \$3.5 million.

- (ii) Credit unions and consumer cooperatives (membership financial intermediaries): IFC generally provides loans and/or guarantees, as well as grant TA for start-up costs, training and operating systems to membership financial intermediaries, such as credit unions and consumer cooperatives. IFC supported two credit unions in a frontier country by guaranteeing their local currency borrowings from local banks; IFC also provided TA support to one of the credit unions. Both projects were closed by the end of 2005.

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<sup>1</sup> Even though IFC made its first MFI project in FY96, the study period starts in FY94 because the SME part of the study, discussed in chapter 4 of the main report and in appendix H, starts with the IFC SME-FI projects approved in FY94.

<sup>2</sup> For a good discussion on the microcredit lending methodologies of nonprofit NGOs, please refer to Working Paper Number 101, November 2006 Edition, "Microfinance as Business, by David Roodman and Uzma Qureshi of the Center for Global Development at [www.cgdev.org](http://www.cgdev.org). Copies of the paper can also be requested from IEG-IFC.

(iii) Special MSME credit facility within a commercial bank: IFC also established special MSME credit facilities within commercial banks, funded jointly by the bank and IFC (or alternatively funded by the bank with an IFC partial guarantee of the MSME borrowers), to channel financing to MSMEs. The partner commercial bank receives a fee for administering the special MSME credit facility. IFC supported three such microfinance credit facilities, all in a frontier country.

(iv) Regional investment funds and private equity funds (i.e., venture capital funds) that specializes in investing in financial intermediaries that lend to micro- and small-size enterprises: IFC invested in one regional private equity fund and also in one regional investment (loan) fund that targeted their investments at financial intermediaries that lent mainly to micro- and small-size enterprises. The private equity fund, in turn, made 12 equity investments either in new microcredit enterprises, banks with MSME clients, or former nonprofit NGO microlending entities that have converted to ‘for profit ’ MSME financial intermediaries. This private equity fund project was evaluated under the XPSR system several years ago, which found that the 12 investee companies of the fund provided loans to slightly more than 300,000 micro and small enterprises in several adjacent countries covered by the fund. The regional investment fund involves cofinancing by several MDBs and bilateral agencies, and the fund provide loans to MSME-FIs.

(v) Commercially oriented, “for-profit” MFIs: These “for-profit” MFIs are generally new financial intermediaries (deposit-taking commercial banks or nonbank, i.e., non-deposit taking, financial intermediaries) specifically established to serve mainly microenterprises, and eventually but to a lesser extent, also SMEs. Some “for-profit” MFIs were conversions of nonprofit microfinance operations of NGOs. Twenty-nine “for-profit” MFIs were supported by IFC, of which eight were in medium-risk countries, and 21 were in frontier countries. The 21 projects in frontier countries comprise the MFI study population. In the case of the 21 projects in the MFI study population, 16 were new entities or start-ups (i.e., greenfield projects), and 5 were conversions. In addition, 18 of the 21 projects in the MFI study population received grant TA from various IFIs, and a different group of 18 received equity financing from IFC. Finally, 20 of the 21 projects in the MFI study population were active as of the end of FY06, and one project closed in FY06.

#### **Box G.1. Actions Taken by One Microcredit NGO to Change to a Profit-oriented MFI**

- **Action 1. Restructuring from a nonprofit microcredit NGO into a profit-oriented MFI**
- A major reorganization of the NGO took place to prepare the organization for its future as a profit-oriented MFI. Staff specialized in nonfinancial services were retrained to become credit officers or were let go. Accountants and cashiers were recruited and trained. Management was trained to make business plans and financial projections. The structure at the head office was adapted to better supervise the branches and to develop and manage the internal control and risk management systems.
- The policy of preferential targeting of clients or areas based solely on poverty status was terminated. Instead, clients and areas served were selected on the basis of sound banking principles. The result was a broader and more diversified client base; activities took place only in areas where the client base was sufficient to sustain operations.
- Activities or joint ventures with other development projects or development organizations that were not directly related to the strategy of delivering microfinance in a profitable and financially sustainable manner were phased out.
- Considerable effort was made to develop software systems and improve the internal control and risk management systems.
- Credit policy and procedures were refined in line with sound profit-oriented microfinance principles.
- **Action 2: International development institutions support the MFI’s transition and expansion**
- A technical assistance project financed by the UNDP, the U.S. Agency for International Development, and the IFC began in the beginning of 1998 to assist the NGO into its transition into an MFI and to expand. The goals were to assist in the transformation of its governance structure, to establish an ownership structure, and to further upgrade its policies, corporate strategy, managerial and technical capacity, organizational structure, MIS systems, and profitability. The project financed a full-time team leader, several short-term specialists, and fellowships for the MFI

staff.

- From June 1998 until August 1998, the MFI prepared a full-fledged business plan. In October 1998, four foreign investors were identified as potential shareholders of the MFI bank (IFC, DEG, FMO, and Triodos Doen). Based on a positive assessment of the business plan, these investors conducted an institutional appraisal of the MFI from February 1999 until March 1999. The investors examined the development of microfinance in the country, the leadership role that the MFI had taken, and the characteristics of the MFI itself.
- **Action 3. Increase financial sustainability**
- Interest rates on loans were raised from a highly subsidized rate to a cost plus recovery rate. This measure was taken after lengthy internal debates and finally accepted as unavoidable. Interestingly, most clients understood and accepted the increase, saying that they wanted the MFI to ensure continued access to credit. The MFI, in turn, promised that, in return for higher rates, the delivery of financial services would become speedier, less cumbersome, and more reliable.
- Financial products were redesigned to meet market demand. Credit line procedures were rationalized and procedures were simplified to meet the requirements of clients. The mandatory savings product was abolished due to the expensive design of the savings scheme and its incompatibility with the newly adopted client-focused approach. The (mandatory) village banking product was dismantled because clients began to demand access to group guarantee loans that the MFI provided in other areas. Clients said they preferred that the MFI offer the group guarantee product in their areas, because they viewed this product as less cumbersome and more reliable. Business training, often required to teach prospective clients how to make a business plan, was shortened considerably based on recommendations from clients themselves.
- The performance criteria for branches were drastically changed from project-led criteria to institutional criteria. Branches were compared on the basis of returns on assets, portfolio quality, administrative efficiency, client/staff ratio, and other productivity ratios. High performance targets were set and a range of measures adopted to increase productivity. Required standards of performance were raised in a graduated manner. Promotion and renewal of staff contracts became dependent on meeting these performance standards.
- **Action 4. Increased outreach with additional funding from other donors**
- A major expansion took place in the number of branches over the project period. The MFI offered to set up the MFI branches in areas where potential donors had projects, and where the client base was sufficient to sustain operations. Donors contributed to the establishment costs and (part of) the operational costs of branches for the start-up years. The MFI, in turn, guaranteed sustainable access to financial services to poor and low-income clients in that area and ensured that those branches would be independent of additional donor subsidy after the termination of the agreement with these donors.
- In this way, donors contributed in a highly cost-efficient manner to poverty alleviation and had a guaranteed exit strategy, while the MFI rapidly expanded in scale. This formula of branch expansion worked well because some donors, notably KfW (soft loan), SIDA, and the government of the Netherlands (grant capital), contributed considerable funding for on-lending to micro and small business entrepreneurs. These donors became convinced that the MFI had sufficient absorptive capacity. The branch expansion had led to a long waiting list of selected clients, which could not be served because of lack of loan capital. This situation ensured that the capital provided by these donors immediately reached the target groups upon disbursement to the MFI. Donor responsiveness was bolstered by the fact that the predecessor NGO and successor MFI entity had been audited by a well-known international auditing firm since 1993, and operated in accord with generally accepted accounting practices. It was also important to these donors that the MFI continued to receive technical assistance from international experts, financed by the UNDP.

### **The MFIs maintained a largely high-quality loan portfolio while serving a large number of clients**

3. The MFIs have maintained a high-quality loan portfolio with a weighted (by total loans) average nonperforming loan (NPL) rate of only about 1.7 percent, and a high deposit to loan to ratio of about 93 percent at the end of 2005. For the two-year period 2004–05, the 21 MFIs had a weighted average return on assets of about 1.4 percent (i.e., ratio of net income to total assets) and a weighted return on equity of 11.5 percent. Only three MFIs had negative returns on total assets (and on equity), while nine had returns on total assets of at least 1.5 percent, and ten had return on total assets between 0.1 percent and 1.4 percent (see table G.2. The MFIs also

established a substantial microenterprise client base or outreach. The 18 MFIs on which IFC has subloan (or borrower) data had a total of 663,000 MSME subloans with an aggregate loan outstanding of \$1.53 billion at the end of 2005. On average, each MFI had 39,207 MSME borrowers (mainly microenterprises and a few small enterprises) with an average loan of \$1,970 per borrower. These are remarkable achievements given that these MFIs were established in a frontier country environment less than a decade ago, and with only an average of 6 years of operations since establishment up to 2005. However, there is wide variability in performance among the MFIs as discussed in appendix G, reflecting the high risks in their operations driven primarily by country conditions, and to a lesser extent, by the quality of the shareholder or technical partner managing the MFI.

4. The client (microenterprises) base or outreach of the MFIs continuously grows as the MFIs mature, and the growth depends mainly on the MFIs profitability and a supportive regulatory framework that liberally allows branches to be established. The main offices of the MFIs in the MFI study population, particularly those in Eastern/Southern Europe and Central Asia, were established in urban areas where there was a large concentration of microenterprises to serve. As their business became profitable, the MFIs established branches outward from the urban centers towards increasingly more rural and less dense areas in terms of microenterprise concentration. This reflects a prudent growth strategy because all MFIs were new entities, and needed to develop their staff and systems where the potential client base is most dense, to achieve profitability very quickly. This growth strategy means that as the MFI businesses grew through the addition of branches, they are progressively serving clients in increasingly more rural areas. Notably, one of the MFIs successfully pioneered agribusiness loans to private farmers and other rural clients in a transition economy when the commercial banks failed to recognize the viability of serving this micro- and small enterprise market segment (see box G.3). Since the incidence of poverty and marginal farming is generally higher in rural areas, the outreach by MFIs to these rural enterprises through an expansion of the MFIs branch network, improves their development results.

5. The MFIs in the study population are all new commercial or “for-profit” entities, either converted from another type (e.g., nonprofit entity) or established for purposes of the project, with operational experience ranging from just 3 to 9 years (as of end-2005). Thus, many are still in their early learning and growth period. Furthermore, these MFIs are not just in low-income or high-risk countries, but are also in countries undergoing substantial economic and political transition, particularly with respect to the policy and regulatory regimes in their financial markets. The future performance of many of these MFIs will therefore depend not only on the ability of their management to improve performance, but also on the evolution of the regulatory regime governing MFIs in these frontier countries, particularly regulations that affect the MFIs’ ability to take deposits, the requirements for minimum equity and second tier (i.e., long-term subordinated debt and redeemable preferred shares) capital, their ability to establish branches, and their freedom to set loan interest rates at levels that provide reasonable profit margins. The MFIs in the transition economies of Eastern/Southern Europe and Central Asia do not have a tradition of private banking in general and institutional microcredit services in particular; the introduction of a supportive regulatory regime for MFIs is important for their long-term sustainability.

### **There is a wide variation in the operating and financial performance of the MFIs**

6. There is a very wide variation in the funding structure, the operating performance indicators, and the profitability (averages for 2004–05) of the 21 projects in the MFI study population, even among the 13 MFIs under the same holding company. Most of the difference reflects local or country conditions, although some are due to how the MFI evolved and is managed. The wide variations in performance indicators are described below:

- Funding or Liability Structure: Deposits as a percentage of total assets (or total funding liabilities) range from 0 percent for those MFIs not allowed to take deposits, up to about 90 percent for those allowed to take deposits and have an extensive branch network, with a

weighted average of about 58 percent and a median of about 39 percent. Conversely, those with low ratios of deposits to total assets then depend on debts, and to a lesser extent on equity, for funding their lending operations. The debts can range from about 5 percent to about 88 percent of total assets. The weighted average debt to total assets is about 21 percent with a median of about 42 percent. The average equity to total assets can range from about 4 percent to about 53 percent with a weighted average of about 12 percent and a median of about 16 percent. In contrast, for the SME-FIs the weighted average deposits to total assets is about 70 percent with a median of about 74 percent. Thus, the SME-FIs have the advantage of a higher proportion of lower cost deposits in their funding structure compared to MFIs (the average interest paid on deposits is slightly lower for MFIs at 3.7 percent, compared to about 5.5 percent for SME-FIs). The comparatively lower proportion of deposits in the funding structure of MFIs compared to SME-FIs reflect the relatively younger age of the MFIs which are still developing their deposit base, as well as the non-deposit taking status of a few MFIs.

- Operating Cost Structure: Administrative and operating expenses (i.e., noninterest expenses) range from about 5 percent to 42 percent of total loans, with a weighted average of 13.2 percent and a median of 14.0 percent. The high administrative and operating expenses, as a percentage of loans, are firstly the result of extremely difficult political, security, and social country conditions (in cases of operating expenses over 25 percent of loans); secondly the result of the MFI business model to closely know and follow their borrowers, which is labor-intensive, coupled with a very much smaller average loan amount per borrower over which to spread the fixed administrative costs; and thirdly, on the lack of operating experience, expertise and proven operational systems of some MFI sponsors/management (e.g., those outside the MFI Holding Company affiliates). In contrast, the weighted average of the administrative and non-interest operating expenses of the SME-FIs is only equivalent to 7.0 percent of total loans. Interest paid on deposits range from negligible (i.e., close to 0 percent) to about 12 percent with a weighted average of about 3.7 percent and a median of 2.7 percent. Interest paid on debt range from 0 percent (subsidized debt) to about 14 percent with a weighted average of about 5.3 percent and a median of about 5.9 percent. As in the case of high administrative expenses, high-cost debt is also generally associated with extremely difficult political, security, and social country conditions. On average, deposits cost MFIs about 160 basis points less than debts, even with some subsidized debts included. Furthermore, the 6 MFIs with a 50 percent or higher ratio of deposits to total assets also have the lowest administrative and operating expenses, ranging from about 5 percent to about 18 percent of total loans (weighted average of about 12 percent and median of about 11.5 percent). In contrast, the 15 MFIs with less than 50 percent deposits to total assets, have administrative and operating expenses ranging from about 11 percent to about 38 percent of total loans (weighted average of about 21 percent and median of about 15 percent). The incremental costs of mobilizing deposits appear small relative to the impact of country or local conditions on the administrative and operating costs of an MFI. The advantage of the lower cost of deposits relative to debt (about 160 basis points for the MFIs in the study population) and the small incremental cost of mobilizing deposits, suggest that MFI regulations that allow deposit taking and branch networks, will facilitate the success of MFIs. Deposits also obviate the need for subsidized loans, although the overall impact of subsidized debts appear relatively small in the MFI study population in the sense that MFIs with high ratios of debt to total assets (i.e., the 7 MFIs with debt of at least 50 percent of assets), also tend to have high average interest cost for debt, ranging from about 4 percent to 13 percent, with a weighted average of about 8.6 percent and a median of about 8 percent. Finally, foreign currency debt, which is the dominant form of MFI debts, carries a local currency devaluation risk for the MFI which it usually does not pass-on to borrowers. Some MFIs “hedge” their foreign currency debts by depositing the foreign funds in commercial banks, and using the foreign funds as collateral for local currency loans from the banks, which the MFIs then use to lend to its clients. However, this type of hedging transaction generally

involves a negative interest spread or “negative carry” for the MFI, in that the deposit interest rate on the foreign funds earned by the MFI is less than the interest rate paid by the MFI for the local currency loan. Finally, the weighted average interest paid on debt by the MFIs (5.3 percent) is only slightly less than that paid by SME-FIs (5.6 percent), indicating that on average, the role of subsidized debts for MFIs is relatively small.

- Revenues from Loan Interest and Fees: Interest charges and fees on loans to MFI borrowers range from about 9 percent to 65 percent per year, with a weighted average of about 21 percent and a median of 23 percent. Very high lending rates (e.g., 30 percent or higher charged by 5 MFIs), are only slightly due to high funding costs, and are largely due to very high administrative and operating expenses (as a percentage of loans), as discussed under “Operating Cost Structure” earlier. Only two MFIs had average lending rates of less than 15 percent, and both had either very low or negative profitability. The MFI with the lowest average lending rate was a former NGO (nonprofit) operation recently converted into a commercially oriented (for-profit) MFI, and still had the legacy of the nonprofit culture and pricing practices.
- Non-Performing Loans (NPLs): The average 2004–05 non-performing loan rate ranged from 0.3 percent to 13 percent, with a weighted average of about 1.7 percent and a median of about 1.5 percent. These NPL rates compare favorably with the average of about 4.6 percent for 22 SME-FIs (out of the 36 SME-FIs) that provided NPL data to IFC.
- Annual Return on Assets and Equity: The 2004–05 average annual return on assets range from negative 0.7 percent to positive 7.5 percent, with a weighted average of 1.4 percent and a median of about 1.2 percent. Likewise, the weighted average return on equity range from negative 1.7 percent to positive 33 percent, with a weighted average of about 11.5 percent and a median of about 8.4 percent. Some MFIs have relatively high or satisfactory return on assets but low equity returns because of the limited debt leverage, or the underutilization of the equity “capacity” to mobilize deposits or loans, which could then allow lending to increase, thereby improving the return on equity. Other MFIs have low return on assets (and also low return on equity), because of one or more of the following factors: (i) comparatively poor management; or (ii) the legacy of the nonprofit NGO lending culture from their predecessor companies which result in low interest charges to borrowers insufficient to have a satisfactory return on assets; or (iii) extremely high operating expenses because of severe political and security problems in the country.
- Comparative Profitability and Operating Efficiency of the 13MFIs under the MFI Holding Company versus the other 8 MFIs: The 13 MFIs under the MFI Holding Company as a group earned a slightly lower return on assets (1.4 percent) compared to the 8 other MFIs as a group (1.9 percent), but had a higher return on equity (13.3 percent) compared to the 8 other MFIs as a group (6.9 percent), because of higher debt leverage for the 13 MFIs under the holding company with equity representing about 9.7 percent of total assets, compared to 24.5 percent equity to total assets for the other 8 MFIs as a group. In addition, the 13 MFIs under the MFI Holding Company earned a lower return on assets as a group because they charge a lower weighted average interest rate on their MSME loans of 20.9 percent, compared to the 22.2 percent weighted average interest charged by the other 8 MFIs as a group. Overall, the 13 MFIs under the MFI Holding Company as a group was more efficient compared to the other 8 MFIs as a group in terms of: (a) lower administrative and operating expenses equivalent to 12.5 percent of average loan outstanding against 17.0 percent for the other 8 MFIs; (b), lower nonperforming loan rate (NPL) of 1.0 percent compared to 2.3 percent for the other 8 MFIs; and (c) lower interest paid on savings deposits of 3.5 percent compared to 5.3 percent for the other 8 MFIs. Part of the efficiency advantage of the 13 MFIs under the MFI holding company is due the higher average loan amount (\$2,870/borrower versus \$700/borrower), as the 13 MFIs expanded their lending to small enterprises, and even a few

medium enterprises, and not just to microenterprises. It is also partly due to the proven and standardized business model and operating practices introduced by the MFI Holding Company, as well as the larger average asset size (\$153.5 million per MFI) of the 13 MFIs under the MFI Holding Company, compared to just \$37.3 million per MFI for the 8 other MFIs. The great value provided by the MFI Holding Company to MFI shareholders such as IFC is the full use of the equity to leverage a higher volume of loans, thus increasing the return on equity. Finally, some of the MFIs in both subgroups are in countries with restrictive banking and related regulations that were not supportive to MFIs that depressed the performance of these MFIs.

7. The table below summarizes the weighted average funding (liability) structure, operating cost structure, loan income for 2004–05, and other performance indicators as of the end of 2005, for the MFI study population, and the subgroup under the MFI holding company and the rest of the MFIs in the study population.

**Table G.1. Financial Performance Data for 21 MFIs in the Study Population**

<b>Weighted Average for 2004–05 (unless otherwise indicated)</b>	<b>Data for All 21 MFIs in the Study Population</b>	<b>Data for 13 MFIs Under an MFI Holding Company</b>	<b>Data for 8 Other MFIs</b>
Aggregate net income as % of average assets	1.4%	1.4 %	1.9 %
Aggregate net income as % of average equity <u>a/</u>	11.5%	13.3 %	6.9 %
Aggregate loan interest & fee income as % of average loans <u>b/</u>	21.1%	20.9 %	22.2 %
Aggregate administration expenses as % of average loans	13.2%	12.5 %	17.0 %
Aggregate interest paid on deposits as % of average deposits	3.7%	3.5 %	5.3 %
Aggregate interest paid on debts as % of average debt	5.3%	5.5 %	4.0 %
Average deposits as % of average assets	57.6%	59.9 %	41.6 %
Average debts as % of average assets	20.8%	30.4 %	34.2 %
Average equity as % of average assets	11.6%	9.7 %	24.2 %
Average loans as % of average assets <u>c/</u>	64.1%	63.0 %	72.0 %
Average non-performing loan (NPL) rate	1.7%	1.0 %	2.3 %
Average deposits as % of average loans	93.2%	99.3 %	55.3 %
Average number of MSME subloans per MFI (end 2005) <u>d/</u>	39,207	23,710	76,399
Average subloan size (end of 2005)	\$1,970	\$2,870	\$700
Average total assets per MFI (end of 2005)	\$109.2 million	\$153.5million	\$37.3 million
Average number of employees per MFI (end of 2005) <u>e/</u>	571	651	399
Average number of branches per MFI (end of 2004) <u>f/</u>	19	23	12
<p>Notes: a/ The annual accounting return on average equity and annual accounting return on average assets are related through the ratio of average equity to average assets. The relationship is given by the formula: (Net Income/Average Assets) = (Net Income/Average Equity) x (Average Equity/Average Assets). For commercial banks in developed countries, a "good" annual return on average equity is about 15 percent, and a "good" return on average assets is at least 1.0 percent when the minimum equity was 5 percent of total assets before the Basel I risk-adjusted capital requirements were introduced. If the minimum equity is about 10 percent of total assets, the return on average assets has to be about 1.5 percent to yield a 15-percent return on equity.</p> <p>b/ The MFIs have other sources of income such as credit life insurance, currency transfer fees, interbank loan interest, and income from short-term investments.</p> <p>c/ In addition to loans, MFIs also hold other assets such as short-term investments and interbank loans. In general, commercial banks are regulated to have not more than between 70 percent to 75 percent of assets in loans, with the balance of the assets held as liquidity and "first loss" support in the form of cash holdings, deposits with central bank, liquid government securities, and interbank overnight loans.</p> <p>d/ The average number of subloans for 17 MFIs (including 12 of 13 MFIs under the MFI holding company) with data on number of subloans. Only 5 of the other 8 MFIs have subloan data, and those without data are the smaller MFIs in terms of total assets, therefore the average number of subloans for the other 8 MFIs as a group is biased upwards.</p> <p>e/ The average number of employees for 19 MFIs (out of 21) with data on employees.</p> <p>f/ The average number of branches for 14 MFIs (out of 21) with data on the number of branches.</p>			

8. In summary, the MFI Holding Company substantially contributed to the development and financial success of the 13 MFIs under its management umbrella (compared to the eight other MFIs not under its management) in several important ways as follows:

- Lower administrative and operating expenses leading to lower interest charges to borrowers. This was partly achieved through lending to a mix of micro- and small-size

enterprises, rather than to just microenterprises, and partly through better operations, practices and systems. Lending to small-size enterprises is consistent with the broader strategy of IFC to also support SMEs, particularly in underserved markets. Expanding lending services by MFIs to small enterprises, in addition to microenterprises, is therefore both developmentally and financially sound;

- Higher mobilization rate of savings deposits relative to loans outstanding, thereby reducing reliance on foreign debts, reducing interest expenses, and reducing exposure to devaluation risk for the MFIs and their borrowers. The MFI Holding Company has adopted an operating strategy and practice of relying mainly on savings deposits and equity for lending operations in countries with very high potential of local currency depreciation. A savings deposit mobilization rate sufficient to cover both loans and working capital needs will make the MFI financially self-sufficient or sustainable, and independent of donor loan support (except for equity injections for growth);
- Maximizing the leverage of the MFIs' equity base to expand lending, thereby increasing both development reach and the return on equity.

### **Seven major factors contributed to the development success of projects in the MFI study population**

9. Seven major success drivers for MFI projects were identified by this evaluation, of which four are the microfinance intermediary project design and structuring parameters used by IFC:

- A specialized regulatory framework for microfinance intermediaries allowing, among others, access to local currency funds through a license to take deposits, establish branches, no limits on interest rates and improving business climates (fostered by reforms). Competition among microcredit providers, such as microfinance intermediaries, nonprofit NGOs, and commercial banks, as well as transparency in interest charges and fees, would be the main instruments for ensuring reasonable and affordable interest rates to borrowers. The IEG-WB review of the World Bank's line of credit operations similarly noted the importance of a good regulatory framework and competition as success drivers;
- A primary sponsor (e.g., the MFI Holding Company through its technical partner) and management specialized in microfinance intermediary operations with a proven business plan and committed to microfinance intermediary development;
- Technical assistance funded by grants to help cover the establishment cost, acquisition of operating systems and know-how, training, and professional management costs for the initial 2 or 3 years of operations;
- Transparent operations and public confidence (to help raise local currency funds);
- Good practice standards to benchmark, and hence improve, performance;
- Substantial equity participation and proactive oversight by development institutions to ensure efficient and prudent management, and to provide confidence to depositors and regulators; and
- IFC's work quality, particularly in projects with a weak MFI sponsor and management. A very experienced sponsor or technical partner can partly substitute for IFC's work quality, or overcome some shortfalls in IFC's work quality.

**Success factor #1: Supportive MFI regulatory framework providing license to take deposits, establish branches, and set adequate interest margins; and good or improving business climate**

10. MFIs, just like commercial banks, need to be and are regulated in many countries. However, some countries have not yet adopted a regulatory framework for MFIs (or have deficient frameworks that need to be reformed), and the regulations for commercial banks are not appropriate for MFIs. Just as leasing can not develop in the absence of a specific leasing regulation, MFIs also can not develop in the absence of a specific regulatory framework for MFIs. Three critical features of a supportive MFI regulatory framework are: (a) the right to take deposits, (b) the right to establish branches, and (c) the absence of controls on the level of interest rate that could be charged. MFIs need to raise local currency deposits to fund most of its loans in order to lower its cost of funds and thereby help offset the MFI's high transaction costs as well as avoid exchange rate risks for itself and/or its borrowers. The MFI should not take the foreign exchange risk if it borrowed foreign currency for relending, but the subborrowers or microenterprise clients also can not take the foreign exchange risk in most cases. The MFI also needs a large volume of customers, but stay close to them to insure timely repayment. MFIs therefore need a large branch network to be successful. Just like any other business, severe political and economic crises can adversely affect the operations of MFIs in some frontier countries with less developed, less diversified, and smaller private sectors (i.e., Eastern and Southern Europe; Central Asia), although not significantly in others (i.e., Asia and Latin America) with more developed, more diversified, and larger private sectors. Three of the five MFIs with low or unsuccessful development outcomes suffered from either or both an unsupportive regulatory framework and/or severe political/economic country problems. Improving the regulatory framework for MFIs is therefore important for the establishment and growth of commercially oriented and successful MFI industry in developing, particularly frontier, countries.

