

# The Partnership For Financial Inclusion

## Greenfield Microfinance in Sub-Saharan Africa Benchmarking Quality, Growth and Outreach

### FIELD NOTES #2

In recent years there has been a rapid increase in the presence and growth of greenfield microfinance institutions in Sub-Saharan Africa. Designed to expand access to financial services for the low-income market in underdeveloped economies, the business model is backed by foreign-owned holding companies or networks that provide initial capital, expertise, common branding, and standard policies and operating procedures. It first entered the African market in the early 21st century, when the local microfinance industry was in its infancy.

Has the greenfield business model worked? In *Benchmarking the Financial Performance, Growth, and Outreach of Greenfield Microfinance Institutions in Sub-Saharan Africa*, researchers from IFC and the World Bank used regressions to benchmark African greenfields relative to other microfinance providers and found that greenfields grew faster in terms of deposits and lending, improved their profitability to levels comparable to the top local microfinance institutions (MFIs), and substantially increased their lending to women.

Effects were especially strong for 'formal greenfields', branded networks of deposit-taking microfinance institutions set up by European-based consultancy firms to establish a deep retail banking presence spanning multiple countries. Though their loan sizes are somewhat larger than most African microfinance institutions, indicating less outreach to the poorest market segments, they have achieved rapid gains in financial inclusion on a broad scale.

“Relative to other microfinance providers, Greenfields grew faster in terms of deposits and lending”

## Introduction

The first African greenfield microfinance institution was set up by ProCredit in Mozambique in 2000, but the business model truly gained momentum from 2005 with an array of entrants such as Advans, Access and MicroCred. By 2012 there were over 30 greenfield microfinance institutions in Africa seeking to expand financial inclusion.

The greenfield model embodied a new approach to cross-border banking on the continent, designed to reach poorer market segments via newly built retail branches. African commercial microfinance was in a nascent stage of development at the time and there was little direct competition between the greenfields and mainstream African commercial banks during this period.

Greenfield microfinance institutions are defined as institutions that were created without any pre-existing organization. They use standard operating procedures disseminated by a central group, often a holding company. The holding company usually plays a strong governance and management role, and holds a majority stake in their investees. Greenfields are grouped into two categories that we have chosen to label formal greenfields and organic greenfields for ease of reference:

- Formal greenfields were established by specialized, European-based consulting firms as branded microfinance networks comprised of subsidiaries spanning multiple countries, with extensive branch presence. These were set up in a rather top-down manner with clear intent as deposit-taking banks, with common structure, policies and standardized procedures and a holding company behind them. These consulting firms were also very successful in attracting investment in their holdings by development finance institutions, including the AfDB, EIB, IFC, and KfW. The holding companies behind the formal greenfields are Access, Advans, Swiss Microfinance, ProCredit, and Microcred. The names of the holding companies are reflected in the names of their microfinance institutions.
- Organic greenfields were created following the bottom-up growth of donor-funded microfinance institutions that operated largely independently and with fewer common policies and standardized procedures. Over time, many of these entities have been consolidated under holding companies that are pursuing stronger cohesion among the network members. These include FINCA, BRAC, ASAI, and Opportunity International, and their names are also reflected in the names of their