**Success factor #2: Main sponsor and management specialized in MFI operations with a proven business plan and commitment to serve microenterprises**

11. Most of the highly successful projects in the MFI study population were sponsored and managed by the MFI Holding Company, which specialized in, and had a strong commitment to, the microfinance business. IFC and other international development institutions, as well as private sector groups (consulting companies specializing in MFI operations and socially oriented pension funds), are substantial shareholders of the MFI Holding Company for almost a decade now and helped it to grow and improve its operating and management practices. It generally provided a good business plan, as well as proven operating systems and training that allowed the MFIs to quickly grow its deposit-taking as well as its lending operations, with low arrears, low operating costs and satisfactory margins. The commitment to the MFIs was also reinforced by the significant direct and indirect equity interest of the main sponsor/managers in the MFI, which aligned incentives with performance of the MFI. Two of the five MFIs with low development outcome had commercial bank sponsors for which the MFI business was not a strategic, but just a minor, business line. A third MFI with low development outcome is managed by a local NGO-type group that was not fully aggressive in growing the business and was not yet fully commercially oriented.

12. IFC is now undertaking an effort to persuade other nonprofit, socially oriented (as opposed to commercially oriented) NGOs active in microlending activities in developing countries to adopt a commercially oriented and "for-profit" approach to microlending along the lines being used by IFC and used by the MFI Holding Company. As a result, IFC has to-date supported and invested equity in ten different MFI holding entities with different technical partners as managers. These technical partners are either consultants specializing in microfinance, or NGOs previously engaged in not-for-profit microcredit programs funded by grants and/or

subsidized loans from bilateral aid agencies and private sector philanthropies. This initiative is important for IFC to pursue as it broadens the sponsorship and management base that is focused on and specialized in MFI operations, and provides some competition among such parties, which can only be good for the development of the MFI industry in developing countries.

**Box G.2. Highlights from the Key Characteristics of Successful MFIs: Case Study—Lending Technology, Lending Methodology, and Operational Strengths of an MFI in Sub-Saharan Africa**

**Lending technology.** Lending operations of this Sub-Saharan MFI were mainly driven by efficiency gains and increased lending capacity. The efficiency gains were achieved by streamlining processes and adjusting some of the loan requirements, based on experience gained with time. The goal was to halve the 16-day average processing time (from submission of application to credit committee decision) by the end of the year, which was accomplished through several improvements to the MFI's organizational structure and procedures. This MFI has three basic products: express loans, micro loans, and SME loans. Each loan officer is exclusively assigned to just one of these product categories, and loan analysis procedures and documentation requirements have been adjusted to match the specific needs of each category. From the outset, the training courses have emphasized the need to assure credit quality, and these efforts are reflected in the low arrears rate of 1.1 percent. In addition to sound training in credit analysis, what is also necessary to ensure high loan portfolio quality through continuous loan monitoring combined with a rigorous approach to handling arrears. By responding quickly to overdue installments, this MFI was able to solve most arrears cases in the early stages before they became a problem loan.

**Lending methodology.** "Know your client" is an inherent part of this MFI's lending practices. During the credit analysis phase, the MFI's loan officers inspect the client's place of business and also visit his or her home. This gives them a solid base of information, which is invaluable when it comes to monitoring the portfolio of outstanding loans. Monitoring is conducted on two levels. The first is daily monitoring of loan repayment. Every day, each loan officer receives a list of payments due on that particular day from borrowers in his or her portfolio, and any failure by borrowers to make their repayment on time show up immediately and become subject to arrears management. The second level consists of regular visits to the client during the lifetime of the loan. On these occasions, the loan officer ensures that, first, the loan is being used for the purpose specified in the loan agreement; second, the business is performing as expected and no developments give cause for concern; and, third, the visit provides an opportunity to find out whether the client is interested in receiving another loan after repayment of the current one. Only clients with a clean repayment record are entitled to a follow-on loan. This principle also contributes to maintaining a healthy portfolio.

**Operational strengths.** These include the following:

- **Credit analysis.** Credit focuses on the borrower's overall capacity to repay a loan. The analysis does not separate the finance of the household from the business the borrower runs.
- **Loan collateral.** Borrowers are asked to pledge nontraditional forms of security, such as productive assets and household items, which are easier to provide but, if seized, would be difficult to replace. The institution would adopt a policy, such as private sale contracts allowing for realization of pledged securities without court procedures (although using movable items as security for loans is permissible under host country law, the legal framework for enforcement of collateral claims is seen as weak). Personal guarantees also will be used.
- **Graduation principle.** Repeat borrowers may receive preferential treatment (in the form of lower interest rates) in recognition of savings in credit analysis; however, only clients with a clean repayment record are entitled to a follow-on loan. This principle is strictly applied and is another factor that contributes to maintaining a healthy portfolio.
- **Credit monitoring.** A performance-related salary scheme for loan officers works as an incentive for them to monitor loan performance, which is done on a daily basis. The loan officer that appraised the loan remains responsible for it until it is fully paid off.

The information technology infrastructure is constantly upgraded to the latest technology. Its latest upgrade ensured faster processing, remote access and maintenance, and greater flexibility in programming.

**Success factor #3: Technical assistance (grants) to help cover establishment cost, acquisition of operating systems and know-how, training and professional management costs for two or three years**

13. Start-up (greenfield) MFIs generally need significant technical assistance (TA) grant funds to cover start-up costs such as training, working capital needs, and procurement of operating and

management systems to provide the necessary infrastructure and systems to accelerate their learning curve and quickly achieve critical portfolio size for profitability. If grant funds are not available for these start-up expenses and they have to be funded by equity and amortized (or expensed) during the initial operating years, then the MFI will not reach profitable operations for many years. This will discourage depositors and lenders as well as private sector investors that expect a business to be profitable within one to three years of start-up. IFC and the other international development institutions that have supported the establishment of MFIs in developing countries during the past decade have developed and refined the scope of the start-up costs to be funded with technical assistance grant funds. The scope typically covers the cost of the general manager, credit manager and trainer, for about 2 to 3 years, plus the cost of training, and the acquisition of operating systems, all costing about \$2 to 4 million per MFI. One of the international development institution shareholders (acting as agent of the TA donor) or the TA donor itself, specifies the terms of reference and scope of the TA contract, selects the contractor, and pays the contractor directly (i.e., the MFI Holding Company, or the MFI management, does not select the suppliers of the goods/services to be financed by the TA grant funds, and also does not receive the TA grant funds to pay the suppliers).

14. Eighteen (out of 21) of the projects in the MFI study population received a total of about US\$54.8 million of TA grant funds (or an average of about \$3.0 million per beneficiary MFI) from international development institutions, of which about \$9.8 million (17.9 percent) was provided by IFC (table G.6). Figure 3.1 of the main report compares the regional distribution of the technical assistance funds provided by IFC and the other international development financial institutions (IFIs) to the projects in the MFI study population. The figure indicates that IFC allocated the highest percentage (67 percent) of its MFI TA in Sub-Saharan Africa, followed by Asia (26 percent). IFC allocated a limited share of its TA (9 percent) in Central and Eastern Europe, where a large TA source is available from the European Bank for Reconstruction and Development (EBRD) and other IFIs. Consequently, IFC provided TA to only 10 of the 21 projects in the MFI study population. Of the \$9.8 million of IFC TA support to these 10 MFIs, \$6.5 million was provided to 4 MFIs in Sub-Saharan Africa and \$2.6 million was provided to 3 MFIs in Asia.
15. Among the 18 MFIs that received TA grant funds, those that achieved high development outcomes were able to earn cumulative net income equal to or exceeding the TA grant funds they received within two to four years of operations. Those MFI projects that had less than successful development outcomes, are estimated to take more than 10 years to accumulate net income equal to or exceeding the TA grant funds they received. By 2005, the cumulative combined net income of the 18 MFIs that received TA grant funds exceeded the aggregate grant funds they received. With the MFI establishment and start-up expenses funded by TA grants, the 18 beneficiary MFIs achieved a combined or aggregate discounted cashflow return on invested capital (ROIC) of about 7.1 percent for the period 1998–2005. Had the MFI establishment and start-up expenses been financed by operating cashflow or equity (rather than grant funds), the profit breakeven point for the 18 MFIs as a group would have been delayed by about 5 years, and their aggregate discounted cashflow ROIC would be about 5.3 percent, or about 180 basis points lower (appendix H).

#### **Success factor #4: Transparent operations and public confidence (to help raise local currency funds)**

16. A common feature of successful MFIs that IEG-IFC visited was exemplary standards in transparent reporting. Transparency reflected the successful MFIs' sound governance, including standardized policies and procedures, publicly posting rates and service charges on the Internet, instituting credit standards, promoting transparent lending policies and commitment to customer satisfaction, and other factors that give credibility to MFIs. Transparency was important in gaining public confidence and contributed to the MFIs' ability to grow deposits, expand their loan

portfolios, and helped them to get a positive rating from rating agencies. One of the important motivations of small businesses to pay their loan back is that they also may be interested in borrowing more in the future. Based on interviews in the field with borrowers and MFIs, the MFIs that practice high standards of transparency have had significantly higher public confidence, which leads to repeat lending, acceleration of deposit growth, and expansion of subloan portfolios.

17. One example described below illustrates the impact of transparency in an MFI's operation. An MFI in the poorest and the most unstable economy of Latin America had exemplary standards in transparent reporting, as well as a reputation for integrity and service orientation, including to the poor. The MFI experienced the fastest relative growth of deposits among local banks and qualified for a favorable credit rating despite a major economic crisis in its country.

#### **Success factor # 5: Good practice operating standards to benchmark and improve performance**

18. Benchmarking operating performance helped MFIs achieve financial viability much earlier than without such benchmarks. All of the MFIs sponsored by the MFI Holding Company use a standard set of financial, operational, risk management, portfolio quality, administrative efficiency, staff efficiency, and productivity ratios and set operating performance and efficiency targets. A review of one development-oriented NGO's transition to an MFI revealed that to increase financial sustainability, the MFI changed its operating performance standards for branches from project-based criteria to institution-based criteria. Branches were compared based on returns on assets, portfolio quality, administrative efficiency, loan-to-staff ratio, and other productivity and efficiency ratios. High performance targets were set and a range of measures adopted to increase productivity. Promotion and renewal of staff contracts depended on meeting these performance criteria.

#### **Success factor #6: Substantial equity participation and proactive oversight by development institutions**

19. All projects in the MFI study population had substantial equity investments by international development institutions (directly and/or indirectly through the MFI Holding Company), NGOs, and similar development-oriented though for-profit entities (e.g., socially oriented pension funds). Traditional private sector investors generally have not invested in MFIs to-date, because of the small scale, low profitability and absence of reliable equity exit opportunities. For those MFIs with deposit-taking licenses, the substantial equity capitalization and in particular the large MDB shareholding and board participation, were factors that regulators considered in granting both the license to operate and the license to take deposits. The MDB shareholders, particularly IFC, have proactively calibrated the growth of the deposit base of the MFIs relative to total assets, in line with the evolving strength, reliability and coverage of the internal risk management and prudential monitoring capabilities of the MFIs, in order to protect depositors, particularly in the absence of deposit insurance for some of these MFIs, and the low income/economic status of most of its depositors. Only one significant fraud case was reported among the 21 projects in the MFI study population so far. This involved collusion between loan officers in a branch, and a group of borrowers, whereby collateral was substantially overvalued to obtain loans exceeding the market value of the collateral. The fraud occurred because the monitoring system of the MFI was not yet fully installed in the branch office involved with the fraud. Nonetheless, the fraud was shortly detected and criminal as well as civil prosecutions have been pursued, with substantial recoveries of the funds achieved, although full recovery is not expected. Fortunately, the MFI had a relatively small deposit base at that time (relative to total assets), and most of its funds were from shareholder equity and loans, thus the depositors were not harmed.

### **Box G.3. A microfinance bank in a European transition economy successfully pioneered agribusiness loans.**

In the early 2000s, when financial sector and banking reform had just begun in a European transition country, a new microfinance bank was established to address the large unmet demand for microcredit. IFC made an investment in the bank shortly after its establishment to help it serve a difficult market. IFC invested \$2 million in two rounds of minority equity plus two loans totaling \$12 million to underpin the bank's expansion. The bank succeeded not only in serving microenterprises, but has been particularly successful in establishing a good portfolio of agribusiness loans. After three years, the bank's loan portfolio reached almost \$121 million, while maintaining good credit quality. The microfinance bank built a strong franchise and extended branches well ahead of plans. Early on, retail business and deposits were promoted; but deposits lagged behind fast loan expansion and had short average terms, leading to material dependence on funding from IFIs until recently.

This microfinance bank is set for continued fast expansion and has made innovative inroads into viable financing for the country's private farmers, pioneering a market segment shunned by other local banks that were not yet convinced of the viability of agribusiness microfinance, turning instead to consumer credit business lines. This microfinance bank continues to stress efficiency improvements over still-high operating costs, while keeping its basic credit approach, involving high direct handling costs. The huge potential microcredit market and recent growth record have positioned the microfinance bank to improve profitability substantially with growth in its scale of operations.

The IEG-IFC field visit identified the following key factors of success:

- Management with a proven business model. The expertise of the foreign sponsor resulted in good credit technology and capacity building, emphasizing knowledge of customers and market.
- Progressive reform in the investment environment. The prospect of accession to the European Union in a later wave gave impetus to advancing economic, financial sector, and business-friendly reforms.
- Timely entry into a big potential market. The microfinance bank was established early in the reform process and entered into a large, underserved market to become a successful lender to microenterprises, particularly in the agriculture sector, in which other banks did not lend. The large underserved market also allowed for high margins and rapid balance sheet growth, both in loans and deposits.
- Substantial TA commitment. Total TA to this MFI was about 5.5 million euros.
- Dedicated local staff provided with good training and incentives. Career progression is well defined and differentiated. The bank uses loyalty schemes to retain staff. All branch staff are trained quarterly.
- Appropriate controls and risk management. The systems introduced by the foreign sponsor or partner are mostly of high standard, covering difficult areas such as risk management, all complemented by extensive staff training.

### **Success factor #7: IFC work quality**

20. Good IFC appraisal, supervision as well as role and contribution throughout the project life is essential for the success of MFI projects with weak sponsors or management. A very experienced sponsor or technical partner, such as the technical partner in the MFI Holding Company, can still achieve successful projects, even with some shortfalls in IFC's work quality.

### **The success drivers for commercially or profit-oriented private sector MFI projects apply also to MFI operations by public sector MFIs**

21. The six success drivers for commercially or profit-oriented private sector MFIs listed above also apply to commercially or profit-oriented public sector MFI projects,<sup>3</sup> except that the equity is provided by the government and the corporate oversight is provided jointly by the government as well as the long-term lenders and technical assistance providers (both generally MDBs and bilateral aid agencies). This is illustrated by one of the most successful transformations of an unprofitable public sector rural bank microfinance operation into a very

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<sup>3</sup> The discussions in this subsection are based on publicly available information through the Internet, including the three references mentioned in footnotes 10 and 11.

profitable and financially sustainable operation—the case of the Microbanking Division of the *Bank Rakyat Indonesia* (BRI). The Microbanking Division of BRI (not an IFC client, but a World Bank client) has been studied several times during the past fifteen years and is considered by recent researchers<sup>4</sup> as among the best public sector commercial or “for-profit” microfinance operation in all developing countries during the past few years. BRI has been in existence for over 100 years as a government-owned rural development bank until it was privatized through a sale of 30 percent of its shares to the public through the Jakarta Stock Exchange in late 2003.

22. During 1983–89, the Microbanking Division of BRI was transformed from an unprofitable and unsustainable business into a profitable and self-sustaining microfinance operation within BRI with financial and technical assistance from the World Bank and the Harvard Institute for International Development (which provided operational “know-how,” credit risk management procedures, and operating systems) under grant funding from the United States Agency for International Development (USAID), and injection of “seed” equity from the government.<sup>5</sup> The Division specializes in microfinance and has developed over the transformation period, effective microfinance lending techniques and operational systems, as well as savings deposit mobilization expertise. While it has also developed operational benchmarks for performance that apply across its branch network, it is not clear (from the publicly available information) how good these benchmarks are compared to those used by the MFIs under the MFI Holding Company, and it is also not clear how good and extensive is the staff training program of the BRI Microbanking Division. This transformation was supported by several government policy and regulatory reforms that provided a supportive framework for rural banks and microfinance as follows:<sup>6</sup> (a) deregulation of interest rates and removal of credit ceilings in 1983, (b) passage of a rural banking law in 1988 to encourage and integrate rural banks and microfinance as part of the financial sector, by among others, removing restrictions on the establishments of branches and defining a reasonable minimum capital requirement for small rural and microfinance banks at the district level, (c) phaseout of 32 of the 39 subsidized credit programs of the government in 1990; (d) passage of a new banking law in 1992 recognizing commercial banks and rural banks, and two banking laws in 1998 and 1999, respectively, to strengthen bank regulations by the Bank of Indonesia and to support Islamic banking in the country; (e) improving prudential regulations and supervision by Bank of Indonesia during 1997–2002; and (f) passing of a microfinance law in 2002 to provide a specific regulatory framework for both public sector and private sector commercially or profit-oriented MFIs and to protect depositors. Finally, several microfinance advocacy institutions assisted in the commercialization of a wide variety of MFIs in Indonesia. Two of the main advocacy institutions are the Indonesian Movement for Microfinance Development and the *Perbarindo*, the main national association of the locally owned peoples’ credit banks (the *Bank Pekreditan Rakyat* or BPRs, which are concentrated in the urban areas of the islands of Java and Bali). Among developing countries, Indonesia today has one of the most supportive policy and regulatory framework for the

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<sup>4</sup> See for example “The Microbanking Division of Bank Rakyat Indonesia: A Flagship of Rural Microfinance in Asia” by Hans Dieter Seibel, 2004, (email address [Seibel@uni-koeln.de](mailto:Seibel@uni-koeln.de)) published in “Small Customers, Big Market: Commercial Banks in Micro-Finance,” edited by Malcolm Harper & Sukwinder Arora, ITDG Publications, Rugby 2005.

<sup>5</sup> The transformation of the Microbanking Division of BRI begun in 1983, and involved a government equity injection of Rp 210 million in 1984 (at that time equivalent to about \$20 million) to support the microfinance operations. The technical assistance services were provided by the Harvard Institute for International Development initially funded by USAID. World Bank provided a loan of \$5 million for technical assistance in 1987 and another loan of \$97 million in 1989 for re-lending to microenterprises.

<sup>6</sup> See the report “Commercialization of Microfinance: Indonesia,” by Ismah Afwa and Stephanie Charitonenko (consultants), Asian Development Bank (ADB), November 2003. The report can be downloaded from the ADB website [www.adb.org](http://www.adb.org).

establishment and growth of both public sector and private sector commercially or profit-oriented MFIs.

23. The Microbanking Division of BRI has been continuously profitable since 1985 and helped BRI survive the Asian Crisis in 1997–98, and the residual effects of the crisis during 1999–2002, when all the other divisions of BRI operated at a loss. The Microbanking Division of BRI operates nationwide and is now the largest microfinance entity in Indonesia in terms of assets, number of savings depositors and number of microenterprise borrowers. Its good financial performance is demonstrated by the following indicators:

- Return on assets of 4.7 percent and 4.9 percent in 1997 and 1998 respectively (during the Asian Crisis), which improved to between 5.7 percent and 6.4 percent during 1999–2003;
- Relatively low loan arrears (i.e., overdue payments of one day or more) of 4.7 percent in 1997 and 5.7 percent in 1998 respectively, during the Asian Crisis, which dropped to a range of 1.6 percent to 2.5 percent during 2000–03.
- At the end of 2003, it had 4,185 branches throughout the country, 30 million depositors with saving deposits of about \$3.5 billion, 3.1 million microenterprise borrowers with an aggregate loan outstanding of about \$1.7 billion.
- Its savings deposits to loan ratio increased from an average of only about 38 percent during 1984–85 to a range of 174 percent to 344 percent during 1992–2003. During 2002–03, it mobilized slightly over two times more savings deposits than it lent out as loans, indicating that there is substantial demand for savings deposit services in the rural areas of Indonesia, in addition to a large demand for microcredit services. Thus since 1990, the Microbanking Division could rely solely on its deposit base to make profitable loans while maintaining adequate liquidity, and has therefore been self-sufficient in terms of funding sources for over 15 years.
- BRI was privatized in late 2003 when 30 percent of its shares were listed in the Jakarta Stock Exchange.

**Table G.2. Aggregate Financial Data for 21 MFIs in the Study Population**

Project Code Name	Approval Sub-period <sup>1/</sup>	Equity	Loan	TA	Start-up vs. Conversion	As of End 2005					Two-Year (2004 & 2005) Averages											
						Number of MSME Borrowers	Number of Branches	Number of Employees	Total Loans in US\$000	Total Assets in US\$000	Funding (Liability) Structure (as % of average assets)			Ave. Deposits as % of Ave. Loans	Ave. Loans as % of Ave. Assets	Income & Fees from Loans as % of Ave. Loans	Cost Structure			NPL Rate (as of Yr-end 2005)	Weighted Average Return on	
											Average Deposits	Average Debt	Average Equity				Non-Interest Expense as % of Ave. Loans	Interest Expense as % of Ave. Deposits	Other Interest Expenses as % of Ave. Debt		Ave. Assets	Ave. Equity
MFI-1	Sub-period 3	✓		✓	Start-up	17,627	18	492	203,802	451,469	90.4%	4.9%	4.7%	235.6%	38.4%	22.0%	11.1%	1.47%	14.28%	0.55%	1.42%	30.78%
MFI-2	Sub-period 2	✓		✓	Start-up	17,761	15	489	99,017	229,363	80.1%	9.9%	9.6%	167.1%	47.9%	18.6%	11.1%	3.16%	2.33%	2.45%	1.30%	13.76%
MFI-3	Sub-period 3	✓	✓		Start-up	35,625	28	990	226,373	325,408	59.1%	31.3%	9.4%	82.7%	71.4%	16.7%	11.6%	5.03%	0%	0.65%	1.75%	18.06%
MFI-4	Sub-period 1	✓		✓	Conversion	63,245	30	397	35,090	52,294	56.7%	20.3%	23.0%	79.1%	71.7%	18.6%	17.5%	2.71%	7.00%	11.00%	1.78%	7.03%
MFI-5	Sub-period 3		✓		Conversion	23,583	39	617	31,187	48,528	51.3%	32.9%	15.8%	79.8%	64.3%	9.4%	4.7%	3.60%	4.7%	0.69%	1.08%	6.50%
MFI-6	Sub-period 2		✓		Conversion	61,514	4	733	148,278	181,413	51.1%	34.4%	10.4%	61.9%	82.5%	19.1%	13.0%	4.42%	5.84%	1.67%	1.12%	10.41%
MFI-7	Sub-period 3	✓		✓	Start-up	na	na	193	6,893	9,028	46.1%	17.4%	31.7%	62.8%	73.4%	45.0%	33.2%	6.96%	13.07%	4.51%	3.33%	9.17%
MFI-8	Sub-period 3	✓		✓	Start-up	138,141	139	2,484	99,997	123,872	45.0%	24.3%	18.2%	56.3%	79.9%	28.0%	18.9%	8.46%	0%	0.31%	3.66%	17.75%
MFI-9	Sub-period 3	✓		✓	Start-up	16,931	na	258	6,387	24,096	42.9%	7.3%	52.6%	188.0%	22.8%	15.0%	37.3%	2.66%	0%	5.10%	-0.68%	-1.28%
MFI-10	Sub-period 3	✓	✓	✓	Start-up	27,163	155	1,002	172,447	210,680	41.0%	45.3%	10.9%	51.6%	79.5%	21.0%	11.3%	5.72%	8.37%	0.64%	1.72%	13.77%
MFI-11	Sub-period 3	✓			Start-up	na	na	217	6,900	9,552	39.9%	27.2%	31.8%	57.9%	69.0%	35.5%	38.6%	4.37%	5.70%	1.81%	-0.68%	-1.60%
MFI-12	Sub-period 2	✓		✓	Start-up	25,727	18	415	95,575	122,128	38.5%	45.6%	13.0%	47.0%	81.9%	17.6%	13.0%	2.66%	3.40%	0.75%	1.72%	11.97%
MFI-13	Sub-period 2	✓		✓	Start-up	26,452	22	731	134,144	183,982	38.0%	46.8%	15.2%	53.0%	71.7%	20.4%	12.6%	4.08%	6.31%	1.44%	0.90%	5.53%
MFI-14	Sub-period 3	✓		✓	Start-up	18,655	12	486	102,739	152,445	37.5%	50.3%	12.2%	53.8%	69.6%	26.2%	13.9%	12.22%	4.21%	1.18%	0.02%	0.36%
MFI-15	Sub-period 3		✓		Start-up	30,974	11	286	73,318	83,400	19.9%	63.3%	14.9%	22.9%	87.1%	28.0%	13.4%	4.84%	8.36%	0.99%	2.17%	12.66%
MFI-16	Sub-period 3	✓		✓	Conversion	140,095	na	619	13,068	15,375	11.9%	46.6%	39.8%	14.9%	80.0%	22.9%	19.5%	0%	8.20%	1.79%	0.83%	1.90%
MFI-17	Sub-period 3	✓			Start-up	na	na	72 <sup>2/</sup>	10,534	10,806	11.6%	66.0%	22.4%	12.0%	96.9%	11.7%	12.4%	0%	6.30%	13.10%	-0.23%	-1.07%
MFI-18	Sub-period 3	✓		✓	Start-up	4,999	3	214	17,907	21,844	2.6%	54.7%	42.0%	3.1%	83.7%	30.2%	19.7%	0%	9.19%	1.01%	0.69%	1.20%
MFI-19	Sub-period 2	✓		✓	Start-up	7,297	na	na	6,511	10,386	0%	83.3%	12.2%	na	62.3%	65.0%	37.1%	na	12.29%	5.46%	-0.75%	-1.76%
MFI-20	Sub-period 3	✓	✓	✓	Start-up	10,727	15	163	18,718	26,154	0%	88.1%	4.3%	na	70.5%	24.3%	12.9%	na	7.50%	1.15%	1.44%	33.53%
MFI-21	Sub-period 3	✓		✓	Start-up	na	na	na	750	1,463	0%	86.4%	13.6%	na	51.9%	19.1%	42.4%	na	5.48%	1.90%	-9.45%	-48.95%

Project Code Name	As of End 2005		Two-Year (2004 & 2005) Averages											
	Total Loans in US\$000	Total Assets in US\$000	Funding (Liability) Structure (as % of average assets)			Ave. Deposits as % of Ave. Loans	Ave. Loans as % of Ave. Assets	Income & Fees from Loans as % of Ave. Loans	Cost Structure			NPL Rate (as of Yr-end 2005)	Weighted Average Return on	
			Average Deposits	Average Debt	Average Equity				Non-Interest Expense as % of Ave. Loans	Interest Expense as % of Ave. Deposits	Other Interest Expenses as % of Ave. Debt		Ave. Assets	Ave. Equity
Aggregate 21	1,509,635	2,293,686	57.6%	29.1%	11.6%	89.9%	64.1%	21.1%	13.2%	3.7%	5.3%	na	1.43%	11.54%
Aggregate 13	1,294,715	1,995,408	59.9%	29.2%	9.7%	95.1%	63.0%	20.9%	12.5%	3.5%	5.5%	na	1.36%	13.29%
Aggregate 8	214,920	298,278	41.6%	28.5%	24.5%	57.8%	72.0%	22.2%	17.0%	5.3%	4.0%	na	1.89%	6.89%

Note:

1/ Approval FY94-96 = Sub-period 1; FY97-99 = Sub-period 2; and FY00-02 = Sub-period 3

2/ 2004 Data

3/ The project names will be deleted in the final annex to disguise the projects.

## Aggregate Financial Statements of 21 MFIs in the Study Population

### Balance Sheet (In US\$ thousands)

Financial Statement Date	1998	1999	2000	2001	2002	2003	2004	2005
Cash & Due From Banks (Non-Int Bearing)	3,838	5,064	11,750	31,174	116,277	136,752	223,663	324,011
Interest Earning Deposits and ST Securities	877	13,091	30,460	44,541	290,836	267,107	386,307	294,604
Accrued Interest Receivable	0	151	987	889	2,626	1,548	1,929	2,357
Other Account Receivables	0	0	0	582	1,881	2,155	2,095	1,909
Microfinance and SME Loans	7,689	57,181	108,974	165,447	338,949	634,799	1,083,666	1,515,059
Unearned Income (-)	0	0	0	736	1,004	0	1,324	5,424
<b>Total Loans</b>	<b>7,689</b>	<b>57,181</b>	<b>108,974</b>	<b>164,711</b>	<b>337,945</b>	<b>634,799</b>	<b>1,082,342</b>	<b>1,509,635</b>
Allowance for Loan Loss Reserve (-)	397	2,910	5,746	9,377	13,549	19,149	26,692	40,334
Net Loans	7,292	54,271	103,228	155,335	324,397	615,650	1,055,650	1,469,301
LT Loans and Investments in Government	2	3	2	1,334	14,467	15,780	4,663	7,209
LT Loans and Investments in Private Companies	0	432	402	44	99	41,008	83	100,167
Net Fixed Assets	605	2,249	5,690	8,416	19,646	30,765	49,145	64,904
OREO + Intangible Assets	0	78	165	560	1,575	337	3,313	3,231
Other Assets	103	592	1,539	4,098	5,873	13,065	21,064	25,997
<b>TOTAL ASSETS</b>	<b>12,719</b>	<b>75,931</b>	<b>154,220</b>	<b>246,355</b>	<b>777,678</b>	<b>1,124,162</b>	<b>1,747,906</b>	<b>2,293,686</b>
Demand Deposits (Non-Int Bearing)	0	4,911	6,847	18,428	224,232	265,102	278,157	258,615
Other Non-Int Bearing Deposits	0	0	0	0	510	953	1,354	1,813
Savings Deposits	188	1,484	3,946	15,030	23,630	43,992	96,112	158,677
All Other Int Bearing Deposits	63	14,987	28,215	51,807	221,761	342,173	627,709	907,223
<b>Total Deposits</b>	<b>251</b>	<b>21,382</b>	<b>39,009</b>	<b>85,267</b>	<b>470,134</b>	<b>652,218</b>	<b>1,003,331</b>	<b>1,326,327</b>
ST Debt	0	0	500	3,429	7,721	39,302	43,819	122,955
Total LT Debt	8,286	35,052	64,377	80,022	134,444	222,576	421,999	504,911
Other Term Debt	2	497	704	1,637	10,862	14,847	10,427	4,115
Commercial Paper and Bond Outstanding	0	0	0	0	88	2,453	9,988	21,656
Total Int Bearing Debt	8,288	35,549	65,581	85,088	153,115	279,178	486,233	653,637
Non-Int Bearing LT Debt	90	0	340	758	4,845	8,746	13,810	22,363
Other Non-Int Bearing Debt	0	0	0	0	158	149	267	356
<b>Total Debt</b>	<b>8,378</b>	<b>35,548</b>	<b>65,921</b>	<b>85,844</b>	<b>158,117</b>	<b>288,073</b>	<b>500,306</b>	<b>676,360</b>
Subordinated LT Debt	0	1,731	11,904	16,502	16,999	8,830	12,024	25,266
<b>Total Accrued and Deferred Liabilities</b>	<b>40</b>	<b>2,564</b>	<b>5,541</b>	<b>9,017</b>	<b>10,287</b>	<b>10,445</b>	<b>12,282</b>	<b>18,193</b>
<b>TOTAL LIABILITIES AND SUBORDINATED DE...</b>	<b>8,670</b>	<b>61,226</b>	<b>122,377</b>	<b>196,631</b>	<b>655,536</b>	<b>959,565</b>	<b>1,527,944</b>	<b>2,046,146</b>
Common Stock	3,506	12,604	27,050	41,967	106,447	142,037	183,079	191,282
Surplus and Other Items	0	0	0	109	2,426	4,771	3,397	4,800
Capital and Revaluation Reserves	0	898	2,076	2,915	5,849	6,491	7,345	8,819
Adj from Foreign Curr Trans	0	623	621	926	1,008	(19)	0	0
Retained Earnings	542	581	2,095	3,803	6,413	11,316	26,139	42,643
<b>TOTAL EQUITY</b>	<b>4,048</b>	<b>14,704</b>	<b>31,843</b>	<b>49,720</b>	<b>122,141</b>	<b>164,599</b>	<b>219,962</b>	<b>247,541</b>
<b>TOTAL LIABS &amp; EQUITY</b>	<b>12,719</b>	<b>75,931</b>	<b>154,220</b>	<b>246,355</b>	<b>777,678</b>	<b>1,124,162</b>	<b>1,747,906</b>	<b>2,293,686</b>

### Income Statement (In US\$ thousands)

Financial Statement Date	1998	1999	2000	2001	2002	2003	2004	2005
<b>INCOME</b>								
Int Income & Fees on Loans	1,191	12,247	22,036	37,438	72,098	118,210	189,905	273,127
Int Income on other investments	143	84	1,679	2,681	8,704	3,801	6,125	7,288
<b>TOTAL INTEREST INCOME</b>	<b>1,334</b>	<b>12,332</b>	<b>23,714</b>	<b>40,119</b>	<b>80,804</b>	<b>122,012</b>	<b>196,029</b>	<b>280,414</b>
Interest Exp on Deposits	2	3,087	4,086	4,918	5,149	11,840	26,714	43,028
Interest Exp on Borrowings/Other Brwd Funds	85	263	1,684	4,234	9,485	12,425	18,226	29,082
Interest Exp on Subord Debt	0	0	0	122	702	481	0	0
Other Interest Exp	0	0	0	1	0	61	1,357	2,065
<b>TOTAL INTEREST EXPENSE</b>	<b>87</b>	<b>3,350</b>	<b>5,771</b>	<b>9,275</b>	<b>15,337</b>	<b>24,808</b>	<b>46,295</b>	<b>74,173</b>
<b>NET INTEREST INCOME</b>	<b>1,247</b>	<b>8,979</b>	<b>17,942</b>	<b>30,843</b>	<b>65,464</b>	<b>97,206</b>	<b>149,733</b>	<b>206,241</b>
Provision for Loan Losses	162	2,019	4,006	5,485	5,777	6,876	11,588	26,869
<b>INT INC NET OF LOSS PROV</b>	<b>1,085</b>	<b>6,960</b>	<b>13,936</b>	<b>25,359</b>	<b>59,689</b>	<b>90,329</b>	<b>138,147</b>	<b>179,372</b>
Fee and Other Income	161	1,194	2,474	4,601	7,031	13,599	18,965	29,045
Exceptional Items	0	0	(49)	0	0	0	0	0
<b>TOTAL NON-INTEREST INCOME</b>	<b>160</b>	<b>1,195</b>	<b>2,425</b>	<b>4,600</b>	<b>7,032</b>	<b>13,598</b>	<b>18,962</b>	<b>29,046</b>
<b>TOTAL REVENUE</b>	<b>1,245</b>	<b>8,155</b>	<b>16,361</b>	<b>29,959</b>	<b>66,721</b>	<b>103,927</b>	<b>157,109</b>	<b>208,418</b>
Salaries/Employee Benefits Expense	256	903	3,782	7,494	15,347	21,926	46,370	68,337
Administrative Expense	422	5,814	9,140	14,893	38,016	59,917	76,142	89,220
Depreciation/Amortization	93	225	622	1,577	3,681	4,116	8,296	13,056
<b>TOTAL NON-INTEREST EXPENSE</b>	<b>773</b>	<b>6,947</b>	<b>13,542</b>	<b>23,965</b>	<b>57,043</b>	<b>85,957</b>	<b>130,811</b>	<b>170,612</b>
<b>OPERATING INCOME</b>	<b>472</b>	<b>1,208</b>	<b>2,819</b>	<b>5,993</b>	<b>9,678</b>	<b>17,970</b>	<b>26,298</b>	<b>37,806</b>
INC B4 TAX, EXTRAORD & SECURITIES	472	1,208	2,819	5,993	9,240	18,237	25,892	37,447
Income Tax	0	339	675	949	2,786	4,598	6,265	7,885
Adjustment to net income	0	(87)	(124)	96	1,049	(665)	(132)	324
<b>NET INCOME</b>	<b>472</b>	<b>782</b>	<b>2,020</b>	<b>5,141</b>	<b>7,503</b>	<b>12,974</b>	<b>19,495</b>	<b>29,886</b>

### Table G.3. Aggregate Financial Statements of 13 MFIs under the MFI Holding Company

<b>Balance Sheet (In US\$ thousands)</b>								
<b>Financial Statement Date</b>	<b>1998</b>	<b>1999</b>	<b>2000</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>
Cash & Due From Banks (Non-Int Bearing)	3,835	4,975	10,449	28,566	109,783	126,945	204,776	293,372
Interest Earning Deposits and ST Securities	872	12,973	19,927	38,126	279,803	254,554	359,768	264,226
Accrued Interest Receivable	0	45	335	260	1,813	381	921	644
Other Account Receivables	0	0	0	570	1,881	2,155	2,095	1,909
Microfinance and SME Loans	7,628	55,735	85,139	128,776	280,041	541,760	935,735	1,300,139
Unearned Income (-)	0	0	0	0	0	0	1,324	5,424
<b>Total Loans</b>	<b>7,628</b>	<b>55,735</b>	<b>85,139</b>	<b>128,776</b>	<b>280,041</b>	<b>541,760</b>	<b>934,411</b>	<b>1,294,715</b>
Allowance for Loan Loss Reserve (-)	396	2,909	4,984	8,336	12,555	16,758	23,062	35,795
Net Loans	7,232	52,826	80,155	120,441	267,486	525,002	911,349	1,258,920
LT Loans and Investments in Government	0	0	0	0	90	0	2,981	3,987
LT Loans and Investments in Private Companies	0	432	402	44	99	41,008	83	100,167
Net Fixed Assets	603	2,218	3,804	6,184	15,482	25,142	41,070	50,540
OREO + Intangible Assets	0	78	165	556	421	287	2,187	1,167
Other Assets	96	570	1,399	3,021	4,703	10,107	17,134	20,478
<b>TOTAL ASSETS</b>	<b>12,639</b>	<b>74,116</b>	<b>116,633</b>	<b>197,150</b>	<b>681,563</b>	<b>985,578</b>	<b>1,542,359</b>	<b>1,995,408</b>
Demand Deposits (Non-Int Bearing)	0	4,911	6,847	14,837	217,349	249,370	268,584	244,763
Other Non-Int Bearing Deposits	0	0	0	0	0	94	0	0
Savings Deposits	183	1,479	3,946	10,670	9,382	26,591	70,752	125,076
All Other Int Bearing Deposits	0	14,925	24,781	51,807	218,971	329,848	583,134	827,570
<b>Total Deposits</b>	<b>183</b>	<b>21,315</b>	<b>35,575</b>	<b>77,315</b>	<b>445,703</b>	<b>605,901</b>	<b>922,469</b>	<b>1,197,408</b>
ST Debt	0	0	500	2,352	4,335	29,383	30,551	110,610
Total LT Debt	8,285	34,933	56,076	72,302	125,027	207,921	384,284	434,907
Other Term Debt	0	0	0	240	8,727	13,346	8,131	2,493
Commercial Paper and Bond Outstanding	0	0	0	0	88	2,453	9,988	21,656
Total Int Bearing Debt	8,285	34,933	56,576	74,894	138,177	253,103	432,954	569,666
Non-Int Bearing LT Debt	90	0	254	331	4,046	6,257	11,590	18,424
Other Non-Int Bearing Debt	0	0	0	0	158	125	144	227
<b>Total Debt</b>	<b>8,375</b>	<b>34,933</b>	<b>56,830</b>	<b>75,224</b>	<b>142,380</b>	<b>259,483</b>	<b>444,685</b>	<b>588,321</b>
Subordinated LT Debt	0	1,731	557	2,805	3,280	107	3,298	13,906
<b>Total Accrued and Deferred Liabilities</b>	<b>35</b>	<b>2,412</b>	<b>3,619</b>	<b>6,161</b>	<b>7,342</b>	<b>7,860</b>	<b>9,710</b>	<b>13,709</b>
<b>TOTAL LIABILITIES AND SUBORDINATED DE...</b>	<b>8,593</b>	<b>60,391</b>	<b>96,582</b>	<b>161,507</b>	<b>598,704</b>	<b>873,351</b>	<b>1,380,163</b>	<b>1,813,344</b>
Common Stock	3,503	11,647	15,701	29,273	71,376	96,550	134,872	139,347
Surplus and Other Items	0	0	0	109	2,290	4,426	1,829	4,810
Capital and Revaluation Reserves	0	876	2,033	2,634	3,638	3,653	3,967	3,862
Adj from Foreign Curr Trans	0	623	621	926	1,001	4	0	0
Retained Earnings	541	580	1,694	2,697	4,554	7,593	21,527	34,048
<b>TOTAL EQUITY</b>	<b>4,045</b>	<b>13,724</b>	<b>20,050</b>	<b>35,640</b>	<b>82,858</b>	<b>112,228</b>	<b>162,197</b>	<b>182,065</b>
<b>TOTAL LIABS &amp; EQUITY</b>	<b>12,639</b>	<b>74,116</b>	<b>116,633</b>	<b>197,150</b>	<b>681,563</b>	<b>985,578</b>	<b>1,542,359</b>	<b>1,995,408</b>
<b>Income Statement (In US\$ thousands)</b>								
<b>Financial Statement Date</b>	<b>1998</b>	<b>1999</b>	<b>2000</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>
<b>INCOME</b>								
Int Income & Fees on Loans	1,186	11,993	17,943	26,724	58,595	96,471	158,365	232,862
Int Income on other investments	143	81	996	1,966	7,422	2,091	5,098	5,602
<b>TOTAL INTEREST INCOME</b>	<b>1,329</b>	<b>12,074</b>	<b>18,939</b>	<b>28,690</b>	<b>66,018</b>	<b>98,562</b>	<b>163,462</b>	<b>238,465</b>
Interest Exp on Deposits	0	3,085	3,994	4,733	4,856	10,203	22,852	37,427
Interest Exp on Borrowings/Other Brwd Funds	85	200	898	2,278	8,412	11,040	16,675	26,210
Interest Exp on Subord Debt	0	0	0	0	0	0	0	0
Other Interest Exp	0	0	0	1	0	61	1,357	2,065
<b>TOTAL INTEREST EXPENSE</b>	<b>85</b>	<b>3,285</b>	<b>4,892</b>	<b>7,012</b>	<b>13,268</b>	<b>21,306</b>	<b>40,882</b>	<b>65,700</b>
<b>NET INTEREST INCOME</b>	<b>1,244</b>	<b>8,787</b>	<b>14,045</b>	<b>21,678</b>	<b>52,748</b>	<b>77,260</b>	<b>122,579</b>	<b>172,765</b>
Provision for Loan Losses	162	2,019	3,519	5,393	4,652	5,004	10,490	24,989
<b>INT INC NET OF LOSS PROV</b>	<b>1,082</b>	<b>6,768</b>	<b>10,526</b>	<b>16,286</b>	<b>48,097</b>	<b>72,254</b>	<b>112,091</b>	<b>147,777</b>
Fee and Other Income	159	1,175	2,069	3,593	5,433	11,735	16,887	23,288
Exceptional Items	0	0	0	0	0	0	0	0
<b>TOTAL NON-INTEREST INCOME</b>	<b>158</b>	<b>1,176</b>	<b>2,069</b>	<b>3,591</b>	<b>5,434</b>	<b>11,735</b>	<b>16,884</b>	<b>23,289</b>
<b>TOTAL REVENUE</b>	<b>1,240</b>	<b>7,944</b>	<b>12,595</b>	<b>19,877</b>	<b>53,531</b>	<b>83,989</b>	<b>128,975</b>	<b>171,066</b>
Salaries/Employee Benefits Expense	255	826	2,074	3,929	10,651	14,453	34,692	51,330
Administrative Expense	420	5,726	7,827	11,800	32,315	52,669	65,884	77,842
Depreciation/Amortization	93	224	410	1,011	2,775	2,816	6,655	10,561
<b>TOTAL NON-INTEREST EXPENSE</b>	<b>769</b>	<b>6,778</b>	<b>10,310</b>	<b>16,741</b>	<b>45,740</b>	<b>69,937</b>	<b>107,234</b>	<b>139,734</b>
<b>OPERATING INCOME</b>	<b>471</b>	<b>1,166</b>	<b>2,285</b>	<b>3,135</b>	<b>7,791</b>	<b>14,052</b>	<b>21,741</b>	<b>31,332</b>
<b>INC B4 TAX, EXTRAORD &amp; SECURITIES</b>	<b>471</b>	<b>1,166</b>	<b>2,285</b>	<b>3,135</b>	<b>7,353</b>	<b>14,319</b>	<b>21,295</b>	<b>30,973</b>
Income Tax	0	317	476	622	2,188	3,397	4,821	6,210
Adjustment to net income	0	(87)	(124)	96	1,041	(665)	(238)	349
<b>NET INCOME</b>	<b>471</b>	<b>762</b>	<b>1,685</b>	<b>2,610</b>	<b>6,206</b>	<b>10,257</b>	<b>16,236</b>	<b>25,112</b>

**Table G.4. Aggregate Financial Statements of the 8 MFIs outside the MFI Holding Company Group**

**Balance Sheet (In US\$ thousands)**

Financial Statement Date	1998	1999	2000	2001	2002	2003	2004	2005
Cash & Due From Banks (Non-Int Bearing)	3	89	1,301	2,608	6,494	9,807	18,887	30,639
Interest Earning Deposits and ST Securities	5	118	10,533	6,415	11,033	12,553	26,539	30,378
Accrued Interest Receivable	0	106	652	629	813	1,167	1,008	1,713
Other Account Receivables	0	0	0	12	0	0	0	0
Microfinance and SME Loans	61	1,446	23,835	36,671	58,908	93,039	147,931	214,920
Unearned Income (-)	0	0	0	736	1,004	0	0	0
<b>Total Loans</b>	<b>61</b>	<b>1,446</b>	<b>23,835</b>	<b>35,935</b>	<b>57,904</b>	<b>93,039</b>	<b>147,931</b>	<b>214,920</b>
Allowance for Loan Loss Reserve (-)	1	1	762	1,041	994	2,391	3,630	4,539
Net Loans	60	1,445	23,073	34,894	56,911	90,648	144,301	210,381
LT Loans and Investments in Government	2	3	2	1,334	14,377	15,780	1,682	3,222
LT Loans and Investments in Private Companies	0	0	0	0	0	0	0	0
Net Fixed Assets	2	31	1,886	2,232	4,164	5,623	8,075	14,364
OREO + Intangible Assets	0	0	0	4	1,154	50	1,126	2,064
Other Assets	7	22	140	1,077	1,170	2,958	3,930	5,519
<b>TOTAL ASSETS</b>	<b>80</b>	<b>1,815</b>	<b>37,587</b>	<b>49,205</b>	<b>96,115</b>	<b>138,584</b>	<b>205,547</b>	<b>298,278</b>
Demand Deposits (Non-Int Bearing)	0	0	0	3,591	6,883	15,732	9,573	13,852
Other Non-Int Bearing Deposits	0	0	0	0	510	859	1,354	1,813
Savings Deposits	5	5	0	4,360	14,248	17,401	25,360	33,601
All Other Int Bearing Deposits	63	62	3,434	0	2,790	12,325	44,575	79,653
<b>Total Deposits</b>	<b>68</b>	<b>67</b>	<b>3,434</b>	<b>7,952</b>	<b>24,431</b>	<b>46,317</b>	<b>80,862</b>	<b>128,919</b>
ST Debt	0	0	0	1,077	3,386	9,919	13,268	12,345
Total LT Debt	1	119	8,301	7,720	9,417	14,655	37,715	70,004
Other Term Debt	2	497	704	1,397	2,135	1,501	2,296	1,622
Commercial Paper and Bond Outstanding	0	0	0	0	0	0	0	0
Total Int Bearing Debt	3	616	9,005	10,194	14,938	26,075	53,279	83,971
Non-Int Bearing LT Debt	0	0	86	427	799	2,489	2,220	3,939
Other Non-Int Bearing Debt	0	0	0	0	0	24	123	129
<b>Total Debt</b>	<b>3</b>	<b>615</b>	<b>9,091</b>	<b>10,620</b>	<b>15,737</b>	<b>28,590</b>	<b>55,621</b>	<b>88,039</b>
Subordinated LT Debt	0	0	11,347	13,697	13,719	8,723	8,726	11,360
<b>Total Accrued and Deferred Liabilities</b>	<b>5</b>	<b>152</b>	<b>1,922</b>	<b>2,856</b>	<b>2,945</b>	<b>2,585</b>	<b>2,572</b>	<b>4,484</b>
<b>TOTAL LIABILITIES AND SUBORDINATED DE...</b>	<b>77</b>	<b>835</b>	<b>25,795</b>	<b>35,124</b>	<b>56,832</b>	<b>86,214</b>	<b>147,781</b>	<b>232,802</b>
Common Stock	3	957	11,349	12,694	35,071	45,487	48,207	51,935
Surplus and Other Items	0	0	0	0	136	345	1,568	(10)
Capital and Revaluation Reserves	0	22	43	281	2,211	2,838	3,378	4,957
Adj from Foreign Curr Trans	0	0	0	0	7	(23)	0	0
Retained Earnings	1	1	401	1,106	1,859	3,723	4,612	8,595
<b>TOTAL EQUITY</b>	<b>3</b>	<b>980</b>	<b>11,793</b>	<b>14,080</b>	<b>39,283</b>	<b>52,371</b>	<b>57,765</b>	<b>65,476</b>
<b>TOTAL LIABS &amp; EQUITY</b>	<b>80</b>	<b>1,815</b>	<b>37,587</b>	<b>49,205</b>	<b>96,115</b>	<b>138,584</b>	<b>205,547</b>	<b>298,278</b>

**Income Statement (In US\$ thousands)**

Financial Statement Date	1998	1999	2000	2001	2002	2003	2004	2005
<b>INCOME</b>								
Int Income & Fees on Loans	5	254	4,093	10,714	13,503	21,739	31,540	40,265
Int Income on other investments	0	3	683	715	1,282	1,710	1,027	1,686
<b>TOTAL INTEREST INCOME</b>	<b>5</b>	<b>258</b>	<b>4,775</b>	<b>11,429</b>	<b>14,786</b>	<b>23,450</b>	<b>32,567</b>	<b>41,949</b>
Interest Exp on Deposits	2	2	92	185	293	1,637	3,862	5,601
Interest Exp on Borrowings/Other Brwd Funds	0	63	786	1,956	1,073	1,385	1,551	2,872
Interest Exp on Subord Debt	0	0	0	122	702	481	0	0
Other Interest Exp	0	0	0	0	0	0	0	0
<b>TOTAL INTEREST EXPENSE</b>	<b>2</b>	<b>65</b>	<b>879</b>	<b>2,263</b>	<b>2,069</b>	<b>3,502</b>	<b>5,413</b>	<b>8,473</b>
<b>NET INTEREST INCOME</b>	<b>3</b>	<b>192</b>	<b>3,897</b>	<b>9,165</b>	<b>12,716</b>	<b>19,946</b>	<b>27,154</b>	<b>33,476</b>
Provision for Loan Losses	0	0	487	92	1,125	1,872	1,098	1,880
<b>INT INC NET OF LOSS PROV</b>	<b>3</b>	<b>192</b>	<b>3,410</b>	<b>9,073</b>	<b>11,592</b>	<b>18,075</b>	<b>26,056</b>	<b>31,595</b>
Fee and Other Income	2	19	405	1,008	1,598	1,864	2,078	5,757
Exceptional Items	0	0	(49)	0	0	0	0	0
<b>TOTAL NON-INTEREST INCOME</b>	<b>2</b>	<b>19</b>	<b>356</b>	<b>1,009</b>	<b>1,598</b>	<b>1,863</b>	<b>2,078</b>	<b>5,757</b>
<b>TOTAL REVENUE</b>	<b>5</b>	<b>211</b>	<b>3,766</b>	<b>10,082</b>	<b>13,190</b>	<b>19,938</b>	<b>28,134</b>	<b>37,352</b>
Salaries/Employee Benefits Expense	1	77	1,708	3,565	4,696	7,473	11,678	17,007
Administrative Expense	2	88	1,313	3,093	5,701	7,248	10,258	11,378
Depreciation/Amortization	0	1	212	566	906	1,300	1,641	2,495
<b>TOTAL NON-INTEREST EXPENSE</b>	<b>4</b>	<b>169</b>	<b>3,232</b>	<b>7,224</b>	<b>11,303</b>	<b>16,020</b>	<b>23,577</b>	<b>30,878</b>
<b>OPERATING INCOME</b>	<b>1</b>	<b>42</b>	<b>534</b>	<b>2,858</b>	<b>1,887</b>	<b>3,918</b>	<b>4,557</b>	<b>6,474</b>
INC B4 TAX, EXTRAORD & SECURITIES	1	42	534	2,858	1,887	3,918	4,597	6,474
Income Tax	0	22	199	327	598	1,201	1,444	1,675
Adjustment to net income	0	0	0	0	8	0	106	(25)
<b>NET INCOME</b>	<b>1</b>	<b>20</b>	<b>335</b>	<b>2,531</b>	<b>1,297</b>	<b>2,717</b>	<b>3,259</b>	<b>4,774</b>

**Table G.5. Aggregate and Economic Returns on Invested Capital, and Return on Equity for 21 MFI Projects**

Thousands \$	1998	1999	2000	2001	2002	2003	2004	2005	Cumulative 98-05
Statement Date	1998	1999	2000	2001	2002	2003	2004	2005	
Net Income	472	782	2,020	5,141	7,503	12,974	19,495	29,886	78,273
Interest Expense	87	3,350	5,771	9,275	15,337	24,808	46,295	74,173	179,096
Depreciation/Amortization	93	225	622	1,577	3,681	4,116	8,296	13,056	31,666
Deposits (changes)	251	21,131	17,627	46,258	384,867	182,084	351,113	322,996	1,326,327
Debt (changes)	8,378	27,170	30,373	19,923	72,273	129,956	212,233	176,054	676,360
Equity (changes)	4,048	10,656	17,139	17,877	72,421	42,458	55,363	27,579	247,541
Terminal Value								2,250,228	
<b>CASE 1</b>									
Up-front costs (TA services) not funded with grants	0	0	0	0	0	0	0	0	-
IRR Cash Flows	(12,025)	(54,600)	(56,726)	(68,065)	(503,040)	(312,600)	(544,623)	1,840,714	289,035
<b>Investment FRR (ROIC)</b>	<b>7.3%</b>								
Income Tax	0	339	675	949	2,786	4,598	6,265	7,885	23,497
ERR Cash Flows	(12,025)	(54,261)	(56,051)	(67,116)	(500,254)	(308,002)	(538,358)	1,848,599	312,532
<b>Investment ERR (EROIC)</b>	<b>7.9%</b>								
ROE Annual Cashflows	(3,483)	(9,649)	(14,497)	(11,159)	(61,237)	(25,368)	(27,572)	15,363	
Terminal Equity Book Value								247,541	
Total ROE Cashflows	(3,483)	(9,649)	(14,497)	(11,159)	(61,237)	(25,368)	(27,572)	262,904	
<b>Discounted Cash Flow ROE</b>	<b>18.3%</b>								
<b>CASE 2</b>									
Up-front costs (TA services) not-funded with grants	6,360	5,520	7,937	4,578	16,096	14,275	0	0	54,765
IRR Cash Flows (TA Costs Funded from Operations)	(18,385)	(60,120)	(64,663)	(72,643)	(519,136)	(326,875)	(544,623)	1,840,714	234,270
<b>Investment FRR (ROIC)</b>	<b>5.7%</b>								
ROE Annual Cashflows	(9,843)	(15,169)	(22,434)	(15,737)	(77,333)	(39,643)	(27,572)	15,363	
Terminal Equity Book Value								247,541	
Total ROE Cashflows	(9,843)	(15,169)	(22,434)	(15,737)	(77,333)	(39,643)	(27,572)	262,904	
<b>Discounted Cash Flow ROE</b>	<b>7.3%</b>								
Income Tax	0	339	675	949	2,786	4,598	6,265	7,885	23,497
ERR Cash Flows	(18,385)	(59,781)	(63,988)	(71,695)	(516,350)	(322,277)	(538,358)	1,848,599	257,766
<b>Investment ERR (EROIC)</b>	<b>6.3%</b>								
<b>ADDITIONAL ANALYSIS</b>									
Cum. Equity	4,048	14,704	31,843	49,720	122,141	164,599	219,962	247,541	
Cum. Deposits	251	21,382	39,009	85,267	470,134	652,218	1,003,331	1,326,327	
Cum. Debt	8,378	35,548	65,921	85,844	158,117	288,073	500,306	676,360	
Sum of Cum (Deposits + Debt)	8,629	56,930	104,930	171,111	628,251	940,291	1,503,637	2,002,687	
Sum of Cum. (Equity + Deposits + Debt)	12,677	71,634	136,773	220,831	750,392	1,104,890	1,723,599	2,250,228	
Average Equity / Average (Equity+Debt+Deposits)	31.9%	22.2%	22.3%	22.8%	17.7%	15.5%	13.6%	11.8%	
Interest / Average (Deposits+Debt)	2.0%	10.2%	7.1%	6.7%	3.8%	3.2%	3.8%	4.2%	
Annual Accounting ROIC	10.3%	10.3%	8.1%	8.9%	5.5%	4.5%	5.2%	5.9%	
Max Equity ROE for ROIC value above	27.9%	10.7%	11.4%	16.5%	13.0%	11.9%	14.5%	18.4%	
Assume Cost of Equity (SAT. Annual ROE %)	15.0%								
Annual WACC for Cost of Equity (ROE) and Cost of Debt (Interest Expense) Above	6.2%	11.3%	8.9%	8.6%	5.8%	5.0%	5.3%	5.5%	

Notes:

1. Terminal value is the sum of the 1998-2005 cumulative increase in deposits, debts and equity.
2. Non-cash income or losses (such as gains or losses from marking securities holdings to fair market value and revaluation of fixed assets are excluded from both net income and retained earnings (or equity). In the case of the 21 MFIs, there were no such non-cash gains or losses.
3. ROIC - return on invested capital; EROIC - economic return on invested capital; ROE - discounted cash flow return on equity (all in nominal terms).



## **CGAP's Key Messages for the "Year of Microcredit 2005"**

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### **CGAP: the Collective Voice of Microfinance's Leading Donors**

The Consultative Group to Assist the Poor (CGAP) is a consortium of 33 public sector and private sector financiers and advocates working together to improve access to financial services by poor people through microfinance intermediaries in developing countries. CGAP is composed of bilateral, regional, and multilateral development agencies (including the World Bank Group and UNDP) and some private foundations. The eleven key messages enumerated below were initially drafted during a meeting of CGAP's executive committee in February 2004. They were circulated to the entire membership for comments, then revised, and endorsed by CGAP as a whole. These messages effectively represent the collective voice of microfinance's leading donors, and reflect the lessons CGAP has learned, and the principles it has developed, since it's founding in 1995.

### **The Eleven Key Messages of CGAP**

1. The poor need a variety of financial services, not just loans. Just like everyone else, poor people need a wide range of financial services that are convenient, flexible, and reasonably priced. Depending on their circumstances, poor people need not only credit, but also savings, cash transfers, and insurance.
2. Microfinance is a powerful instrument against poverty. Access to sustainable financial services enables the poor to increase incomes, build assets, and reduce their vulnerability to external shocks. Microfinance allows poor households to move from everyday survival to planning for the future, investing in better nutrition, improved living conditions, and children's health and education.
3. Microfinance means building financial systems that serve the poor. Poor people constitute the vast majority of the population in most developing countries. Yet, an overwhelming number of the poor continue to lack access to basic financial services. In many countries, microfinance continues to be seen as a marginal sector and primarily a development concern for donors, governments, and socially responsible investors. In order to achieve its full potential of reaching a large number of the poor, microfinance should become an integral part of the financial sector.
4. Financial sustainability is necessary to reach significant number of poor people. Most poor people are not able to access financial services because of the lack of strong retail financial intermediaries. Building financially sustainable institutions is not an end in itself. It is the only way to reach significant scale and impact far beyond what donor agencies can fund. Sustainability is the ability of a microfinance provider to cover all of its costs. It allows the continued operation of the microfinance provider and the ongoing provision of financial services to the poor. Achieving financial sustainability means reducing transaction costs, offering better products and services that meet client needs, and finding new ways to reach the "unbanked" poor.
5. Microfinance is about building permanent local financial institutions. Building financial systems for the poor means building sound domestic financial intermediaries that can provide financial services to poor people on a permanent basis. Such institutions should be able to mobilize and recycle domestic savings, extend credit, and provide a range of services. Dependence on funding from donors and governments—including government-financed development banks—will gradually diminish as local financial institutions and private capital markets mature.
6. Microcredit is not always the answer. Microcredit is not appropriate for everyone or every situation. The destitute and hungry, having no income or means of repayment, need other forms of support before they can make use of loans. In many cases, small grants, infrastructure improvements, employment and training programs, and other nonfinancial services may be more appropriate tools for poverty alleviation. Wherever possible, such nonfinancial services should be coupled with building savings.
7. Interest rate ceilings can damage poor people's access to financial services. It costs much more to make many small loans than a few large loans. Unless microlenders can charge interest rates that are well above average bank loan rates, they cannot cover their costs, and their growth and sustainability will be limited

by the scarce and uncertain supply of subsidized funding. When governments regulate interest rates, they usually set them at levels too low to permit sustainable microcredit. At the same time, microlenders should not pass on operational inefficiencies to clients in the form of prices (interest rates and other fees) that are far higher than they need to be.

8. The government's role is as an enabler, not as a direct provider of financial services. National governments play an important role in setting a supportive policy environment that stimulates the development of financial services while protecting poor people's savings. The key things that a government can do for microfinance are to maintain macroeconomic stability, avoid interest-rate caps, and refrain from distorting the market with unsustainable subsidized, high-delinquency loan programs. Governments can also support financial services for the poor by improving the business environment for entrepreneurs, clamping down on corruption, and improving access to markets and infrastructure. In special situations, government funding for sound and independent microfinance institutions may be warranted when other funds are lacking.

9. Donor subsidies should complement, not compete with private sector capital. Donors should use appropriate grant, loan, and equity instruments on a temporary basis to build the institutional capacity of financial providers, develop supporting infrastructure (like rating agencies, credit bureaus, audit capacity, etc.), and support experimental services and products. In some cases, longer-term donor subsidies may be required to reach sparsely populated and otherwise difficult-to-reach populations. To be effective, donor funding must seek to integrate financial services for the poor into local financial markets; apply specialist expertise to the design and implementation of projects; require that financial institutions and other partners meet minimum performance standards as a condition for continued support; and plan for exit from the outset.

10. The lack of institutional and human capacity is the key constraint. Microfinance is a specialized field that combines banking with social goals, and capacity needs to be built at all levels, from financial institutions through the regulatory and supervisory bodies and information systems, to government development entities and donor agencies. Most investments in the sector, both public and private, should focus on this capacity building.

11. Financial and outreach transparency is important. Accurate, standardized, and comparable information on the financial and social performance on financial institutions providing services to the poor is imperative. Bank supervisors and regulators, donors, investors, and more importantly, the poor who are clients of microfinance need this information to adequately assess risk and returns.

**Table G.6. TECHNICAL ASSISTANCE DATA FOR MFIS**

MFI-ID	Region - Five	Total TA mobilized by IFC (In US\$000)	Total TA mobilized by all other IFIs (In US\$000)	TA Amount mobilized by IFIs (In US\$000)
MF11	EUROPE & CENTRAL ASIA		5,111	5,111
MF12	EUROPE & CENTRAL ASIA		3,345	3,345
MF13	EUROPE & CENTRAL ASIA		7,390	7,390
MF14	AFRICA	600		600
MF15	ASIA	391		391
MF16	LAC			
MF17	AFRICA	1,250		1,250
MF18	ASIA	170	1,380	1,550
MF19	MENA	200	2,400	2,600
MF110	EUROPE & CENTRAL ASIA		3,965	3,965
MF111	AFRICA			
MF112	EUROPE & CENTRAL ASIA		5,419	5,419
MF113	EUROPE & CENTRAL ASIA		5,085	5,085
MF114	EUROPE & CENTRAL ASIA		4,516	4,516
MF115	LAC		463	463
MF116	ASIA	2,000		2,000
MF117	AFRICA			
MF118	EUROPE & CENTRAL ASIA		3,800	3,800
MF119	LAC	75	607	682
MF120	EUROPE & CENTRAL ASIA	400	1,528	1,928
MF121	AFRICA	4,670		4,670
TOTAL		9,756	45,008	54,764



**Table G.7. Developing Countries with At Least One Microcredit Account per 100 People in 2000**

Active Microcredit Accounts, Circa 2000, with At Least 1.0 Account Per 100 People <u>a/</u>							
Country	Number of Microcredit Accounts (1000)	Percent of Total Accounts	Population (1000)	Accounts per 100 Population	No. of IFC MFI clients w/ One or More Projects		
					Projects Approved in FY96-FY02 <u>b/</u> (operationally mature)		Projects Approved in FY03-FY06
					In the MFI Study Population	Not in MFI Study Population	Not in MFI Study Population
1. Bangladesh	17,300	41.4%	130,407	13.3	1 <u>c/</u>		
2. Indonesia	15,159	36.3%	224,138	6.8			
3. Guatemala	833	2.0%	12,820	6.5			
4. Bolivia	494	1.2%	8,153	6.1	1 <u>c/</u>		2 <u>c/+</u> 1
5. Nicaragua	220	0.5%	4,932	4.5			1 <u>c/</u>
6. Gambia	50	0.1%	1,367	3.6			
7. Tunisia	313	0.8%	9,564	3.3			
8. Niger	322	0.8%	10,174	3.2			
9. El Salvador	191	0.5%	6,123	3.1		1 <u>c/</u>	1 <u>d/</u>
10. Honduras	183	0.4%	6,201	3.0			
11. Thailand	1,728	4.1%	62,352	2.8			
12. Ecuador	345	0.8%	12,505	2.8			1 <u>c/</u>
13. Sri Lanka	524	1.3%	19,239	2.7			
14. Malawi	260	0.6%	10,874	2.4			
15. Senegal	233	0.6%	9,784	2.4		1 <u>c/</u>	
16. Mongolia	61	0.1%	2,601	2.3	1 <u>c/</u>		1 <u>c/</u>
17. Peru	588	1.4%	25,980	2.3		1 <u>c/</u>	1 <u>d/</u> + 1
18. Nepal	492	1.2%	24,702	2.0			
19. Cambodia	243	0.6%	12,433	2.0	1 <u>c/</u>		1 <u>d/</u>
20. Benin	122	0.3%	6,428	1.9	1 <u>c/</u>		
21. Togo	90	0.2%	5,033	1.8			
22. Colombia	699	1.7%	39,686	1.8			1 <u>c/</u> + 1
23. Uganda	407	1.0%	23,496	1.7			1 <u>c/</u>
24. Bosnia & Herzegovina	59	0.1%	3,836	1.5	1 <u>c/</u>		1 <u>c/</u>
25. Paraguay	69	0.2%	5,586	1.2			
26. Dominican Republic	97	0.2%	8,354	1.2			1
27. Georgia	54	0.1%	4,777	1.1	1 <u>c/</u>		1 <u>d/</u>
28. Samoa	2	0.0%	179	1.0			
29. Ethiopia	638	1.5%	62,651	1.0			
<b>Total</b>	<b>41,776</b>	<b>100.0%</b>	<b>754,375</b>	<b>5.5</b>	<b>7</b>	<b>3</b>	<b>16</b>

Note a/ Data is from Table 3 of the Working Paper 101, Microfinance as Business, (Nov. 2006) by David Roodman and Uzma Qureshi, Center for Global Development, Washington DC, USA ([www.cgdev.org](http://www.cgdev.org)), except for the IFC MFI project data.

b/ IFC approved funding operations to 37 MFIs in FY96-FY02 of which 21 are in "frontier countries" (i.e., low income or high risk) and based on the "for-profit" MFI business model (the MFI study population); eight were "for-profit" MFIs in "nonfrontier" countries; six were either nonprofit membership entities (e.g., credit unions, cooperatives) or special purpose vehicles; one was a regional private equity fund; and another one was a regional investment (loan provider only) fund. The two regional funds invest in financial intermediaries that serve micro- and small-size enterprises. The IFC clients in this table exclude global and regional investment funds or holding companies supporting MFIs. During FY03-FY06, IFC approved operations with 37 new clients (30 country level clients and 7 regional clients), and operations with 14 repeat clients (13 country-level clients and one global MFI holding company). Of the 43 country level clients (30 new and 13 repeat clients), with projects approved in FY03-FY06, 16 are in countries with at least 1.0 microcredit account per 100 people, while 27 clients are in countries with less than 1.0 microcredit account per 100 people.

c/ Greenfield project (new commercial MFI or conversion of nonprofit NGO to a commercial MFI).

d/ Repeat client (with earlier projects approved in FY96-FY02).



**Table G.8. Foreign Financiers of Private Sector MFIs Surveyed by CGAP**

Sources of Foreign Investment for Microfinance Surveyed (by category, mid-2003)		
Development Investors	Social Investment Funds	
<p><b>Multilateral</b></p> <ul style="list-style-type: none"> <li>CAF (Corporation Andina de Fomento)</li> <li>EBRD (European Bank for Reconstruction and Development)</li> <li>IFC (International Finance Corporation)</li> <li>IADB Multilateral Investment Fund (Inter-American Development Bank)</li> <li>OPEC Fund (Organization of Petroleum Exporting Countries)</li> </ul> <p><b>Bilateral</b></p> <ul style="list-style-type: none"> <li>BIO (Belgiische Investerings Maatschappij voor Ontwikkelingslanden)</li> <li>DEG (Deutsche Investitions- und Entwicklungsgesellschaft)</li> <li>FMO (Nederlandse Financierings Maatschappij voor Ontwikkelingslanden NV)</li> <li>KfW (Kreditanstalt für Wiederaufbau)</li> <li>USAID Development Credit Authority (United States Agency for International Development)</li> </ul>	<p><b>Predominantly Debt Funds</b></p> <ul style="list-style-type: none"> <li>Alterfin</li> <li>Calvert Foundation</li> <li>CORDAID (Catholic Organization for Relief and Development Aid)</li> <li>Creditosud</li> <li>Developpement International Desjardins (Partnership Fund, FONIDI Fund)</li> <li>Dexia Microcredit Fund</li> <li>Etimos</li> <li>Hivos-Triodos Fund</li> <li>LA-CIF (Latin American Challenge Investment Fund)</li> <li>Oikocredit</li> <li>Luxmint-ADA</li> </ul> <p><b>Guarantee Funds</b></p> <ul style="list-style-type: none"> <li>FIG (Fonds Internacional de Garantie)</li> <li>ACCION (Latin American Bridge Fund)</li> <li>Deutsche Bank Microcredit Development Fund</li> </ul>	<p><b>Predominantly Equity Funds</b></p> <ul style="list-style-type: none"> <li>ACCION Gateway Fund</li> <li>AfriCap Microfinance Fund</li> <li>IMI-AG (Internationale Micro Investition Aktien-Gesellschaft)</li> <li>La Fayette Participations, Horus Banque et Finance</li> <li>Opportunity International-Opportunity Transformation Investments</li> <li>ProFund</li> <li>SIDI (Societe d'Investissement et de Developpement International)</li> </ul> <p><b>Mixed Debt and Equity Funds</b></p> <ul style="list-style-type: none"> <li>Open society institute</li> <li>Sarona Global Investment Fund</li> <li>Unitus</li> <li>Triodos Fair Share Fund</li> <li>Triodos-Doen Foundation</li> </ul> <p><b>New Funds</b> (created or operational in 2003)</p> <ul style="list-style-type: none"> <li>PlaNet finance Revolving Fund</li> <li>Deutsche Bank Fund</li> <li>Microvest</li> <li>Positive Fund</li> <li>AIM (ACCION Investments in Microfinance)</li> <li>ShoreCap Fund</li> <li>LA-CIF MFI Equity Fund</li> <li>LA-CIF High Risk Fund</li> <li>Unitus Debt Fund</li> <li>Soros Fund</li> </ul>

Source: Reprinted from CGAP Focus Note, "Foreign Investment In Microfinance: Debt And Equity From Quasi-Commercial Investors," with data from *Sources of Foreign investment for Microfinance Surveyed*.

Type	Fund Name	Regions of Operation	% of Local Currency	% of Equity Investments	\$ of Debt Investments	% of Guarantee
<b>Over \$100 MILLION</b>						
D	EBRD	ECA	0%	6%	94%	0%
D	IFC	ECA, MENA, LAC, Africa, S Asia, E Asia	N/A	43%	57%	0%
D	KfW	ECA, S Asia, E Asia, Africa, MENA, LAC,	N/A	2%	86%	12%
<b>\$40-100 MILLION</b>						
D	FMO	LAC, Aafrica, S Asia, ECA, E Asia	80%	20%	80%	0%
D	IADB Multilateral Investment Fund	LAC	29%	47%	53%	0%
S	IMI-AG	ECA, LAC, Africa, E Asia	0%	100%	0%	0%
S	Oikocredit	LAC, E Asia, Africa, ECA	21%	24%	74%	2%
<b>\$20-40 MILLION</b>						
D	CAF	LAC	0%	19%	72%	9%
D	DEG	LAC, ECA, E Asia, Africa	0%	44%	56%	0%
S	Dexia Microcredit Fund	Lac, E Asia, S Asia, ECA, Africa	21%	0%	96%	4%
D	OPEC Fund	Africa, LAC, Asia	0%	0%	100%	0%
S	Profund	LAC	75%	75%	25%	0%
D	USAID Development Credit Authority	Africa, Asia, MENA, LAC	N/A	0%	0%	100%
<b>\$10-20 MILLION</b>						
S	AfriCap Microfinance Fund	Africa	N/A	100%	0%	0%
D	BIO	LAC, Africa, Asia	N/A	60%	40%	0%
S	Calvert Foundation	Africa, E Asia, S Asia, ECA, LAC	0%	0%	100%	0%
S	CORDAID	Africa, E Asia, S Asia, ECA, LAC	N/A	0%	100%	0%
S	Hivos-Triodos Fund	LAC, Africa, S Asia, MENA, E Asia	38%	25%	73%	2%
S	LA-CIF	LAC	N/A	0%	100%	100%
S	Open Society Institute	ECA, Africa	N/A	25%	25%	50%
S	Triodos-Doen Foundation	LAC, Africa, MENA, S Asia, E Asia, ECA	25%	19%	77%	4%

**Notes:**

Type **D**: Development Investor

Type **S**: Social investment fund

<b>Regions:</b>	<b>ECA</b>	Central and Eastern Europe and Central Asia
	<b>MENA</b>	Middle East / North Africa
	<b>LAC</b>	Latin American and Caribbean
	<b>S Asia</b>	South Asia
	<b>E Asia</b>	East Asia / Pacific

Type	Fund Name	Regions of Operation	% of Local Currency	% of Equity Investments	\$ of Debt Investments	% of Guarantee
<b>\$5-10 MILLION</b>						
S	Developpement Int'l. Desjardins (Partnership Fund, FONIDI Fund)	LAC	N/A	28%	72%	0%
S	ACCION Latin American Bridge Fund	LAC	0%	0%	0%	100%
S	Opportunity International-Opportunity Transformation Investments	ECA	0%	90%	10%	0%
S	Unitus	LAC, S Asia	N/A	6%	66%	28%
<b>\$1-5 MILLION</b>						
S	ACCION Gateway Fund	LAC	80%	100%	0%	0%
S	Alterfin	LAC, E Asia, Africa	1%	4%	96%	0%
S	CreditoSud	LAC	0%	0%	100%	0%
S	Deutsche Bank Microcredit Development Fund	LAC, S Asia, ECA, E Asia, Africa	100%	0%	0%	100%
S	Etimos	Italy, LAC, Africa	N/A	N/A	N/A	N/A
S	FIG	LAC, Africa	0%	0%	0%	100%
S	Luxmint-ADA	LAC, Africa	0%	10%	84%	6%
S	Sarona Global Investment Fund	LAC, ECA, E Asia, Africa	0%	25%	75%	0%
S	SIDI	MENA, Africa, E Asia, ECA, LAC	20%	62%	38%	0%
S	Triodos Fair Share Fund	E Asia, LAC	100%	35%	65%	0%
<b>UNDER \$1 MILLION</b>						
S	La Fayette Participations, Horus Banque et Finance	Africa, E Asia	N/A	400%	0%	0%

Notes:

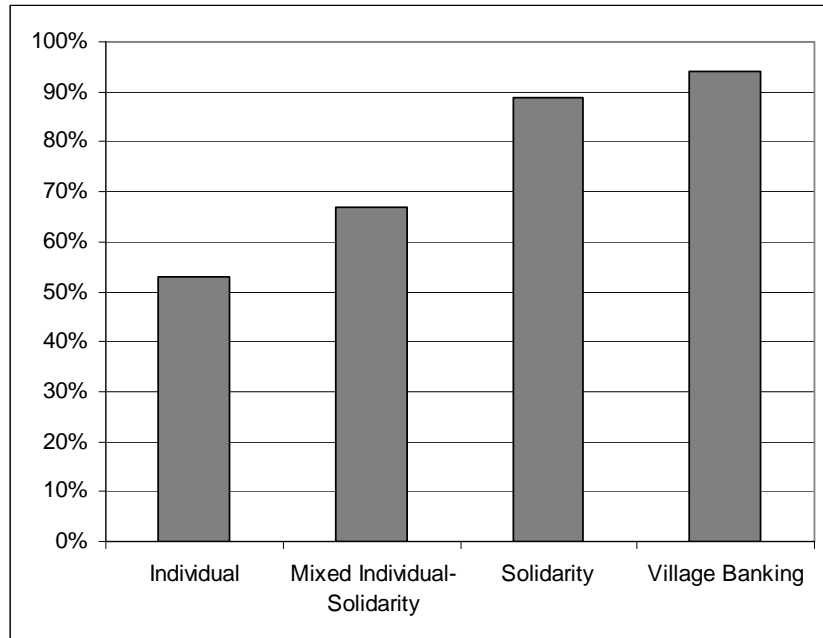
Type **D**: Development Investor

Type **S**: Social investment fund

<b>Regions:</b>	<b>ECA</b>	Central and Eastern Europe and Central Asia
	<b>MENA</b>	Middle East / North Africa
	<b>LAC</b>	Latin American and Caribbean
	<b>S Asia</b>	South Asia
	<b>E Asia</b>	East Asia / Pacific



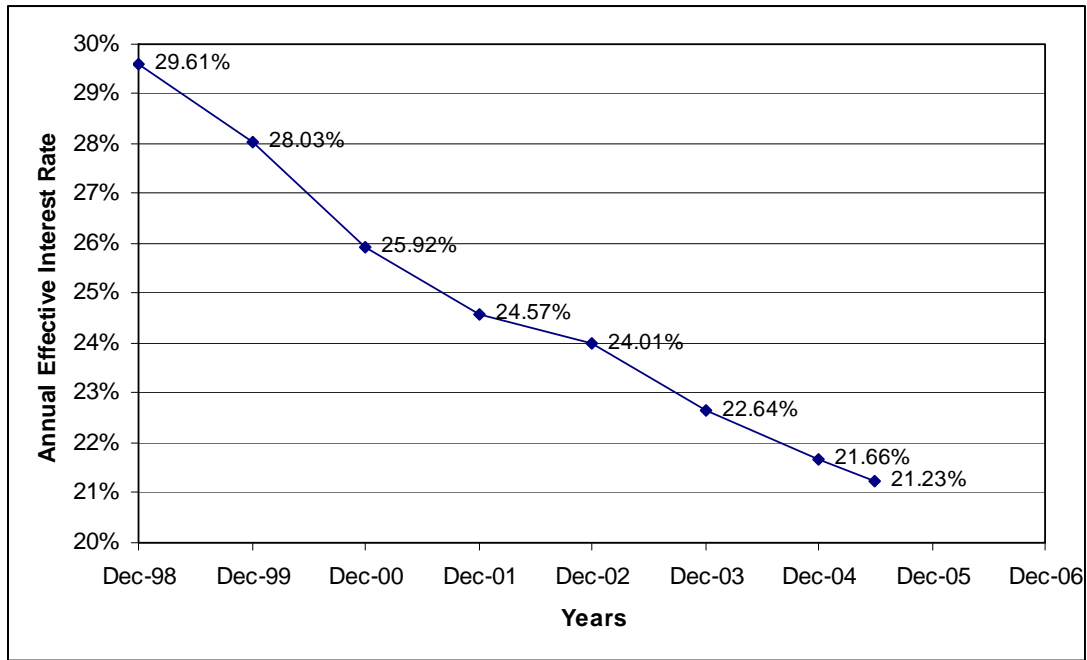
**Figure G.1: Share of MFI Borrowers That Are Women, by Lender Type (median)**



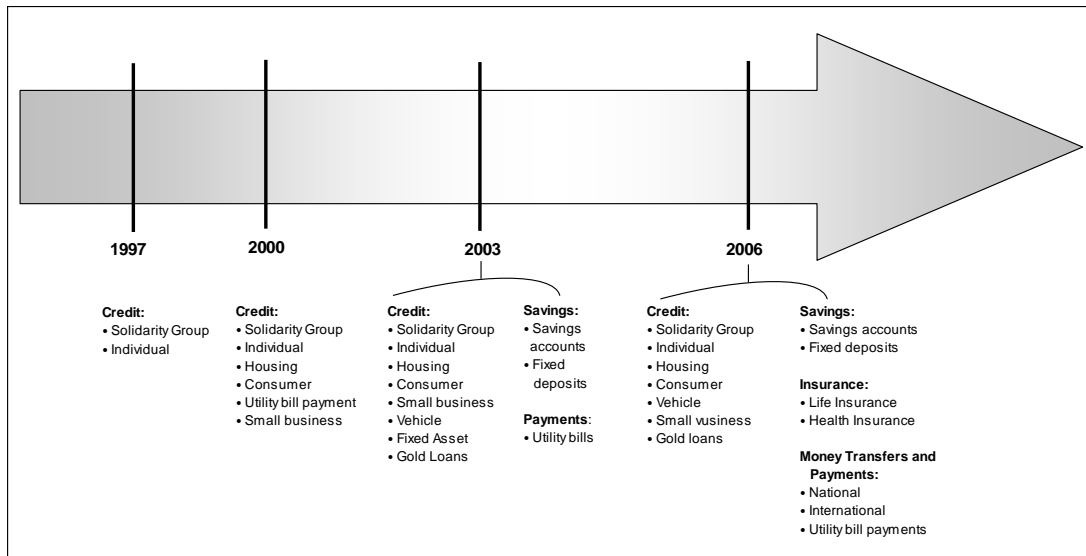
*Source:* Reprinted from Center for Global Development, Working Paper Number 101, November 2006 edition, with original data from *MicroBanking Bulletin* survey, 2004.



**Figure G.2. Interest Rates on Microfinance Loans in Bolivia, 1998–2004**



**Figure G.3. Diversified Products Offered by Bolivia's BancoSol, 1997–2006**



Source: **Microfinance through the Next Decade: Visioning the Who, What, Where, When and How**, a Paper commissioned for the Global Microcredit Summit 2006, Nov. 2006, by Elisabeth Rhyne and Maria Otero, ACCION International



## Appendix H

### SME-FI Study Population: Project Evaluations and Success Drivers

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#### Introduction

24. This appendix provides the project-level evaluations that form the bases for answering the evaluative questions listed in chapter 1 of the main report. The appendix describes in full and evaluates the operating results and development outcomes of the SME-FI projects that have reached operating maturity (i.e., those with at least two years of reported financial results by the end of 2005, or projects approved in FY96–FY02); the main drivers of successful project outcomes; and in the context of these project success drivers, IFC's value-added role in designing, structuring, and supervising its MFIs projects. Chapter 4 of the main report discusses the main findings and recommendations from the project-level evaluations in this appendix. The environmental performance of the projects that form part of the development outcomes of the projects are described separately in appendix I and in chapter 5 of the main report.

#### **The SME-FIs developed a large SME client base; smaller SME-FIs received most of the IFC TA, and had 10 times more SME borrowers than larger SME-FIs that had no TA**

25. IEG evaluated in greater detail the operating results and performance of a subgroup of 36 SME-FIs out of the 72 in the SME-FI study population (regionally distributed). Some operating performance indicators for this subgroup of 36 SME-FIs, such as the funding (liability) structure, cost structure and profitability, and number of MSME borrowers, are shown in table G.2 and summarized in table 3.2 of the report. Overall, the subgroup of 36 SME-FIs showed significant growth in MSME lending and supported a large number of MSMEs at the end of 2005. As a group, the 36 SME-FIs in 2005 achieved a higher annual return on average equity than the 15 percent considered as satisfactory for the banking industry in developed countries. The main observations about these financial performance data for these 36 SME-FIs are as follows:

- **Funding or Liability Structure:** Except for one new SME-FI with insignificant deposits (1 percent of total assets), deposits as a percentage of total assets range from 28 percent to 89 percent, with an average of 70.3 percent and a median of about 62 percent. The equity to total assets ratio range from 4 percent to 33 percent with a weighted average of 9.2 percent and a median of 15 percent. The debt to total asset ratio range from 3 percent to 64 percent with a weighted average of 20 percent and a median of about 23 percent. Thirty-three out of 36 SME-FIs have a ratio of at least 50 percent deposits to total assets. Only 9 out of 36 SME-FIs rely on more than 20 percent debt for their total funding, but 12 out of 36 had a ratio of less than 10 percent equity relative to total assets. As a group, the 36 SME-FIs mobilized a substantial amount of deposits for their lending operations (in fact, deposits exceed loans by about 43 percent of total assets) although one-third of these 36 SME-FIs appear to have inadequate equity (i.e., less than 10 percent of total assets), which may explain why 16 out of these 36 SME-FIs received equity financing from IFC.
- **Operating Cost Structure:** Administrative and operating expenses (noninterest expenses) range from about 3 percent to 20 percent of total loans (excluding one SME-FI with insignificant MSME loan portfolio and invest mainly in government securities), with a weighted average of about 7.0 percent and a median of about 10.0 percent. As mentioned in chapter 2, the operating cost range for the SME-FIs is much lower, about half of those for MFIs. The weighted average interest paid on deposits (local currency) of about 5.5 percent is almost the same as the weighted average interest on debt of 5.6

percent, perhaps reflecting the foreign currency denomination of most of the debts and the relatively low level of interest rate in the international capital markets recently during the period under review. The 20 SME-FIs that did not receive TA funds are the larger SME-FIs, with average total assets of about \$1,810.8 million per SME-FI and with larger average loan amount of \$67,578 per MSME borrower, compared to the average total assets of only \$548.8 million per SME-FI, and an average loan amount of only \$6,716 per MSME borrower, for the 16 SME-FIs that received TA funds. This difference in scale of operations and average loan amount largely explain the higher operating efficiency (in terms of lower administration expenses a percentage of total loans) of the 20 SME-FIs that did not receive TA, compared to the 16 SME-FIs that received TA.

- Revenues from Loan Interest and Fees: The interest and fees charged by SME-FIs range from about 8 percent to 28 percent of loans, with a weighted average of about 12.4 percent and a median of about 16.0 percent. These relatively low interest charges (compared to those charged by MFIs) is mainly due to economies of scale, and explained by the large average loan size and average total assets size of the SME-FIs, of about 5 times and 10 times respectively, compared to those for MFIs.
- Non-Performing Loans (NPLs): The weighted average NPL rate of the SME-FIs of about 4.7 percent is about 2.8 times that for MFIs (1.7 percent), but is not onerous for commercial banks in developing countries in general, and particularly for frontier country banks.
- Annual Return on Assets and Equity: The average annual return on average assets for the 36 SME-FIs range from negative 1 percent to positive 5.6 percent, with a weighted average of 1.8 percent and a median of 1.0 percent. The average annual return on average equity range from negative 6.6 percent to positive 39 percent, with a weighted average of 19.4 percent and a median of 10.0 percent. As a group, these 36 SME-FIs have a satisfactory profitability.
- Growth in Loans and Assets: In the 5 years between the end of 2000 and the end of 2005, the aggregate loan volume of the 36 SME-FIs grew by about 313 percent from \$5,611.8 million to \$23,186.8 million, while their aggregate total assets grew by about 242 percent from \$13,133.9 million to \$44,911.3 million. These imply that the ratio of aggregate loans to aggregate total assets increased from about 42.7 percent in 2000 to 51.5 percent in 2005. Thus, as they are growing, the SME-FIs are directing more of their assets to private sector businesses and household borrowers, as opposed to investments in government securities (i.e., treasury bills), interbank loans, and reserves with the central bank.
- Technical Assistance (TA) and Outreach to MSME Borrowers: The main purpose of the TA funds provided by IFC and the other IFIs was to help the SME-FI establish, or enhance an existing, MSME business line. TA funds were directed by IFC (and other IFIs) to smaller SME-FIs. The 2004–05 average total assets of the 16 (out of 36) SME-FIs that received TA funds was about \$548.8 million, or only about 30 percent of the 2004–05 average total assets of \$1,810.5 million for the other 20 (out of 36) SME-FIs that did not receive TA funds. At the end of 2005, these smaller SME-FIs that received TA funds on average had 10 times more MSME borrowers (an average of 16,116 MSME borrowers per SME-FI), compared to the larger SME-FIs that did not receive TA funds (an average of 1,585 MSME borrowers per SME-FI). Thus, it appears that smaller SME-FIs have a higher predisposition towards MSME lending compared to larger SME-FIs, and TA funds helped these smaller SME-FIs increase their MSME

outreach. However, the average MSME outreach of these smaller SME-FIs that received TA is still lower than the average outreach of the MFIs at the end of 2005 of about 39,200 microenterprise borrowers per MFI in the MFI study population, although the average loan amount per MFI borrower is only \$1,970, equivalent to just one-fifth, compared to the average MSME loan amount of about \$10,171 per SME-FI borrower.

**Table H.1. Financial Performance Data for a Subgroup of 36 SME-FIs in the Study Population**

<b>Weighted Average for 2004–05 (unless otherwise indicated; see appendix G)</b>	<b>Subgroup of 36 SME-FIs in the Study Population</b>	<b>16 SME-FIs in the Subgroup that received TA</b>	<b>20 SME-FIs in the Subgroup with no TA</b>
Aggregate net income / average assets	1.8 %	2.1 %	1.8 %
Aggregate net income/ average equity a/	19.4 %	18.4 %	20.3 %
Aggregate interest income & fees from loans / average loans b/	12.4 %	15.5 %	11.5 %
Aggregate administration expenses/ average loans	7.0 %	9.5 %	6.3 %
Aggregate interest paid on deposits/ average deposits	5.5 %	3.4 %	4.2 %
Aggregate interest paid on debts/ average debt c/	5.6 %	8.2 %	4.0 %
Average deposits/ average assets	70.3 %	76.0 %	68.0 %
Average debts/ average assets	20.5 %	13.0 %	23.0 %
Average equity / average assets	9.2 %	11.0 %	9.0 %
Average loans / average assets d/	50.4 %	53.0 %	48.0 %
Average non-performing loan (NPL) rate	4.7 %	3.8 %	5.1 %
Average deposits / average loans	142.5 %	145.0 %	142.0
Average number of MSME subloans per FI (end 2005) e/	10,171	16,115	1,585
Average MSME subloan size per borrower (end of 2005)	\$10,591	\$6,716	\$67,578
Average total assets per SME-FI (end of 2005)	\$1,249.8 million	\$548.8 million	\$1,810.5million
<b>Notes:</b>			
a/ The annual accounting return on average equity and annual accounting return on average assets are related through the ratio of average equity to average assets. The relationship is given by the formula: (Net Income/Average Assets) = (Net Income/Average Equity) x (Average Equity/Average Assets). For commercial banks in developed countries, a “good” annual return on average equity is about 15 percent, and a “good” return on average assets is at least 1.0 percent when the minimum equity was 5 percent of total assets before the Basel I risk-adjusted capital requirements were introduced. If the minimum equity is 10 percent of total assets, the return on average has to be about 1.5 percent to yield a 15 percent return on equity.			
b/ The SME-FIs have other sources of income such as credit life insurance, currency transfer fees, interbank loan interest income from short-term investments.			
c/ The aggregate interest paid on debts/ average debt excludes banks that had no other interest expense related to debt.			
d/ In addition to loans, SME-FIs also hold other assets such as short-term investments and interbank loans. In general, commercial banks have between 70 percent to 75 percent of assets in loans, with the balance of the assets held as liquidity and “first loss” support in the form of cash holdings, deposits with central bank, liquid government securities, and interbank overnight loans.			
e/ The average number of MSME subloans for 22 SME-FIs (including 13 of 16 SME-FIs that received TA, and 9 of the other 20 SME-FIs that did not receive TA) have subloan data, and those without data are the smaller SME-FIs.			

## **Six major factors drive the success of SME-FI projects**

26. The development outcome and the investment outcome success drivers for SME-FI projects are similar to those for microfinance intermediary projects discussed in chapter 3. More specifically, the six major success drivers for the SME-FI study population, discussed in more detail in Appendix H, are as follows:

- Sponsor Quality: Sponsor and management expertise in SME lending, commitment to serve the SME market, and a strategic business plan;
- Operational Standards: Cost-effective but prudent lending procedures and practices (see appendix E), as well as good benchmarks for comparing performance;<sup>7</sup>
- Technical Assistance: Technical assistance for staff training and development, as well as for establishing good lending practices and loan portfolio risk management systems;
- Transparency: Transparency and good governance to attract depositors, borrowers, investors, and comply with regulatory requirements;
- IFC Work Quality: Good IFC work quality including the screening and selection of suitable SME-FIs for serving the SME market and for IFC support; and
- IFC Equity: IFC equity investment in new or privatized SME-FIs, and in existing SME-FIs to support faster growth than what retained earnings alone can achieve.

### **Success Driver #1: Sponsor and management expertise and commitment to serve the SME market, and strategic business plan to do so**

27. The SME market, like the microfinance market, is more expensive to serve relative to the amount lent, and therefore requires specialized lending expertise very different from those used by commercial banks for large corporate clients, to be profitable. In addition, smaller commercial banks do not have the resources to fully serve the large corporations, and therefore tend to cater more to SMEs compared to the large commercial banks. In order for a bank to serve the SME market profitably, it has to have, or to acquire, the best lending techniques and operating practices suited to this market. In the SME-FI study population, the field visits noted that SME-FIs supported by IFC all have some specialized group or loan officers assigned to the SME business line, but have a range of SME lending expertise as well as commitment. The more successful SME-FIs had more of both expertise and commitment, and also have employee training and incentive programs. Finally, the management needs a good business strategy for serving and reaching out to the SME market, because many SMEs are still informal businesses, or just became formal businesses for a few years, and are not used to dealing with commercial banks or disclosing business information to banks.

28. Foreign-owned or sponsored SME-FIs had higher development outcome success rates than domestically owned SME-FIs. The better performance of foreign-owned banks was mostly due to greater managerial experience accompanied by better technology access, better access to capital markets, and more focus on diversifying risks. This last point regarding risk management and prudent lending technologies is also a critical success driver by itself and is expanded on below.

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<sup>7</sup> “A More Complete Conceptual Framework for SME Finance,” by Allen Berger and Gregory Udell. World Bank conference titled Small and Medium Enterprises: Overcoming Growth Constraints, October 14–15, 2004.

## **Success Driver #2: Cost effective but prudent lending procedures and practices**

29. The study findings show another success driver for SME-FI projects was the establishment of efficiency standards and targets, including a diversified portfolio based on prudent lending guidelines and rules. Many of the efficiency indicators are similar to those used by successful MFIs. Given the high inherent business risks in frontier countries, and the relatively high cost of serving the SME market (compared to the large corporate market), prudent lending procedures and risk management become essential elements for successful SME operations. In cases in which the SME-FI's risk management and lending procedures have needed enhancement, IFC has supported establishment of the necessary credit policies, lending procedures, and improvement of risk management systems.
30. *Six types of credit practices form the core of prudent SME lending.* The credit procedures of all SME-FIs, include one or more of six types of credit practices, five of which are transaction-oriented, and the sixth is relationship-oriented. The five transaction-oriented credit technologies, namely financial statement lending, small business credit scoring, asset-based lending, factoring, and trade credit, and the relationship lending technology<sup>8</sup> are briefly described in appendix E. In a country with good sources of business and other sponsor/company information, small business credit scoring may be feasible. In more developed lending environments, asset-based lending may be feasible for those borrowers with good quality accounts receivables, inventory, and/or equipment. Asset-based lending, however, may not be feasible in all frontier countries. Factoring is feasible even in weak lending environments, but it depends on the existence of high-quality accounts receivables. Although trade credit is ubiquitous, it is quite expensive. For opaque SMEs for which small business credit scoring, asset-based lending or factoring are not feasible or cost-effective, relationship lending may be the best alternative (very similar to microenterprise lending by MFIs). The availability of relationship lending, however, also appears to depend on the financial institution's structure. Field visit observations suggest that relationship lending may best be delivered by small SME-FIs.<sup>9</sup>

### **Box H.1. An SME-FI in South America Succeeds in the Aftermath of Civil War**

An SME-FI located in South America is owned by a regional international group. The local economy suffers from lack of confidence caused by a civil war which ended in early 1990s. Despite the unfavorable macroeconomic conditions in this country, as of the end of 2004, the SME-FI's average cost of funds was 2.2 percent, whereas loan interest received was about 6.9 percent, which reflects self-sufficiency in funding. The SME-FI's planning process is strong, clear, and all-embracing with comprehensive bottom-up contributions. The chief executive officer is an experienced banker that demonstrates a hands-on approach to guiding the FI. Employee performance targets flow into the financial plan and budget and are accompanied by an ongoing performance evaluation and reward system. Management takes a holistic view of the region and how it interfaces with the world economy and clearly defines threats and opportunities. The SME-FI also applies a comprehensive evolving credit risk management policy, and its reserves against losses stand at 143 percent of nonperforming assets, illustrating a conservative approach to risk taking.

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<sup>8</sup> "A More Complete Conceptual Framework for SME Finance," Allen Berger, Gregory Udell, World Bank Conference on "Small and Medium Enterprises: Overcoming Growth Constraints," October 14–15, 2004.

<sup>9</sup> "A More Complete Conceptual Framework for SME Finance," Allen Berger, Gregory Udell, World Bank Conference on "Small and Medium Enterprises: Overcoming Growth Constraints," October 14–15, 2004, p.27.

### Success Driver #3: Technical Assistance for staff training, development of lending practices specific to SMEs, and establishment of risk management systems

31. IFC's TA was specifically directed at helping smaller SME-FIs either establish a new unit (or train specialized loan officers) dedicated to serve the SME market, or to expand and improve an existing unit of core staff. The IFC TA was a contributing factor to the SME-FIs' successful development outcomes. Capacity-building and institution-building TA has played a very important role in SME-FI's ability to reach out and profitably serve the SME businesses, based on a review of the SME-FI projects' extensive supervision reports. IFC provided TA to 29 percent (21 out of 72) of the SME-FIs. Most of the SME-FIs that received TA from IFC were locally owned second-tier (i.e., small) commercial banks with an existing SME client base. The SME-FIs that received IFC's TA had a higher development success rate (76 percent) compared to those that did not (55 percent). The success of TA in helping MFIs perform better, as discussed in chapter 3, reinforce the observations in the field visits about the positive contribution of TA to the development performance of SME-FIs.

**Table H.2. Technical assistance to SME-FIs in the study sample improved Development Outcome success rates**

	Number of SME-FI	Number of SME-FIs with High Development Outcome	Number of SME-FIs with High Equity Outcome	Number of SME-FIs with High Loan Outcome
SME-FIs that received IFC TA	21	76 % a/	56 % of 9	82 % of 17
SME-FIs that did not receive IFC TA	51	55 % a/	52 % of 27	77 % of 31
All 72 SME-FI projects	72	61 %	53 % of 36	79 % of 48

Note: a/ Statistically significant difference at the 0.02 confidence level.

32. Successful SME-FIs invested in training and professional development of their staff, because their management had the vision that sustained success lies in their staff's hands. Empirical studies identified training as one of the key success drivers. Successful SME-FIs that were visited shared a similar set of standards for management of human resources. These standards included a rigorous screening process for new employees, ongoing vocational training, clear definition of responsibilities for each employee accompanied by performance targets, regular evaluations, and incentives that reward employee contributions. Training is an important success driver, particularly for SME-FIs that operate in high-risk countries, given the paucity of educated staff with experience in this line of business.

## **Box H.2. Training Assists an African SME-FI in an Unpredictable Environment**

An SME-FI is one of the leading commercial banks in an African country. The political and economic environment has been very unpredictable. The bank has an experienced and well-educated executive management committed to its success. All new staff are rigorously screened and, upon joining, undergo two months of intensive training to expose them to the bank's culture, objectives, and modus operandi. Staff are encouraged to seek vocational training sponsored by the SME-FI. A weakness of the market is that the high demand for experienced staff encourages banks to "poach" qualified staff from one another. This problem is market-wide, but this SME-FI had seen a tendency for ex-staff to reapply, once they recognized the SME-FI's qualities on which one can build a career. Staffs' skills in credit assessment and processing were weak, so the bank did not actively pursue this type of business until it has upgraded staff skills. IFC supported a training program to strengthen these weaknesses, which also included a review of all its policies and procedures to identify weaknesses and omissions. The bank's loan portfolio increased from US\$73 million in 2000 to US\$400 million in April 2005. Between 2000 and 2005, NPLs dropped from 6 percent to 4.9 percent in a challenging market.

## **Success Driver #4: Transparency and good governance**

33. A common feature of successful SME-FIs visited for this study was transparency and good governance; this was among the key elements of their success. For similar reasons, as discussed under the transparency success driver for MFIs, transparency and good governance helped SME-FIs grow their loan portfolios and deposits relatively faster, and also placed them in a better position to attract capital.
34. An example related to this success driver is an SME-FI in Africa. The MFI's financial statements were published on the Internet and posted in all branches. Its interest rates and service charges are clearly posted throughout the branch network and loan and deposit products were profiled in dedicated brochures and distributed to the public. This bank's commitment to customer satisfaction and transparency fostered public confidence with the result that the bank had successfully developed their deposit business to the point that aggregate balances grew to more than \$125 million as of 2005, compared with about \$42 million in 2002. The MFI had an ROAE of 38 percent at the end of 2004. Customer deposits as a percentage of total assets reached 69 percent at the end of 2004, while attaining one of the highest loan-to-deposit ratios in the country of 68 percent. Although the MFI is located in a very poor underdeveloped country with a high level of risk, its performance indicators proved that despite the risk, good progress can be made when applying inalienable components of sound banking, including transparency, which helped its healthy growth under challenging circumstances.

### **Box H.3. IFC Helped Enhance the Efficiency of Credit Management of an Asian SME-FI**

A domestically owned SME-FI in Asia is well-established, well-managed, and profitable. Generally well-matched foreign exchange assets and liabilities were all in U.S. dollars as of the mid-1990s. Deposits funded 73 percent of assets. The equivalent of about 20 percent to 30 percent of the value of the assets at risk are held in the form of cash to provide liquidity during stressed market conditions. Liabilities, mainly short term, created a mismatch reflecting the shorter term of the SME-FI's liabilities compared with its loans, but this was not considered a serious problem, because depositors typically roll over a significant portion of their deposits. The SME-FI did not suffer a run on its deposits during economic crisis in the late 1990s in the host country; however, they experienced significant influx of new funds and deposit relationships.

IFC-funded consultants have advised the SME-FI on various aspects of its operations under two sparsely documented TA programs in the areas of strategy, organization, credit risk management, and credit scoring systems in 2002 and 2003. As a result of these interventions, improvements in portfolio quality, risk management, and other areas, including corporate governance, have been observed in the monitoring reports. At the same time, IFC funded a TA operation designed to strengthen the SME-FI's asset liability and funds management systems and processes. IFC also funded enhanced technology and information systems, including a credit scoring system that assists the assessment of retail, SME, and commercial loans. Enhanced loan monitoring and risk grading systems were part of the credit risk management work delivered with apparent good results. As a result of these measures, the SME-FI's nonperforming loans (NPLs) dropped from 15 percent at the end of 1990s to 1.3 percent at the end of 2004. The SME-FI's well-diversified portfolio also had minimal exposure to construction, real estate development, and related parties. During the three years ending December 2003, the SME-FI's loan portfolio grew 200 percent compared with a growth rate of 80 percent for its peers. Deposits grew substantially, and its balance sheet more than quadrupled from 1999 to 2004.

### **Success Driver #5: IFC work quality, including screening and selection of suitable SME-FIs for IFC support**

35. IFC's appraisal work quality, particularly the selection of SME-FIs (with an existing SME client base and commitment to serve the SME market) to finance including its decision to provide TA, also drive the success of SME-FI projects as shown in the table below. However, IFC's appraisal work quality was rated high in only 60 percent (43 out of 72) of the SME-FI projects in the SME-FI study population.

**Table H.3. High IFC Appraisal Work Quality, particularly in the selection of SME-FIs, is another Development Outcome success driver**

	<b>Number of SME-FI</b>	<b>Number of SME-FIs with High DO</b>	<b>Number of SME-FIs with High Equity Outcome</b>	<b>Number of SME-FIs with High Loan Outcome</b>
SME-FI projects with High IFC Appraisal Work Quality	43	79 % of 43 a/	68 % of 22	89 % of 28
SME-FI projects with Low IFC Appraisal Work Quality	29	34 % of 29 a/	29 % of 14	65 % of 20
All 72 SME-FI projects	72	61 % of 72	53 % of 36	79 % of 48

Note: a/ Statistically significant difference at the 0.0001 confidence level.

## **Success Driver #6: IFC equity investment in new or privatized SME-FIs, and in existing SME-FIs to support faster growth than what retained earnings alone can achieve**

36. IFC invested equity in 36 (one-half) of the SME-FIs in the study population, of which 15 were in greenfield or new SME-FIs, 13 were in existing SME-FIs (for expansion) and 8 were in privatizations. In all cases, IFC's equity investment was necessary to achieve minimum capital adequacy regulatory requirements or management targets, and in the case of the existing SME-FIs, also necessary to support growth in lending to SMEs. Notwithstanding these IFC equity investments, about one-third of the subgroup of 36 SME-FIs evaluated in depth by IEG still appear to have inadequate equity (i.e., less than 10 percent of total assets) at the end of 2005, which may explain why 16 SME-FIs in the subgroup of 36 received equity financing from IFC earlier, and may require additional equity injections in the near future.

### **Box H.4. A Small, Dynamic African Bank Achieved Financial Viability Serving SMEs**

As a result of banking sector liberalization in the mid-1990s in the country, a group of local entrepreneurs established one of the country's first private commercial banks. Its lending, trade finance, and foreign exchange services expanded quickly along with the economy. The economy is characterized mainly by a small number of large corporations and a large number of SMEs. The mainstream local banks serve mainly the large corporations and tend to ignore the SMEs. For many SME clients, the bank's service has been essential for their sustainability. Lack of term funds and longer deposits before 2000, however, constrained growth, despite the bank's success in increasing deposits and new retail business via more branches.

IFC invested about US\$3.5 million of senior and subordinated debt in the early 2000s to provide the bank much needed term as well as second-tier capital. IFC also provided TA to establish a risk management system, which became a priority when the bank began doubling its business very quickly. Following IFC's financing, the bank continued to expand rapidly and profitably, with an asset size which, as of March 2005, had reached US\$150 million. At the same time, the bank's medium-term financing to SMEs grew from an insignificant level in 2002 to more than US\$17 million in 2004. When fast expansion strained the bank's capacity, IFC provided more TA to further develop its risk management system and a third financing facility to continue the bank's outreach to SMEs. The bank exhibits material regulatory compliance, good governance, a continuous high loan-to-deposits ratio, good returns, and good portfolio quality, all of which indicate good financial intermediation and economic sustainability.

The IEG field visit identified the following main success factors:

- **Good IFC client selection.** IFC supported a young and dynamic private bank, whose reform-oriented owners and managers had a well-thought-out strategy for its core SME business and strong commitment to transparency and good governance. The bank was efficient and competitive and established good practice standards in the newly liberalized banking sector. Furthermore, the bank has a strong employee incentive program with performance targets, evaluations, and reward systems designed to maximize productivity.
- **Strong, existing SME client base.** The bank had built a well-diversified and profitable SME client base in a largely underserved market, generally linked to growth sectors.
- **Term funds from IFC helped strengthen the capital base and balance sheet.** Although the amounts of the IFC investments were not large relative to the bank's assets, the subordinated debt component helped improve capital adequacy and the term loans provided maturity matching. As a result, the bank attracted new clients and grew its SME business more quickly.
- **Trade finance intermediary.** Since its establishment, the bank has been a key trade finance and foreign exchange intermediary. This business is a very specific short-term, self-liquidating type of business that generates low-risk fee income, which until recently has been the main line of the bank's business.
- **Commitment to transparency.** The bank's financial statements are published on the Internet and posted in branches. Interest and service charges are clearly and publicly posted throughout the branch network. The management culture, coupled with the bank's commitment to customer satisfaction, has fostered public confidence; the result has been the successful development of its deposit business, which is now in excess of US\$125 million.

### **Box H.5. A Bank Achieves 10 Years of Continuous Success, Despite the Asian Crisis**

An Asian bank has a long-standing SME business and survived the Asian crisis to achieve nearly 10 years of continuous success. IFC provided an aggregate of US\$15 million in loans and equity in the late 1990s before the crisis and early 2000s after the crisis. In the early 2000s, IFC also provided TA to improve corporate strategy, organizational structure, as well as risk and asset liability management, although involving modest TA amounts relative to the bank's size.

From 1999, as the Asian crisis subdued, the bank's assets more than quadrupled in five years via its extended branch network, supported by several rounds of IFC financing. In the three years to the end of 2003, the bank's loan portfolio grew more than 200 percent, compared with 80 percent for its peers, as a result of its conservative lending policies and risk diversification during and following the Asian crisis. Despite the Asian crisis and follow-up economic difficulties during the late-1990s, the bank suffered relatively minor damage, buffered by its sound capital base, diverse loan portfolio, and sound lending policies, as well as its SME focus. The profitable expansion and low credit arrears in its SME portfolio, even during the Asian crisis made for good economic sustainability and contribution to growth. The bank employed about 3,000 people in 2004. The crowning success was the acquisition of a majority interest in the bank by a leading regional bank in 2005.

The IEG field visit identified the following key success drivers:

- **Strong governance and diverse board.** Members of the bank's board are well educated and possess considerable banking experience. Sound governance has driven development of comprehensive policies and clear business plans to guide the bank. Training has been institutionalized, structured, and focused according to the needs of the bank and its staff.
- **Sound capital base and ability to raise funds from the public.** The bank sold 20 percent of its shares to the public following its initial listing in the mid-1990s. The bank subsequently went to the market several times. It has also successfully issued five-year bonds to reduce its maturity mismatch.
- **Sound lending policy and credit risk management.** The bank's loan portfolio has been well selected, diversified, and managed with credit decisions given only by committees requiring unanimous agreement to transactions. The bank has had minimal exposure to the construction and real estate development sector. IFC funded a consultant to modernize the credit risk management process complemented by the delivery of a credit scoring lending model that brings consistency to the analysis and accelerates the processing time of loan applications.
- **Large underserved SME market.** The bank has 160 operating units or branches throughout the country and is one of the few private financial institutions that serve the SME market. This advantage coupled with a large underserved SME sector propelled its growth and success.
- **Sound conservative asset liability management.** The bank has well matched its foreign exchange assets and liabilities. Deposits from the public funded 73 percent of its assets. About 20 to 30 percent of the bank's assets have been held in cash or other liquid instruments, which have provided liquidity during stressed market conditions.
- **Term funding in support of post-crisis stabilization and growth.** IFC senior and convertible loans, along with a new equity injection and subsequent guarantee facility after the Asian crisis helped diversify the bank's liability structure, reduce maturity mismatches, and further supported lending to SMEs, including consumer credit and leasing.
- **Nearly a decade of IFC support contributed to attracting a strategic investor for the bank.** IFC's investments coupled with committed and innovative management allowed the bank not only to survive, but prosper in difficult economic times, and eventually attract a major regional bank as a strategic majority investor. The majority stake taken by this strong regional strategic investor will reinforce the bank's competitive strength and contribute to the growth of the SME sector.

**Table H.4. LIST OF SME-FIS AND AGGREGATE FINANCIAL DATA FOR SUBGROUP**

SME-FI-ID	Approval FY	Region- Five	Equity	Loan	TA	Typology
SME-FI-1	Sub-period 3	EUROPE & CENTRAL ASIA	✓			Greenfield
SME-FI-2	Sub-period 3	AFRICA		✓		Expansion
SME-FI-3	Sub-period 1	MENA		✓		Expansion
SME-FI-4	Sub-period 3	ASIA		✓	✓	Expansion
SME-FI-5	Sub-period 3	ASIA	✓		✓	Expansion
SME-FI-6	Sub-period 1	EUROPE & CENTRAL ASIA	✓			Greenfield
SME-FI-7	Sub-period 3	AFRICA	✓			Privatization
SME-FI-8	Sub-period 2	EUROPE & CENTRAL ASIA	✓		✓	Privatization
SME-FI-9	Sub-period 3	AFRICA	✓	✓		Privatization
SME-FI-10	Sub-period 3	AFRICA	✓			Privatization
SME-FI-11	Sub-period 3	ASIA	✓	✓	✓	Expansion
SME-FI-12	Sub-period 1	LAC		✓		Expansion
SME-FI-13	Sub-period 3	AFRICA		✓	✓	Expansion
SME-FI-14	Sub-period 3	ASIA	✓		✓	Greenfield
SME-FI-15	Sub-period 3	EUROPE & CENTRAL ASIA	✓	✓	✓	Privatization
SME-FI-16	Sub-period 3	EUROPE & CENTRAL ASIA		✓	✓	Expansion
SME-FI-17	Sub-period 2	EUROPE & CENTRAL ASIA		✓		Expansion
SME-FI-18	Sub-period 1	EUROPE & CENTRAL ASIA	✓	✓		Greenfield
SME-FI-19	Sub-period 3	EUROPE & CENTRAL ASIA		✓		Expansion
SME-FI-20	Sub-period 2	MENA	✓			Expansion
SME-FI-21	Sub-period 1	AFRICA	✓			Expansion
SME-FI-22	Sub-period 3	AFRICA		✓		Expansion
SME-FI-23	Sub-period 3	EUROPE & CENTRAL ASIA		✓	✓	Expansion
SME-FI-24	Sub-period 2	EUROPE & CENTRAL ASIA	✓	✓	✓	Expansion
SME-FI-25	Sub-period 3	EUROPE & CENTRAL ASIA		✓	✓	Expansion
SME-FI-26	Sub-period 3	EUROPE & CENTRAL ASIA		✓	✓	Expansion
SME-FI-27	Sub-period 1	LAC	✓	✓		Expansion
SME-FI-28	Sub-period 3	EUROPE & CENTRAL ASIA		✓	✓	Expansion
SME-FI-29	Sub-period 2	LAC		✓		Expansion
SME-FI-30	Sub-period 3	AFRICA		✓		Expansion
SME-FI-31	Sub-period 3	EUROPE & CENTRAL ASIA		✓	✓	Expansion
SME-FI-32	Sub-period 3	AFRICA		✓		Greenfield
SME-FI-33	Sub-period 3	EUROPE & CENTRAL ASIA		✓	✓	Expansion
SME-FI-34	Sub-period 2	EUROPE & CENTRAL ASIA		✓		Privatization
SME-FI-35	Sub-period 2	EUROPE & CENTRAL ASIA	✓	✓		Expansion
SME-FI-36	Sub-period 1	MENA	✓			Greenfield
SME-FI-37	Sub-period 2	AFRICA		✓		Expansion
SME-FI-38	Sub-period 1	MENA		✓		Expansion
SME-FI-39	Sub-period 1	AFRICA		✓		Expansion
SME-FI-40	Sub-period 1	AFRICA		✓		Expansion
SME-FI-41	Sub-period 1	MENA		✓		Expansion
SME-FI-42	Sub-period 1	AFRICA	✓			Greenfield
SME-FI-43	Sub-period 1	ASIA	✓	✓	✓	Greenfield
SME-FI-44	Sub-period 1	ASIA	✓			Greenfield
SME-FI-45	Sub-period 1	EUROPE & CENTRAL ASIA	✓			Greenfield
SME-FI-46	Sub-period 1	MENA		✓		Privatization
SME-FI-47	Sub-period 1	EUROPE & CENTRAL ASIA		✓		Expansion
SME-FI-48	Sub-period 1	EUROPE & CENTRAL ASIA	✓			Greenfield
SME-FI-49	Sub-period 1	AFRICA	✓	✓		Expansion
SME-FI-50	Sub-period 1	AFRICA	✓			Expansion
SME-FI-51	Sub-period 2	AFRICA		✓		Expansion
SME-FI-52	Sub-period 1	EUROPE & CENTRAL ASIA	✓			Greenfield
SME-FI-53	Sub-period 2	EUROPE & CENTRAL ASIA	✓		✓	Greenfield
SME-FI-54	Sub-period 2	AFRICA	✓			Expansion
SME-FI-55	Sub-period 2	AFRICA		✓		Expansion
SME-FI-56	Sub-period 2	AFRICA		✓		Expansion
SME-FI-57	Sub-period 2	EUROPE & CENTRAL ASIA	✓	✓		Expansion
SME-FI-58	Sub-period 2	AFRICA	✓			Privatization
SME-FI-59	Sub-period 2	AFRICA	✓			Greenfield
SME-FI-60	Sub-period 2	EUROPE & CENTRAL ASIA		✓		Expansion
SME-FI-61	Sub-period 2	EUROPE & CENTRAL ASIA		✓		Expansion
SME-FI-62	Sub-period 2	MENA	✓			Greenfield
SME-FI-63	Sub-period 2	AFRICA		✓		Privatization
SME-FI-64	Sub-period 2	AFRICA	✓	✓		Expansion
SME-FI-65	Sub-period 2	EUROPE & CENTRAL ASIA		✓	✓	Expansion
SME-FI-66	Sub-period 3	EUROPE & CENTRAL ASIA	✓			Privatization
SME-FI-67	Sub-period 2	EUROPE & CENTRAL ASIA		✓		Privatization
SME-FI-68	Sub-period 3	EUROPE & CENTRAL ASIA	✓			Greenfield
SME-FI-69	Sub-period 3	ASIA	✓			Expansion
SME-FI-70	Sub-period 3	EUROPE & CENTRAL ASIA		✓	✓	Expansion
SME-FI-71	Sub-period 3	EUROPE & CENTRAL ASIA		✓	✓	Expansion
SME-FI-72	Sub-period 3	EUROPE & CENTRAL ASIA	✓	✓	✓	Privatization

**Table H.5. Aggregate Financial Data for a Subgroup of 36 (out of 72) SME-FIs**

SME-FI-ID	Approval FY	Equity	Loan	TA	As of End 2005				Two-Year (2004 & 2005) Averages												
					Subloan Data 1/			Total Loans (\$ millions)	Total Assets (\$ millions)	Funding (Liability) Structure (as a % of average assets)			Ave. Deposits as % of Ave. Loans	Ave. Loans as % of Ave. Assets	Income and Fees from Loans as % of Ave Loans	Cost Structure			NPL Rate(as of Yr-end 2005) 3/	ROA	ROE
					Number MSME Borrowers 2/	MSME Loans 2/	MSME Loans as a % of All Loans by amount			Average Deposits	Average Debt 4/	Average Equity				Non-Interest Expense as % of Ave. Loans	Interest Expense as a % of Ave. Deposits	Other Interest Expense as a % of Ave. Debt			
SME-FI-1	Sub-period 3	✓					1108	1676	89%	3%	8%	142%	64.3%	8.3%	5.5%	2.1%	3.3%	4.8%	2.0%	25.0%	
SME-FI-2	Sub-period 3		✓		634	152	3%	5812	12422	89%	5%	5%	194%	46.2%	12.6%	6.7%	7.0%	5.1%	2.4%	43.1%	
SME-FI-3	Sub-period 1		✓					675	4656	88%	4%	8%	573%	15.3%	6.0%	9.7%	4.9%	3.4%	0.9%	11.2%	
SME-FI-4	Sub-period 3		✓	✓				13	18	86%	3%	11%	123%	73.9%	15.1%	14.7%	4.6%	0.0%	1.4%	12.3%	
SME-FI-5	Sub-period 3	✓		✓	2451	82	8%	970	1581	84%	4%	12%	183%	54.1%	15.9%	7.8%	5.0%	7.4%	2.0%	3.5%	
SME-FI-6	Sub-period 1	✓			9	3	41%	7	88	84%	5%	11%	994%	7.2%	17.0%	73% 7/	1.7%	13.7%	0.0%	0.5%	
SME-FI-7	Sub-period 3	✓			769	85	35%	244	540	83%	8%	9%	203%	42.7%	9.0%	12.9%	0.6%	0.0%	6.4%	3.7%	
SME-FI-8	Sub-period 2	✓		✓	151631	93	24%	382	647	83%	6%	12%	182%	54.3%	12.3%	11.2%	1.5%	23.0%	27.8%	0.3%	
SME-FI-9	Sub-period 3	✓	✓					106	238	83%	11%	7%	207%	41.4%	11.4%	13.1%	2.1%	0.0%	1.9%	28.2%	
SME-FI-10	Sub-period 3	✓						375	616	82%	8%	9%	135%	57.8%	10.4%	8.0%	3.5%	0.0%	2.4%	26.1%	
SME-FI-11	Sub-period 3	✓	✓	✓	8079	329	27%	1223	1890	82%	12%	6%	129%	60.6%	11.1%	4.7%	5.3%	9.7%	1.7%	1.1%	
SME-FI-12	Sub-period 1	✓	✓					369	568	80%	9%	11%	122%	65.1%	10.3%	6.0%	2.1%	0.0%	1.3%	12.4%	
SME-FI-13	Sub-period 3		✓	✓				86	184	79%	13%	8%	176%	45.5%	17.5%	8.2%	3.9%	0.7%	3.0%	38.7%	
SME-FI-14	Sub-period 3	✓	✓	✓	21753	113	58%	197	282	78%	16%	6%	115%	65.5%	15.5%	6.5%	7.2%	4.5%	4.0%	1.4%	
SME-FI-15	Sub-period 3	✓	✓	✓	4273	188	23%	833	1881	78%	9%	13%	177%	45.7%	21.0%	17.4%	5.0%	4.0%	0.0%	1.0%	
SME-FI-16	Sub-period 3	✓	✓	✓	4476	91	87%	105	146	77%	8%	16%	107%	70.0%	16.2%	11.3%	4.9%	23.8%	2.3%	5.1%	
SME-FI-17	Sub-period 2				219	20	49%	41	64	76%	11%	14%	126%	63.5%	17.1%	9.7%	3.2%	20.5%	1.4%	3.1%	
SME-FI-18	Sub-period 1	✓						271	411	75%	9%	16%	133%	54.0%	5.8%	10.3%	0.8%	6.2%	5.0%	32.3%	
SME-FI-19	Sub-period 3	✓	✓		855	63	74%	85	163	73%	13%	13%	140%	51.6%	17.0%	9.0%	5.6%	0.0%	4.5%	3.5%	
SME-FI-20	Sub-period 2	✓						83	342	73%	14%	12%	365%	24.7%	11.2%	12.3%	0.4%	0.0%	1.9%	15.0%	
SME-FI-21	Sub-period 1	✓						127	201	72%	24%	4%	113%	59.6%	10.7%	5.8%	3.5%	5.6%	0.0%	0.0%	
SME-FI-22	Sub-period 3		✓		1881	231	58%	400	988	70%	16%	13%	179%	40.1%	16.5%	19.5%	4.4%	0.0%	9.6%	1.8%	
SME-FI-23	Sub-period 3		✓	✓	870	40	94%	43	70	70%	13%	17%	111%	61.4%	18.8%	10.7%	7.0%	3.8%	0.1%	3.9%	
SME-FI-24	Sub-period 2	✓	✓	✓	1162	117	55%	211	333	66%	17%	17%	106%	61.3%	15.4%	8.3%	3.9%	5.1%	0.0%	5.6%	
SME-FI-25	Sub-period 3	✓	✓	✓	6568	106	60%	178	257	66%	13%	21%	97%	61.8%	17.6%	15.1%	3.6%	10.4%	4.1%	1.0%	
SME-FI-26	Sub-period 3	✓	✓	✓	605	40	46%	88	140	66%	20%	15%	106%	63.9%	17.1%	7.7%	6.3%	7.2%	2.9%	19.8%	
SME-FI-27	Sub-period 1	✓	✓					378	536	64%	22%	14%	89%	70.4%	8.5%	4.5%	3.6%	0.0%	-1.0%	-6.6%	
SME-FI-28	Sub-period 3		✓	✓	2602	178	35%	506	801	62%	28%	10%	102%	58.9%	16.2%	11.3%	5.9%	11.1%	3.7%	0.7%	
SME-FI-29	Sub-period 2		✓		4183	0.3	16%	1609	2560	61%	23%	9%	101%	61.7%	7.3%	6.0%	1.9%	4.3%	2.8%	1.2%	
SME-FI-30	Sub-period 3		✓		4203	97	33%	298	702	59%	18%	24%	138%	41.8%	18.2%	20.6%	5.8%	6.1%	22.6%	1.0%	
SME-FI-31	Sub-period 3		✓	✓	4866	17	45%	38	52	56%	22%	22%	75%	75.1%	27.9%	13.4%	16.6%	10.3%	0.0%	5.0%	
SME-FI-32	Sub-period 3		✓	4/				154	484	53%	32%	14%	157%	31.8%	22.5%	13.5%	0.0%	0.0%	5.4%	37.1%	
SME-FI-33	Sub-period 3		✓	✓	165	13	100%	13	17	51%	36%	13%	65%	80.7%	22.8%	6.4%	10.6%	23.9%	0.0%	0.7%	
SME-FI-34	Sub-period 2		✓		1516	59	15%	394	508	35%	32%	33%	47%	74.6%	8.7%	7.6%	3.8%	4.4%	2.5%	0.3%	
SME-FI-35	Sub-period 2	✓	✓					5762	8918	28%	64%	8%	43%	66.8%	13.6%	2.5%	15.9%	0.0%	1.8%	22.6%	
SME-FI-36	Sub-period 1	✓						4	14	1%	84%	15%	10%	33.4%	11.6%	11.2%	1.4%	0.3%	-0.2%	-1.6%	

SME-FI	As of End 2005		Two-Year (2004 & 2005) Averages											
	Total Loans (\$ millions)	Total Assets (\$ millions)	Funding (Liability) Structure (as a % of average assets)			Ave. Deposits as % of Ave. Loans	Ave. Loans as % of Ave. Assets	Income and Fees from Loans as % of Ave Loans	Cost Structure			NPL Rate(as of Yr-end 2005) 2/	ROA	ROE
			Average Deposits	Average Debt	Average Equity				Non-Interest Expense as % of Ave. Loans	Interest Expense as a % of Ave. Deposits	Other Interest Expense as a % of Ave. Debt 8/			
<b>Aggregate 36</b>	23,187	44,991	70.3%	20.5%	9.2%	142.5%	50.4%	12.4%	7.0%	5.5%	5.6%	4.7%	1.8%	19.4%
<b>Aggregate 16 with TA</b>	5,038	8,781	76.0%	12.0%	11.0%	145.0%	53.0%	15.5%	9.5%	3.4%	8.2%	3.8%	2.1%	18.4%
<b>Aggregate 20 with No-TA</b>	18,149	36,210	68.0%	23.0%	9.0%	142.0%	48.0%	11.5%	6.3%	4.2%	4.0%	5.1%	1.8%	20.3%

- Notes:
- 1/ Subloan Data for 22 banks only.
  - 2/ MSME loans only (excluding housing and other consumer loans).
  - 3/ Non-performing loans are overdue loans 90 days at the end of fiscal year
  - 4/ Includes subordinated debt & accrued liabilities
  - 5/ Sponsor provided TA
  - 6/ Approval FY94-96 = Sub-period 1; FY97-99 = Sub-period 2; and FY00-02 = Sub-period 3
  - 7/ High due to low Bank's loan base as the bank maintains 70% of the assets in short term securities and interest earning deposits
  - 8/ The Aggregate interest paid on debts excludes banks who have no other interest expense related to debt

## Aggregate Financial Statements for a Subgroup of 36 (out of 72) SME-FIs

### Balance Sheet (In US\$ thousands)

Financial Statement Date	1999	2000	2001	2002	2003	2004	2005
Cash & Due From Banks (Non-Int Bearing)	797,794	1,185,764	1,832,998	1,924,256	2,259,848	4,094,620	5,486,376
Interest Earning Deposits & ST Securities	710,947	3,547,073	4,959,690	5,034,884	6,944,944	11,078,929	12,343,934
Accrued Interest Receivable	38,508	48,851	106,191	103,706	45,359	164,056	153,709
Gross Loans	2,264,622	5,612,179	6,620,986	8,120,670	10,343,822	18,464,175	23,215,140
Unearned Income (-)	16	330	9,794	10,803	110,363	106,637	28,323
<b>Total Loans</b>	<b>2,264,606</b>	<b>5,611,849</b>	<b>6,611,192</b>	<b>8,109,867</b>	<b>10,233,459</b>	<b>18,357,538</b>	<b>23,186,817</b>
Allowance for Loan Loss Reserve (-)	223,854	340,207	429,590	669,021	454,231	551,262	788,744
<b>Net Loans</b>	<b>2,040,752</b>	<b>5,271,642</b>	<b>6,181,602</b>	<b>7,440,846</b>	<b>9,779,228</b>	<b>17,806,276</b>	<b>22,398,073</b>
Total Long Term Securities	1,448,042	1,942,589	1,525,539	2,234,253	2,146,990	2,287,842	2,359,065
Investments in Subsidiaries	20,568	23,889	21,754	22,619	13,533	43,941	121,684
Net Fixed Assets	313,481	555,861	615,734	701,025	745,734	869,203	966,249
Other Real Estate Owned (OREO)	445	352	480	20,844	21,248	15,844	11,775
Other Assets	177,166	557,907	630,494	735,125	822,481	1,094,539	1,150,467
<b>TOTAL ASSETS</b>	<b>5,547,703</b>	<b>13,133,928</b>	<b>15,874,481</b>	<b>18,217,558</b>	<b>22,779,368</b>	<b>37,455,248</b>	<b>44,991,330</b>
Demand Deposits (Non-Interest Bearing)	-	156,736	252,997	247,932	527,978	646,870	800,631
Savings Deposits	867,460	1,570,483	2,220,346	2,624,273	3,253,257	4,687,513	5,132,348
Other Non-Int Bearing Deposits	1,738,114	2,714,181	3,565,501	4,194,229	5,728,825	9,180,596	10,500,025
All other Interest bearing Deposits	161,871	127,897	162,256	202,815	295,941	429,323	378,752
<b>Total Deposits</b>	<b>1,061,492</b>	<b>5,275,705</b>	<b>5,736,792</b>	<b>6,526,489</b>	<b>7,091,800</b>	<b>12,951,730</b>	<b>15,217,784</b>
Overnight and Short Term Borrowings	3,828,937	9,688,266	11,684,895	13,547,807	16,369,822	27,249,162	31,263,447
Long-Term Debt	165,749	179,128	254,072	231,081	639,093	3,549,528	5,770,866
Other Non-Int Bearing Liabilities-LT	444,840	683,585	853,765	912,140	1,096,979	926,995	1,363,402
<b>Total Debt</b>	<b>202,711</b>	<b>691,250</b>	<b>817,614</b>	<b>927,500</b>	<b>1,693,391</b>	<b>1,510,896</b>	<b>1,088,545</b>
Subordinated Debt	813,300	1,553,963	1,925,450	2,070,720	3,429,463	5,963,749	8,195,407
Accrued Liabilities	6,597	97,864	121,602	182,308	299,734	503,923	669,883
<b>TOTAL LIABILITIES AND SUBORDINATED DEBT</b>	<b>4,830,013</b>	<b>11,747,674</b>	<b>14,272,740</b>	<b>16,288,682</b>	<b>20,667,973</b>	<b>34,160,846</b>	<b>40,837,417</b>
Common Stock	321,013	650,781	704,887	888,442	987,572	1,212,067	1,413,695
Surplus	2,249	62,806	74,676	100,426	168,381	822,200	1,040,636
Reevaluation of fixed assets	23,327	23,341	72,814	40,315	103,950	44,090	47,930
Capital reserve	58,801	196,313	255,521	247,554	185,731	242,128	314,773
Revaluation Reserves	39,236	40,777	23,906	55,478	49,376	24,047	30,918
Retained Earnings	273,064	412,236	469,937	596,661	616,385	949,870	1,305,961
<b>TOTAL EQUITY</b>	<b>717,690</b>	<b>1,386,254</b>	<b>1,601,741</b>	<b>1,928,876</b>	<b>2,111,395</b>	<b>3,294,402</b>	<b>4,153,913</b>
<b>TOTAL LIABS &amp; EQUITY</b>	<b>5,547,703</b>	<b>13,133,928</b>	<b>15,874,481</b>	<b>18,217,558</b>	<b>22,779,368</b>	<b>37,455,248</b>	<b>44,991,330</b>

### Income Statement (In US\$ thousands)

Financial Statement Date	1999	2000	2001	2002	2003	2004	2005
Int Income & Fees on Loans	410,101	979,097	1,065,684	1,152,052	1,309,861	1,813,689	2,316,970
Int Income on other investments	216,714	386,602	435,689	451,379	465,200	831,876	890,699
<b>TOTAL INTEREST INCOME</b>	<b>626,815</b>	<b>1,365,699</b>	<b>1,501,373</b>	<b>1,603,430</b>	<b>1,775,061</b>	<b>2,645,565</b>	<b>3,207,670</b>
Interest Exp on Deposits	295,219	683,692	722,868	775,845	864,885	1,180,599	1,462,071
Interest Exp on Borrowings/Other Brwd funds	43,171	87,620	80,122	75,917	61,652	81,818	113,336
Interest Exp on Subord Debt	18,438	16,607	7,412	16,114	8,808	4,698	9,324
Other Int Expense	4,908	18,956	24,731	19,108	20,480	35,747	40,843
<b>TOTAL INTEREST EXPENSE</b>	<b>361,736</b>	<b>806,876</b>	<b>835,134</b>	<b>886,984</b>	<b>955,825</b>	<b>1,302,861</b>	<b>1,604,438</b>
<b>NET INTEREST INCOME</b>	<b>265,079</b>	<b>558,821</b>	<b>666,239</b>	<b>716,445</b>	<b>819,236</b>	<b>1,342,705</b>	<b>1,603,230</b>
Provision for Loan Losses	108,660	101,540	186,407	223,638	247,463	310,573	382,263
<b>INT INC NET OF LOSS PROV</b>	<b>156,419</b>	<b>457,281</b>	<b>479,832</b>	<b>492,807</b>	<b>571,773</b>	<b>1,032,132</b>	<b>1,220,969</b>
Fee Income & Commissions	90,379	170,175	178,459	235,849	255,168	372,474	400,354
All other Non-Interest Income	149,394	233,366	257,303	259,795	223,417	316,030	404,750
<b>TOTAL NON-INTEREST INCOME</b>	<b>239,772</b>	<b>403,541</b>	<b>435,762</b>	<b>495,643</b>	<b>478,585</b>	<b>688,504</b>	<b>805,104</b>
<b>TOTAL REVENUE</b>	<b>396,192</b>	<b>860,823</b>	<b>915,592</b>	<b>988,451</b>	<b>1,050,356</b>	<b>1,720,635</b>	<b>2,026,073</b>
Salaries Expense/Employee Benefits	92,859	188,400	217,353	266,818	240,510	392,262	450,664
Administrative expense	109,382	235,777	281,980	293,741	463,658	580,747	657,208
Depreciation/Amortization	45,597	66,446	64,819	80,086	83,924	114,374	140,238
<b>TOTAL NON-INTEREST EXPENSE</b>	<b>247,838</b>	<b>490,623</b>	<b>564,152</b>	<b>640,644</b>	<b>788,091</b>	<b>1,087,382</b>	<b>1,247,692</b>
<b>OPERATING INCOME</b>	<b>148,353</b>	<b>370,198</b>	<b>351,438</b>	<b>347,809</b>	<b>262,266</b>	<b>633,254</b>	<b>778,378</b>
Non-Operating Income/exp	-	-	(21,092)	(27,792)	(1,384)	9,169	12,563
<b>INC B4 TAX, EXTRAORD &amp; SECURITIES</b>	<b>148,354</b>	<b>370,198</b>	<b>330,346</b>	<b>320,017</b>	<b>260,881</b>	<b>642,423</b>	<b>790,940</b>
Income Tax	37,049	54,629	59,725	35,662	62,233	114,698	89,415
Extr. Items & Adjust (+/-) Net of Taxes	11,531	14,763	1,658	(523)	2,875	767	20,722
Minority Interest	(552)	335	(914)	45	2,560	12,803	1,582
<b>NET INCOME</b>	<b>122,138</b>	<b>327,981</b>	<b>268,711</b>	<b>277,237</b>	<b>194,287</b>	<b>499,221</b>	<b>715,843</b>

**Table H.6. Aggregate Financial Statements for 16 SME-FIs That Received TA in the Subgroup of 36**

<b>Balance Sheet (In US\$ thousands)</b>							
<b>Statement Date</b>	<b>1999</b>	<b>2000</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>
Cash & Due From Banks (Non-Int Bearing)	267,689	373,968	396,085	377,585	595,810	623,055	700,898
Interest Earning Deposits & ST Securities	55,637	1,006,445	1,358,825	1,928,329	1,914,991	2,045,696	1,974,089
Accrued Interest Receivable	5,264	5,010	6,358	13,087	20,598	33,888	38,422
Gross Loans	365,543	673,198	998,519	2,079,613	3,034,872	4,070,266	5,038,291
Unearned Income (-)	-	-	5,000	11,000	17,000	-	21
<b>Total Loans</b>	<b>365,543</b>	<b>673,198</b>	<b>993,519</b>	<b>2,068,613</b>	<b>3,017,872</b>	<b>4,070,266</b>	<b>5,038,270</b>
Allowance for Loan Loss Reserve (-)	77,218	64,719	80,922	108,588	96,621	160,483	182,824
<b>Net Loans</b>	<b>288,325</b>	<b>608,479</b>	<b>912,597</b>	<b>1,960,025</b>	<b>2,921,251</b>	<b>3,909,783</b>	<b>4,855,446</b>
Total Long Term Securities	128,560	116,990	111,967	353,617	609,473	826,936	613,749
Investments in Subsidiaries	-	-	-	1,000	6,000	6,258	8,894
Net Fixed Assets	170,223	190,021	218,062	273,201	276,514	336,617	386,343
Other Real Estate Owned (OREO)	445	352	-	20,000	20,000	15,000	11,246
Other Assets	32,475	48,462	54,592	83,298	120,665	210,078	191,880
<b>TOTAL ASSETS</b>	<b>948,618</b>	<b>2,349,727</b>	<b>3,058,485</b>	<b>5,010,143</b>	<b>6,485,304</b>	<b>8,007,310</b>	<b>8,780,966</b>
Demand Deposits (Non-Interest Bearing)	437,195	792,111	1,099,114	902,020	1,324,983	1,697,993	1,810,386
Savings Deposits	52,235	512,087	448,961	208,589	487,921	1,164,738	1,249,043
Other Non-Int Bearing Deposits	225	9,358	22,080	39,424	70,857	214,944	195,400
All other Interest bearing Deposits	121,523	533,240	705,357	2,618,458	3,094,157	2,952,412	3,429,684
<b>Total Deposits</b>	<b>611,178</b>	<b>1,846,796</b>	<b>2,275,512</b>	<b>3,768,492</b>	<b>4,977,917</b>	<b>6,030,087</b>	<b>6,684,514</b>
Overnight and Short Term Borrowings	55,410	18,628	18,852	102,642	132,907	209,514	183,209
Long-Term Debt	68,972	91,441	107,705	155,543	178,440	274,925	351,519
Other Non-Int Bearing Liabilities-LT	330	39,137	62,786	91,548	147,931	293,283	307,334
<b>Total Debt</b>	<b>124,712</b>	<b>149,206</b>	<b>189,343</b>	<b>349,733</b>	<b>459,278</b>	<b>777,722</b>	<b>842,062</b>
Subordinated Debt	-	-	5,249	25,747	98,577	111,421	58,193
Accrued Liabilities	68,162	67,184	208,888	262,898	267,426	172,885	168,516
<b>TOTAL LIABILITIES AND SUBORDINATED DEBT</b>	<b>804,051</b>	<b>2,063,185</b>	<b>2,678,991</b>	<b>4,406,870</b>	<b>5,803,198</b>	<b>7,092,115</b>	<b>7,753,285</b>
Common Stock	47,024	159,057	177,748	313,060	361,463	521,582	538,710
Surplus	18	25,731	42,376	58,701	64,843	28,542	35,562
Reevaluation of fixed assets	-	33	53,000	12,748	65,405	3,865	6,975
Capital reserve	28,365	26,066	33,333	36,700	47,516	95,793	110,783
Revaluation Reserves	36,293	34,654	22,000	53,650	43,298	13,224	19,039
Retained Earnings	32,867	41,001	51,037	128,414	99,581	252,189	316,612
<b>TOTAL EQUITY</b>	<b>144,567</b>	<b>286,542</b>	<b>379,494</b>	<b>603,273</b>	<b>682,106</b>	<b>915,195</b>	<b>1,027,681</b>
<b>TOTAL LIABS &amp; EQUITY</b>	<b>948,618</b>	<b>2,349,727</b>	<b>3,058,485</b>	<b>5,010,143</b>	<b>6,485,304</b>	<b>8,007,310</b>	<b>8,780,966</b>

<b>Income Statement (In US\$ thousands)</b>							
<b>Statement Date</b>	<b>1999</b>	<b>2000</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>
Int Income & Fees on Loans	144,979	278,665	358,310	477,736	574,598	569,910	681,843
Int Income on other investments	19,796	16,467	37,588	68,125	75,654	133,401	127,300
<b>TOTAL INTEREST INCOME</b>	<b>164,775</b>	<b>295,132</b>	<b>395,898</b>	<b>545,860</b>	<b>650,252</b>	<b>703,311</b>	<b>809,144</b>
Interest Exp on Deposits	78,856	168,681	174,681	277,283	321,176	250,842	291,646
Interest Exp on Borrowings/Other Brwd funds	10,608	11,788	17,682	26,156	31,122	37,832	43,343
Interest Exp on Subord Debt	19	23	24	194	7,695	3,190	6,871
Other Int Expense	4,896	3,947	10,828	6,544	8,896	19,540	17,219
<b>TOTAL INTEREST EXPENSE</b>	<b>94,379</b>	<b>184,440</b>	<b>203,216</b>	<b>310,177</b>	<b>368,890</b>	<b>311,403</b>	<b>359,655</b>
<b>NET INTEREST INCOME</b>	<b>70,396</b>	<b>110,691</b>	<b>192,682</b>	<b>235,682</b>	<b>281,362</b>	<b>391,908</b>	<b>449,488</b>
Provision for Loan Losses	45,878	14,093	48,075	35,352	41,219	47,014	40,223
<b>INT INC NET OF LOSS PROV</b>	<b>24,518</b>	<b>96,598</b>	<b>144,607</b>	<b>200,330</b>	<b>240,143</b>	<b>344,894</b>	<b>409,265</b>
Fee Income & Commissions	48,234	62,759	68,543	81,210	73,891	89,625	88,699
All other Non-Interest Income	35,388	16,225	38,600	61,921	75,558	101,449	119,150
<b>TOTAL NON-INTEREST INCOME</b>	<b>83,621</b>	<b>78,984</b>	<b>107,143</b>	<b>143,130</b>	<b>149,449</b>	<b>191,074</b>	<b>207,850</b>
<b>TOTAL REVENUE</b>	<b>108,140</b>	<b>175,582</b>	<b>251,749</b>	<b>343,460</b>	<b>389,590</b>	<b>535,968</b>	<b>617,115</b>
Salaries Expense/Employee Benefits	45,241	62,667	66,771	100,361	112,098	152,717	187,855
Administrative expense	26,022	50,634	81,824	92,062	138,835	143,139	162,666
Depreciation/Amortization	37,407	35,573	22,196	27,207	35,651	48,520	73,087
<b>TOTAL NON-INTEREST EXPENSE</b>	<b>108,670</b>	<b>148,874</b>	<b>170,791</b>	<b>219,630</b>	<b>286,584</b>	<b>344,375</b>	<b>423,191</b>
<b>OPERATING INCOME</b>	<b>(530)</b>	<b>26,706</b>	<b>80,956</b>	<b>123,831</b>	<b>103,007</b>	<b>191,594</b>	<b>193,923</b>
Non-Operating Income/exp	-	-	-	-	452	742	1,603
<b>INC B4 TAX, EXTRAORD &amp; SECURITIES</b>	<b>(529)</b>	<b>26,706</b>	<b>80,956</b>	<b>123,831</b>	<b>103,459</b>	<b>192,336</b>	<b>195,526</b>
Income Tax	12,590	20,418	36,221	34,152	30,942	34,878	33,907
Extr. Items & Adjust (+/-) Net of Taxes	11,952	14,863	4,726	(633)	2,340	(115)	(72)
Minority Interest	(576)	(894)	(997)	(179)	(325)	1,698	586
<b>NET INCOME</b>	<b>(1,743)</b>	<b>20,309</b>	<b>48,474</b>	<b>87,461</b>	<b>74,824</b>	<b>154,983</b>	<b>159,883</b>

**Table H.7. Aggregate Financial Statements for 20 SME-FIs without TA in the Subgroup of 36**

<b>Balance Sheet (In US\$ thousands)</b>							
<b>Statement Date</b>	<b>1999</b>	<b>2000</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>
Cash & Due From Banks (Non-Int Bearing)	530,105	811,796	1,436,913	1,546,671	1,664,038	3,471,565	4,785,478
Interest Earning Deposits & ST Securities	655,310	2,540,628	3,600,865	3,106,555	5,029,953	9,033,233	10,369,845
Accrued Interest Receivable	33,244	43,841	99,833	90,619	24,761	130,168	115,287
Gross Loans	1,899,079	4,938,981	5,622,467	6,041,057	7,308,950	14,393,909	18,176,849
Unearned Income (-)	16	330	4,794	(197)	93,363	106,637	28,302
<b>Total Loans</b>	<b>1,899,063</b>	<b>4,938,651</b>	<b>5,617,673</b>	<b>6,041,254</b>	<b>7,215,587</b>	<b>14,287,272</b>	<b>18,148,547</b>
Allowance for Loan Loss Reserve (-)	146,636	275,488	348,668	560,433	357,610	390,779	605,920
<b>Net Loans</b>	<b>1,752,427</b>	<b>4,663,163</b>	<b>5,269,005</b>	<b>5,480,821</b>	<b>6,857,977</b>	<b>13,896,493</b>	<b>17,542,627</b>
Total Long Term Securities	1,319,482	1,825,599	1,413,572	1,880,636	1,537,517	1,460,906	1,745,316
Investments in Subsidiaries	20,568	23,889	21,754	21,619	7,533	37,683	112,790
Net Fixed Assets	143,258	365,840	397,672	427,824	469,220	532,586	579,906
Other Real Estate Owned (OREO)	-	-	480	844	1,248	844	529
Other Assets	144,691	509,445	575,902	651,827	701,816	884,461	958,587
<b>TOTAL ASSETS</b>	<b>4,599,085</b>	<b>10,784,201</b>	<b>12,815,996</b>	<b>13,207,415</b>	<b>16,294,064</b>	<b>29,447,938</b>	<b>36,210,364</b>
Demand Deposits (Non-Interest Bearing)	430,265	778,372	1,121,232	1,722,253	1,928,274	2,989,520	3,321,962
Savings Deposits	1,685,879	2,202,094	3,116,540	3,985,640	5,240,904	8,015,858	9,250,982
Other Non-Int Bearing Deposits	161,646	118,539	140,176	163,391	225,084	214,379	183,352
All other Interest bearing Deposits	939,969	4,742,465	5,031,435	3,908,031	3,997,643	9,999,318	11,822,637
<b>Total Deposits</b>	<b>3,217,759</b>	<b>7,841,470</b>	<b>9,409,383</b>	<b>9,779,315</b>	<b>11,391,905</b>	<b>21,219,075</b>	<b>24,578,933</b>
Overnight and Short Term Borrowings	110,339	160,500	235,220	128,439	506,186	3,340,014	5,587,657
Long-Term Debt	375,868	592,144	746,060	756,597	918,539	628,400	984,477
Other Non-Int Bearing Liabilities-LT	202,381	652,113	754,828	835,952	1,545,460	1,217,613	781,211
<b>Total Debt</b>	<b>688,588</b>	<b>1,404,757</b>	<b>1,736,107</b>	<b>1,720,987</b>	<b>2,970,185</b>	<b>5,186,027</b>	<b>7,353,345</b>
Subordinated Debt	6,597	97,864	116,353	156,561	201,157	392,502	611,690
Accrued Liabilities	113,018	340,398	331,906	224,949	301,528	271,127	540,164
<b>TOTAL LIABILITIES AND SUBORDINATED DEBT</b>	<b>4,025,962</b>	<b>9,684,489</b>	<b>11,593,749</b>	<b>11,881,812</b>	<b>14,864,775</b>	<b>27,068,731</b>	<b>33,084,132</b>
Common Stock	273,989	491,724	527,139	575,382	626,109	690,485	874,985
Surplus	2,231	37,075	32,300	41,725	103,538	793,658	1,005,074
Reevaluation of fixed assets	23,327	23,308	19,814	27,567	38,545	40,225	40,955
Capital reserve	30,436	170,247	222,188	210,854	138,215	146,335	203,990
Revaluation Reserves	2,943	6,123	1,906	1,828	6,078	10,823	11,879
Retained Earnings	240,197	371,235	418,900	468,247	516,804	697,681	989,349
<b>TOTAL EQUITY</b>	<b>573,123</b>	<b>1,099,712</b>	<b>1,222,247</b>	<b>1,325,603</b>	<b>1,429,289</b>	<b>2,379,207</b>	<b>3,126,232</b>
<b>TOTAL LIAB &amp; EQUITY</b>	<b>4,599,085</b>	<b>10,784,201</b>	<b>12,815,996</b>	<b>13,207,415</b>	<b>16,294,064</b>	<b>29,447,938</b>	<b>36,210,364</b>
<b>Income Statement (In US\$ thousands)</b>							
<b>Statement Date</b>	<b>1999</b>	<b>2000</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>
Int Income & Fees on Loans	265,122	700,432	707,373	674,315	735,263	1,243,778	1,635,126
Int Income on other investments	196,918	370,135	398,102	383,255	389,546	698,475	763,400
<b>TOTAL INTEREST INCOME</b>	<b>462,040</b>	<b>1,070,567</b>	<b>1,105,475</b>	<b>1,057,570</b>	<b>1,124,809</b>	<b>1,942,254</b>	<b>2,398,526</b>
Interest Exp on Deposits	216,363	515,011	548,187	498,562	543,709	929,757	1,170,425
Interest Exp on Borrowings/Other Brwd funds	32,563	75,832	62,440	49,761	30,530	43,986	48,834
Interest Exp on Subord Debt	18,419	16,584	7,388	15,920	1,113	1,509	2,453
Other Int Expense	12	15,009	13,903	12,564	11,584	16,206	23,624
<b>TOTAL INTEREST EXPENSE</b>	<b>267,357</b>	<b>622,436</b>	<b>631,918</b>	<b>576,807</b>	<b>586,935</b>	<b>991,458</b>	<b>1,244,783</b>
<b>NET INTEREST INCOME</b>	<b>194,683</b>	<b>448,130</b>	<b>473,557</b>	<b>480,763</b>	<b>537,874</b>	<b>950,797</b>	<b>1,153,742</b>
Provision for Loan Losses	62,782	87,447	138,332	188,286	206,244	263,559	342,040
<b>INT INC NET OF LOSS PROV</b>	<b>131,901</b>	<b>360,683</b>	<b>335,225</b>	<b>292,477</b>	<b>331,630</b>	<b>687,238</b>	<b>811,703</b>
Fee Income & Commissions	42,145	107,416	109,916	154,639	181,277	282,849	311,655
All other Non-Interest Income	114,006	217,141	218,703	197,874	147,859	214,581	285,599
<b>TOTAL NON-INTEREST INCOME</b>	<b>156,151</b>	<b>324,557</b>	<b>328,619</b>	<b>352,513</b>	<b>329,136</b>	<b>497,430</b>	<b>597,254</b>
<b>TOTAL REVENUE</b>	<b>288,052</b>	<b>685,241</b>	<b>663,843</b>	<b>644,991</b>	<b>660,766</b>	<b>1,184,667</b>	<b>1,408,958</b>
Salaries Expense/Employee Benefits	47,618	125,733	150,582	166,457	128,412	239,545	262,809
Administrative expense	83,360	185,143	200,156	201,679	324,823	437,608	494,542
Depreciation/Amortization	8,190	30,873	42,623	52,879	48,273	65,854	67,150
<b>TOTAL NON-INTEREST EXPENSE</b>	<b>139,168</b>	<b>341,749</b>	<b>393,361</b>	<b>421,014</b>	<b>501,507</b>	<b>743,007</b>	<b>824,501</b>
<b>OPERATING INCOME</b>	<b>148,883</b>	<b>343,492</b>	<b>270,482</b>	<b>223,978</b>	<b>159,259</b>	<b>441,660</b>	<b>584,455</b>
Non-Operating Income/exp	-	-	(21,092)	(27,792)	(1,836)	8,427	10,960
<b>INC B4 TAX, EXTRAORD &amp; SECURITIES</b>	<b>148,883</b>	<b>343,492</b>	<b>249,390</b>	<b>196,186</b>	<b>157,422</b>	<b>450,087</b>	<b>595,414</b>
Income Tax	24,459	34,211	23,504	1,510	31,291	79,820	55,508
Extr. Items & Adjust (+/-) Net of Taxes	(421)	(100)	(3,068)	110	535	882	20,794
Minority Interest	24	1,229	83	224	2,885	11,105	996
<b>NET INCOME</b>	<b>123,881</b>	<b>307,672</b>	<b>220,237</b>	<b>189,776</b>	<b>119,463</b>	<b>344,238</b>	<b>555,960</b>



**Table H.8. SME-FI TECHNICAL ASSISTANCE MOBILIZED BY IFC**

SME-FI-ID	Region- Five	Total TA mobilized by IFC (In US\$000)
SME-FI-1	EUROPE & CENTRAL ASIA	
SME-FI-2	AFRICA	
SME-FI-3	MENA	
SME-FI-4	ASIA	99
SME-FI-5	ASIA	190
SME-FI-6	EUROPE & CENTRAL ASIA	
SME-FI-7	AFRICA	
SME-FI-8	EUROPE & CENTRAL ASIA	59
SME-FI-9	AFRICA	
SME-FI-10	AFRICA	
SME-FI-11	ASIA	728
SME-FI-12	LAC	
SME-FI-13	AFRICA	200
SME-FI-14	ASIA	1,000
SME-FI-15	EUROPE & CENTRAL ASIA	185
SME-FI-16	EUROPE & CENTRAL ASIA	52
SME-FI-17	EUROPE & CENTRAL ASIA	
SME-FI-18	EUROPE & CENTRAL ASIA	
SME-FI-19	EUROPE & CENTRAL ASIA	
SME-FI-20	MENA	
SME-FI-21	AFRICA	
SME-FI-22	AFRICA	
SME-FI-23	EUROPE & CENTRAL ASIA	337
SME-FI-24	EUROPE & CENTRAL ASIA	110
SME-FI-25	EUROPE & CENTRAL ASIA	110
SME-FI-26	EUROPE & CENTRAL ASIA	337
SME-FI-27	LAC	
SME-FI-28	EUROPE & CENTRAL ASIA	700
SME-FI-29	LAC	
SME-FI-30	AFRICA	
SME-FI-31	EUROPE & CENTRAL ASIA	247
SME-FI-32	AFRICA	
SME-FI-33	EUROPE & CENTRAL ASIA	247
SME-FI-34	EUROPE & CENTRAL ASIA	
SME-FI-35	EUROPE & CENTRAL ASIA	
SME-FI-36	MENA	
SME-FI-37	AFRICA	
SME-FI-38	MENA	
SME-FI-39	AFRICA	
SME-FI-40	AFRICA	
SME-FI-41	MENA	
SME-FI-42	AFRICA	
SME-FI-43	ASIA	34
SME-FI-44	ASIA	
SME-FI-45	EUROPE & CENTRAL ASIA	
SME-FI-46	MENA	
SME-FI-47	EUROPE & CENTRAL ASIA	
SME-FI-48	EUROPE & CENTRAL ASIA	
SME-FI-49	AFRICA	
SME-FI-50	AFRICA	
SME-FI-51	AFRICA	
SME-FI-52	EUROPE & CENTRAL ASIA	
SME-FI-53	EUROPE & CENTRAL ASIA	128
SME-FI-54	AFRICA	
SME-FI-55	AFRICA	
SME-FI-56	AFRICA	
SME-FI-57	EUROPE & CENTRAL ASIA	
SME-FI-58	AFRICA	
SME-FI-59	AFRICA	
SME-FI-60	EUROPE & CENTRAL ASIA	
SME-FI-61	EUROPE & CENTRAL ASIA	
SME-FI-62	MENA	
SME-FI-63	AFRICA	
SME-FI-64	AFRICA	
SME-FI-65	EUROPE & CENTRAL ASIA	86
SME-FI-66	EUROPE & CENTRAL ASIA	
SME-FI-67	EUROPE & CENTRAL ASIA	
SME-FI-68	EUROPE & CENTRAL ASIA	
SME-FI-69	ASIA	
SME-FI-70	EUROPE & CENTRAL ASIA	350
SME-FI-71	EUROPE & CENTRAL ASIA	50
SME-FI-72	EUROPE & CENTRAL ASIA	1,287
<b>TOTAL</b>		<b>6,536</b>



## Appendix I: Environmental Performance of IFC's MSME-FI Projects

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### Introduction

1. This appendix provides the project-level environment, social, health, and safety (ESHS) evaluations for the MFI and the SME-FI study populations.

### Design of IEG ESHS Review

2. The ESHS review for this study relied on two sources of data: (a) visits to 20 of the FIs in the two study populations (7 MFIs and 13 SME-FIs respectively) and 65 subborrowers (28 clients of MFIs and 37 clients of SME-FIs) in 16 frontier countries; and (b) a desk review of the 13 (out of 14) other MFI projects in the MFI study population (one MFI was incorrectly categorized as having no potential adverse ESHS impacts and exempted from IFC's ESHS compliance and reporting requirements), and 51 (out of 59) other SME-FI projects in the SME-FI study population (8 of the SME-FI projects were incorrectly categorized as having no potential adverse ESHS impacts and were not required to comply with IFC's ESHS requirements). The 65 subborrowers that were visited were selected by IEG from a list prepared by the MSME-FIs. IEG's selections were based on having a diversified business sector as well as subloan size distribution. IEG separately rated the subborrower's ESHS outcomes against requirements using IEG's standard real sector ESHS evaluation methodology used in the XPSR system. The 65 subprojects visited represented US\$27 million in total MSME-FI financing, which is a small and not statistically representative of the portfolios of the MSME-FIs that provided the subloans. Therefore, the study's findings on the subprojects' ESHS outcomes are only illustrative. The MSME-FIs selected for the site visits were considered to be the better performers in IFC's active portfolio, thus the results may represent an optimistic bias relative to the total SME-FI active portfolio.

### Site visit findings: 83 percent of the MSME-FI sub-projects visited achieved satisfactory ESHS outcomes, but only 50 percent of the MSME-FIs did

3. The IEG site visits found that 83 percent of the 65 MSME sub-projects had satisfactory or better ESHS outcomes, but only 50 percent of the 20 MSME-FIs did. The subprojects had a higher ESHS success rate compared to the MSME-FIs themselves because the subprojects either have management commitment to good ESHS practices, or the local ESHS regulatory enforcement is good. On the other hand, many MSME-FIs visited either did not implement a good Environmental Management System (EMS), or did not train their staff, or did not properly screen the subprojects prior to providing the loans, or did not regularly submit annual ESHS reports to IFC.

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Table I.1. ESHS outcomes of FIs visited by IEG-IFC

Type of FI or Lender	Number of FIs visited	FIs with satisfactory or better ESHS outcomes	
		Number	Percentage
MFIs	7	4	57 %
SME-FIs	13	6	46 %
Total	20	10	50 %

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4. Of the 7 MFIs IEG visited, only 4 had satisfactory or better ESHS outcomes. Even though all 7 MFIs had implemented an Environmental Management System, only 4 of the 7 are assessed as conducting appropriate screening of subprojects, and some subprojects with unsatisfactory ESHS ratings remained unmitigated, indicating a lack of follow-up on ESHS noncompliance by subprojects.

5. Of the 13 SME-FIs visited, only 6 (46 percent) are rated as having a satisfactory or better ESHS outcome. All were required under the terms of the IFC loan agreement, and depending on the nature of the subprojects, to obligate these subborrowers to comply with IFC’s ESHS policies and guidelines, in addition to compliance with local regulations and the Exclusion List. While about 85 percent of the SME-FI subprojects visited had satisfactory or better ESHS performance, only 7 of the 13 SME-FIs visited had a documented EMS in accordance with IFC requirements and only 7 of the 13 had implemented satisfactory training. ESHS screening of subprojects by the SME-FIs was satisfactory for only 6 of the 13 SME-FIs (46 percent). Furthermore, training and ESHS supervision of subprojects were satisfactory for only 7 of the 13 SME-FIs (54 percent); and only 6 (46 percent) of the SME-FIs prepared and submitted satisfactory annual ESHS reports to IFC.

**Table I.2. MSME-FI Subproject ESHS outcomes**

By Type of FI or Lender	Number of subprojects visited by IEG	Subprojects with at least a satisfactory ESHS outcome	
		Number	Percentage
MFI	32	26	81 %
SME-FI	33	28	85 %
<b>By Type of Subborrower</b>			
Microenterprises	14	12	86 %
Small & Medium Enterprises	51	42	78 %
Total (all) MSMEs visited	65	54	83 %

Notes:

MFI Borrowers: 14 (out of 32) MFI subborrowers were SMEs.

SME-FI Borrowers: 2 (out of 33) SME-FI subborrowers are microenterprises.

5 (out of 33) SME-FI subborrowers are large enterprises.

**Among the MSME-FIs visited, IFC’s ESHS appraisal work and contribution was satisfactory in most; but only half had satisfactory IFC ESHS supervision**

6. About half of the MSME-FIs visited by IEG did not regularly submit annual ESHS reports to IFC. As a result, IFC had very little ESHS performance data related to about one-half of the MSME-FIs visited by IEG. The quality and timeliness of annual ESHS reports from MSME-FIs and their review by IFC have often been less than satisfactory; IFC had not allocated adequate resources for tracking the ESHS performance of these MSME-FI projects, some of which have financed subprojects in environmentally sensitive sectors, such as in some manufacturing and processing industries. The field visits also found that SME-FIs generally do not utilize local ESHS specialist or consultants to help diagnose and/or remedy ESHS noncompliance by subprojects. Remedial action for noncompliance by subprojects was not a standard practice by SME-FIs.

**Some SME-FI sub-projects visited have medium ESHS risk, making them category-B subprojects**

7. Environmental risks of many medium- and small-sized subprojects visited by IEG, especially in manufacturing and processing industries and some other risky sectors, are comparable to risks in many real-sector medium-ESHS-risk (category-B) projects. Eleven of 65 subprojects visited by IEG had ESHS problems; these included a gasoline station with soil contamination and improper discharging of effluents and storing of fuels, a tannery with waste water and health and safety problems, a steel mill with health and safety problems, four auto and machining shops with soil contamination or health and safety problems, a textile plant where workers’ ear protection was not available despite high noise

levels, two lead industry subprojects with high emissions, and a hotel project with some deficiencies in fire safety. While the environmental impact of one small or medium manufacturing/processing enterprise may be minimal or insignificant in the short term, the cumulative and aggregate impacts over time of the many such category-B SMEs (hundreds or even thousands of SMEs) in an urban area or region can be substantial. Thus, diligent enforcement of IFC's ESHS requirements on its SME-FI projects is important (as well as diligent enforcement by the government of its environmental regulations not just on large companies, but also on SMEs).

8. Small (less than US\$1,000 subloan amounts) MFI subprojects, for example, for street kitchens and retail and tailor shops, do not in general pose environmental concerns and may have significant positive social effects in providing job opportunities and gender-oriented lending programs (e.g., through "women enterprise loans"). MFI subprojects in sensitive industry sectors, however, may not be within the ESHS appraisal competence of the MFIs and, if not properly addressed, may cause limited local ESHS problems, as was found at two auto repair subprojects and at a tannery project. The potential environmental impacts usually included contaminated soil and groundwater, air emissions, effluent discharges, wastes, fire safety, storing of hazardous and flammable chemicals, and use of materials with PCBs, CFCs, and asbestos. Judging the environmental sensitivity and effects of the project based on the loan size is in many cases arbitrary; a better indicator would be the volume and ESHS risks of the MSME-FIs subproject portfolio. IFC is developing a system to identify ESHS risks in various industry sectors to be used by IFC's MSME-FI clients.

**Desk study findings: 77 percent of MFI projects, but only 18 percent of SME-FI projects, had satisfactory ESHS outcomes**

9. The desk study covered an additional 13 MFIs (out of 14), of which 8 were also cosponsored or affiliated with the MFI Holding Company. One (the fourteenth) MFI with only an equity investment by IFC was excluded from the ESHS desk review because it was not required to comply with IFC's ESHS guidelines nor submit annual ESHS reports to IFC as a result of an incorrect ESHS categorization of the project at its approval. Overall, 10 of the 13 MFI projects (77 percent) covered by the desk review were assessed as having satisfactory ESHS outcomes.
10. The 59 SME-FI projects that were not visited by IEG included 8 projects (2 with loans only and 6 with equity only) designated at project approval as not having significant ESHS risks and therefore exempted from any ESHS requirements. This left 51 SME-FI projects for the desk review, although 4 of the SME-FI projects did not have enough information to allow an ESHS rating and were therefore given an ESHS rating of "no opinion possible" or NOP, based on IFC's XPSR evaluation procedures. Only 9 of the 51 SME-FI (18 percent) were rated as having satisfactory or better ESHS outcomes.

**Overall, 70 percent of the MFIs had satisfactory ESHS outcomes; however, only 25 percent of the SME-FIs had satisfactory ESHS outcomes**

11. The better ESHS outcomes of the MFI study population with a 70 percent ESHS success rate (i.e., satisfactory or better) was partly due to the simpler ESHS requirements for MFIs (i.e., not to finance businesses in the Exclusion List), and was also aided by the 13 MFIs under the MFI Holding Company which has instituted a very good ESHS compliance and monitoring system in 12 of the 13 MFIs under its overall management. On the other hand, the SME-FI study population achieved only a 25 percent (15/60)<sup>1</sup> success rate for ESHS outcomes partly because: (a) they were not closely supervised by IFC with respect to both their implementation of an ESHS compliance and monitoring system within the SME-FI, as well as the ESHS performance reporting and supervision of their MSME subborrowers or clients; (b) weak local ESHS regulations and enforcement; and (c) lack of commitment to good ESHS

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<sup>1</sup> Fifty percent (30/60) of the MSME-FI projects were rated as partially unsatisfactory, and 25 percent (15/60) were rated as unsatisfactory for ESHS compliance.

practices by the SME-FI and/or their borrowers. The table below shows the comparative ESHS outcomes for the MFIs, the SME-FIs, all other IFC commercial banks worldwide, and all other IFC financial markets worldwide (excluding collective investment vehicles, or CIVs, such as private equity funds), evaluated with XPSRs. IFC did not have enough ESHS information on 4 SME-FIs (3 financed with loans only and 1 with equity only) covered by the desk review and these have been given the rating of “no opinion possible” (NOP) for ESHS outcomes. Finally, 8 SME-FIs (6 financed with equity only and 2 with loans), and one MFI (with equity investment only) did not have ESHS compliance requirements because they were incorrectly identified at project appraisal as having no potential adverse ESHS impacts and therefore designated as a category-C project under IFC’s 1998 ESHS policies and procedures (category-C projects such as trade finance, brokerage services, insurance, etc., were exempt from IFC’s ESHS requirements). During the review period, there was also a widespread belief among investment officers that IFC’s ESHS requirements did not apply to equity only investments, both in real sector as well as financial markets projects.<sup>2</sup>

#### **Box I.1. Central American SME-FI ESHS Success Story**

Six of the FIs visited by IEG met all at-appraisal requirements. At the top of the list in terms of best practice was a Central American bank, which received an excellent ESHS rating because it had gone beyond compliance requirements of the Environmental and Social Clearance Memorandum (ESCM), including:

- Training that not only exceeded compliance requirements, but included active training of bank credit officers.
- An excellent EMS with detailed appraisal procedures for all subprojects, not only for the IFC financed subportfolio.
- Compliance by subprojects with IFC’s ESHS requirements, as well as with host-country laws.
- Strong likelihood that the subprojects visited will materially comply with IFC’s guidelines on wastewater treatment and air emissions after implementation of planned investments.
- Use of external grant funding and consultants to improve environmental performance of subprojects.

The bank had submitted all requested environmental reports and exceeded required procedures by implementing internal ESHS training and exemplary appraisal and monitoring procedures, complying with IFC’s Exclusion List, for all subprojects. The bank was furthermore cooperating well with external environmental funding sources, several environmental consultants, and ESHS authorities. For example, the bank is negotiating additional grants from the U.S. Agency for International Development for environmental improvements in several subprojects.

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<sup>2</sup> In projects where IFC provides only an equity investment (for both real sector and financial market projects), IFC does not generally directly obligate the investee company to comply with IFC’s ESHS requirements because that would provide IFC with special rights and access to information not generally available to all shareholders. In such equity only investments involving non-category-C projects, IFC will generally enter into an agreement among the top shareholders to use their voting rights (constituting the majority block of shareholders) to nominate directors who would in turn cause the board of directors to direct the company to follow good ESHS practices, such as IFC’s ESHS requirements, and report the company’s ESHS performance to all its shareholders.

**Table I.3. ESHS Ratings of the SME-FI Study Population Is Poor Compared with the MFI Study Population and Other Commercial Bank Projects**

Financial markets project groupings	N/A <u>a/</u>	NOP <u>b/</u>	Satisfactory rates		
	Number	Number	ESHS compliance	ESHS Supervision Quality	IFC Overall Work Quality <u>c/</u>
21 projects in the MFI study population	1		70% of 20	83% of 18	76% of 21
(a) 13 intermediaries under the MFI holding company			85% of 13	92% of 13	85% of 13
(b) 8 other microfinance intermediaries,	1		43% of 7	60% of 5	63% of 8
72 SME-FI projects in the SME-FI study population	8	4	25% of 60	32% of 66	65% of 72
(a) 52 active SME-FI projects	4	3	31% of 45	33% of 49	38% of 52
(b) 20 closed SME-FI projects	4	1	6% of 15	29% of 17	55% of 20
42 other commercial bank projects worldwide evaluated with XPSRs			55% of 42		64% of 42
108 other financial market projects (excluding CIVs <u>d/</u> ) worldwide with XPSRs			63% of 108		64% of 108

Notes: a/ N/A means not applicable, meaning IFC's ESHS requirements are not applicable because the project has been given a category-C designation for ESHS purposes. Category-C projects have no or negligible potential ESHS adverse impacts, and therefore are exempt from IFC's ESHS requirements. Examples of category-C projects are trade finance, insurance, and brokerages. For the two study populations, there should have been no category-C project, and the eight SME-FI projects, as well as the single MFI project with N/A ESHS ratings were incorrectly given category-C status.

b/ NOP means "no opinion possible" on ESHS outcomes due to insufficient information about the project's ESHS performance.

c/ IFC overall work quality covers appraisal, supervision, and role quality, including work quality on ESHS aspects.

d/ CIVs are collective investment vehicles such as private equity funds and mutual funds.

### Other Observations on ESHS Outcomes of MSME-FIs<sup>3</sup>

12. MSME-FIs with satisfactory (or better) ESHS compliance ratings generally have the Environmental Management System (EMS) embedded in their operations. An EMS that is not effectively implemented, and good host-country ESHS laws that are weakly enforced, do not necessarily insure good environmental performance by subprojects. A satisfactory EMS is a proxy, but not always a guarantee for good ESHS appraisal and monitoring on the ground by the MSME-FIs. Three MSME-FIs visited had reasonably well-documented EMS, but they failed to screen, identify, and mitigate the adverse environmental impacts of the subprojects properly.

13. Cofinancing by international development financial institutions reinforces ESHS compliance and monitoring by MSME-FIs. Cofinancing with international banks with strong ESHS sustainability agendas, and other international (development) financial institutions (IFIs), such as EBRD, helps the

<sup>3</sup> The IEG-WB study, OED Review of Bank Lending for Lines of Credit (Report No. 31131, January 6, 2005) found that those lines of credit (LOCs) that could have an environmental impact, roughly one-third, had no mention at appraisal of requiring environmental assessments on subprojects, and of the closed LOCs, only about half made any mention of environmental impact.

MSM-FIs achieve better ESHS outcomes. These MSME-FIs benefited from the strong environmental management requirements and oversight, and support, of these international organizations.

14. The IFC project appraisals of the MSME-FI projects in the two study populations did not include an in-depth review of local ESHS regulations and enforcement. Such a review would have revealed the weak enforcement of local ESHS regulations with respect to the MSME operations which tend to have low priority for government ESHS oversight because of their small size and low perceived ESHS risks. The main concern related to IFC's ESHS requirements for MSME-FI subprojects is the implicit and almost sole reliance on local ESHS authorities' capability to assess and monitor the ESHS aspects of these subprojects properly under the ESHS regulatory regime of the country. All subprojects visited, including 11 with ESHS noncompliance problems, claimed compliance with host-country laws. In many countries, ESHS law enforcement is weak and prone to corruption and, often, the local authorities do not have resources and equipment for proper measurement of pollution. There is also a lack of local ESHS consulting capacity that MSME-FIs or their borrowers can call on for assistance in addressing and mitigating ESHS problems.
15. Good environmental regulation and enforcement in the country promotes sustainability of the MSME-FI subproject portfolio and IFC's financing of MSMEs through FIs. Key drivers toward improved environmental, social, and labor legislation and law enforcement are international agreements such as the EU accession and the DR-CAFTA, the free trade agreement negotiated by Costa Rica, the Dominican Republic (DR), El Salvador, Guatemala, Honduras, and Nicaragua, with the U.S. EU-accession countries will follow a tailored transition schedule to accommodate their legislation with various EU directives covering, for example, air pollution, wastewater treatment, waste management, and worker protection. For those subborrowers that are actively seeking markets that require high environmental standards and a good EMS from suppliers, technical assistance from the EU is available for meeting EU requirements. DR-CAFTA includes cooperation accords to boost standards and enforcement levels in areas such as labor, environment, customs, and other areas.
16. IFC's Exclusion List is an effective tool for avoiding financing of excluded activities and businesses. Most (93 percent) of the MSME-FIs visited complied with IFC's Exclusion List. Some MSME-FIs reported that they had rejected some loan applications based on the Exclusion List. Given the weak enforcement of local ESHS regulations in some countries, the Exclusion List remains an effective tool for preventing financing of unacceptable business activities.
17. Some of the important characteristics of MSME-FIs with good ESHS compliance are:
  - Proactive and experienced environmental coordinators and advocates in the MSME-FI. The environmental coordinator implements a regular, extensive training program for ESHS appraisal and monitoring that includes the front-end investment officers, enabling the staff to properly assess and mitigate environmental risks of the subprojects
  - An ESHS sustainability strategy, including a good EMS, as well as IFC's Exclusion List and checklists for identification of environmental risks and opportunities.
  - An EMS that is applied in a rigorous, transparent, and verifiable manner, ensuring sustainable investments even in environmentally sensitive subprojects. The EMS would include credit manuals that address ESHS appraisal, monitoring, and reporting requirements. ESHS appraisal is part of credit risk assessment and environmental guidelines and information are stored in a bankwide database. ESHS appraisal and monitoring are reported to the FI's board. Subproject appraisal procedures include detailed environmental information memoranda for each high-risk subproject, identifying key environmental concerns and describing environmental covenants to mitigate potential adverse impacts.
  - Use of external ESHS consultants in subproject ESHS reviews as needed, for example, for environmental impact assessments and for developing the MSME-FI's own EMS if necessary.

- Use of punitive loan conditions to enforce ESHS compliance by borrowers (i.e., raising interest rates and/or fixing the time period to solve any noncompliance issue before accelerating the loan).
  - Use of external sources of financing for ESHS related investments, such as from donor-funded environmental programs and carbon credits, and use of grant funds to implement additional environmental targets in subprojects, or requiring subprojects to include environmental mitigation.
  - Use of social and security components as optional parts of the loan package, such as credit life insurance, medical care insurance or gender-oriented features, thereby providing some social safety net for poor borrowers.
  - Advising clients on good ESHS practices.
  - Utilizing environmental funds, such as the Global Environment Facility rural environmental programs in agribusiness, to help subproject improve their ESHS outcomes.
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**International Finance Corporation -  
Independent Evaluation Group**

**Approach Paper for MSME Study:**

**IFC's support for micro, small and medium-sized enterprises (MSMEs)  
through banks and microfinance institutions in frontier countries  
(MSME-FI study), July 11, 2005**

**Introduction**

1. This special evaluation study addresses an IFC business segment that has been high among IFC priorities in its corporate strategies since 1998, including three of the five current strategic priorities, viz. (1) support for MSMEs in frontier countries;<sup>1</sup> (2) support for local financial market development;<sup>2</sup> and (3) providing IFC's additionality for environmental, social (E&S) and governance sustainability. Targeting MSMEs is believed to be particularly important in promoting private sector development, economic growth and ultimately poverty reduction, because MSMEs comprise the bulk of the private sector, especially in the smaller and poorer frontier countries, and have relatively greater difficulty in accessing financing. From the late 1980s, IFC made many direct investments in MSMEs, but later, because of unsustainable results<sup>3</sup> and the desire to widen its reach and impact, IFC shifted its strategy to building wholesale financing delivery capacity in local financial intermediaries (FIs). IFC's current corporate strategy includes expansion of support for MSMEs as an area of major growth opportunity in frontier markets during FY06–FY08. At the same time, IEG's XPSR syntheses have found that financial market project E&S performance in frontier countries has been significantly below average. This evaluation thus addresses a core strategic priority area for IFC, and aims to help inform IFC's execution of its sustainable growth strategy, as elaborated below.

**MSME definition**

2. Practitioners in IFC's financial markets operations have found the official World Bank Group definition of MSMEs<sup>4</sup> difficult to implement, since many FIs (except perhaps microfinance institutions) do not organize their credit processes according to these groups and do not systematically track the relevant data (e.g. employment of MSMEs). As a working definition, the study will thus use the following definitions based on subloan size:

<i>MSME type:</i>	<i>Sub-loan size:</i>
Microenterprise	<\$10,000
Small enterprise	<\$100,000
Medium enterprise	<\$ 1 million <sup>5</sup>

**Objective**

3. The objective of this study is to analyze IFC's experience to date to help determine how IFC can sustainably support viable MSMEs in frontier countries by channeling its financing and technical assistance (TA) through financial intermediaries in these countries ("MSME-FIs"). The primary aim will be to identify how IFC can assist FIs in building commercially viable MSME business lines with subportfolios that are both profitable and help achieve IFC's development objectives, viz. to support

MSMEs that are financially, economically, and environmentally and socially sustainable. The study will identify lessons of experience and best practices from current IFC portfolio companies, with a particular focus on successful models that might be replicated and scaled up in frontier country environments.

## Scope

4. The study will cover commercial banks and microfinance institutions (MFIs). The reason for focusing on these subsectors is that commercial banks constitute by far the largest subsector of IFC's FI portfolio.<sup>6</sup> Microfinance investments, while still a relatively small portion of IFC's portfolio, have expanded during the past five years and are expected to substantially increase further.<sup>7</sup> Also, many FIs supporting microenterprises are either already incorporated as commercial banks, or intend to incorporate as such.<sup>8</sup>

5. The study will focus mainly on MSME-FI projects approved by IFC between FY94–FY02<sup>9</sup> in frontier countries and still active in IFC's portfolio. IEG has identified 58 portfolio companies that fulfill these criteria (some with multiple IFC investments) and are considered “the study population” for this evaluation. Of these, the 56 FY94–FY02 approvals *per se* comprise 32% of IFC's commitments to commercial banks and microfinance institutions between FY94 and FY02 in frontier countries, and 8% of its global commitments in those sectors.

## Evaluation methodology

6. For the study population of 58 banks and MFIs, IEG will conduct a desk review of key project documents and send a questionnaire to assess the MSME reach and success of the operations. In addition, IEG will visit a subsample of 18–20 FIs in the study population that are *prima facie* considered by the responsible IFC investment department staff to be particularly successful within their region in building sustainable MSME business lines.

7. The study sample and the field visit subsample will include FIs in all regions of IFC's operations. The field visits will cover the FIs themselves and a small sample of the MSMEs they support. The latter MSMEs will be selected on the basis of their environmental risk classification to assess to what extent and how IFC and the FIs have helped them achieve good environmental standards. The performance of investee MSMEs in other respects will, however, be evaluated on a per FI portfolio basis with due regard to the assessed quality of the obtained information from the FIs. The field visits will additionally cover the financial sector and MSME business contexts in which the FIs operate. Finally, any technical assistance provided in the context of a specific FI operation will be reviewed, based on the questionnaire for the full study sample supplemented by TA progress and completion reports and the field visit findings.

8. The evaluations will use IFC's standard evaluation framework for development outcomes (i.e. financial, economic, environmental and social sustainability, and impact on private sector development) in assessing the success of the MSME operations, and will also profile IFC's relative investment success of its MSME-FI portfolio.

9. It is anticipated that four to five missions will be undertaken, covering all major geographic areas e.g. Europe/Central Asia, Africa, Asia and LAC. Each mission will typically review 3 to 6 FIs in their local contexts, and involve two evaluators (one focusing on the MSME-financing aspects, and the other on the environmental/social aspects).

10. IEG will further seek to compare the portfolio performance of the study population against similar operations in nonfrontier countries and against other FI operations without MSME focus. For comparison and lessons, a selection of projects in nonfrontier countries, identified by IFC's SME-FI practitioners as demonstrating particularly useful know-how, will also be reviewed, but not visited or evaluated in-depth. The main focus of the study will be to identify lessons and results drivers for frontier country MSME-FI operations, to inform IFC's future strategy and operations.

11. IEG will also review relevant literature related to MSME financing and interview key practitioners in the World Bank Group, in other multilateral development banks and in the context of its field visits.

12. IEG will provide a summary of technical assistance operations related to IFC's MSME-FI support and, based upon available documentation, evaluate technical assistance provided in relation to the sample of projects covered by field visits.

### **Key questions to be addressed in the evaluation**

13. The following are the key questions that will be addressed in the evaluation:

- *What have been the primary success factors that have enabled FIs to build high-quality, profitable and sustainable MSME subportfolios? To what extent have the following affected success:*
  - The enabling business environment in the host country
  - Characteristics of the FI
  - Characteristics of the MSME clients
- *What key characteristics of IFC's relationships with MSME-FIs have contributed to satisfactory outcomes? What lessons can IFC learn from them?*
  - What were the key issues for successful screening, appraisal, structuring and supervision by IFC?
  - What were the key issues for successful provision of associated technical assistance and capacity building?
  - What were the key issues in successfully helping FIs establish and commit to appropriate environmental and social management systems, and comply with IFC's environmental, social, and health and safety (ESHS) procedures, resulting in sustainable MSME portfolios?
  - How have IFC and FIs improved the ESHS performance of MSMEs, and to what extent have the MSMEs complied with IFC's environmental and social procedures?

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**ENDNOTES:**

<sup>1</sup> For example, strategy papers emphasized financial markets development (including microfinance institutions) and support for SMEs. Subsequent *IFC Strategic Directions* reports have continued this focus. *Beyond 2000* and subsequent strategy papers also emphasized IFC's role in frontier countries, mainly those that are considered "high risk," defined in IFC's corporate scorecard as those with an Institutional Investor country credit rating below 30 at approval. For the purpose of this study, "frontier" will be equated with such a rating.

<sup>2</sup> As of June 2004, "finance and insurance" was by far the largest sector in IFC's held portfolio: \$4.9 billion, or 27% of IFC's held portfolio. It was also the largest sector among IFC's FY02-04 commitments (\$3.3 billion, 35%).

<sup>3</sup> See for example IEG's study *An Evaluation of IFC's Investments through the Africa Enterprise Fund*, February 2000. As part of the "IFC-Extending the Reach" initiative, IFC also created a Small Enterprise Fund, which was similarly unsustainable. IFC has been evolving its technical assistance and advisory services from direct support to individual SMEs to support for SME-service providers, training for FIs and advisory services for addressing business climate constraints, particularly on SME development.

<sup>4</sup> *Microenterprises*: Up to 10 employees; \$100,000 total assets and/or revenues. *Small enterprises*: Up to 50 employees; \$3m in assets and/or revenues. *Medium enterprises*: Up to 300 employees; \$15m in assets and/or revenues. In IFC, investment officers are supposed to classify FI operations by number of MSME loans in the FI's portfolio (more than 50% by number), and also by the target market of the IFC investment (e.g., a SME-specific credit line), if it differs from that of the FI. However, given the poor quality of the underlying data from the FIs, this indicator is relatively unreliable. Also, using number of operations rather than portfolio size could potentially distort the relative extent of financing reaching MSMEs.

<sup>5</sup> For comparison, EBRD reports on its MSME-operations also based on loan size, using the following cutoffs: micro < \$10,000, small < \$200,000, medium < \$500,000.

<sup>6</sup> Also, a forthcoming IEG evaluation brief will address leasing operations, the next largest subsector among IFC's FI-operations.

<sup>7</sup> Support for microenterprises, most of it through commercial banks, had already been increasing dramatically from commitments of under \$5 million in FY00 to almost \$100 million by FY04. While the microfinance portfolio (\$272 million in FY04), is still small compared to IFC's general commercial bank portfolio (\$2.9 billion, 16% of IFC's portfolio), as noted above, recent *IFC Strategic Directions* papers have included further "scaling up" of IFC's microfinance investments to be among the core strategic priorities.

<sup>8</sup> The ability to raise local-currency funding tends to be critical for the sustainability of MFIs, since their own clients often cannot prudently bear foreign exchange risk.

<sup>9</sup> Two FY03-FY04 approvals were added selectively as they were deemed to have reached early operating maturity. For the subsample of 18-20 FIs selected for field visits, almost all were well established in the MSME lending business at the time of IFC's investments, so IFC project maturity is not a constraint in the context of this study's objectives. Moreover, relative subportfolio performance for this purposive field visit subsample, considered alone, is not relevant to the study's objective, but rather will be addressed for the study population as a whole.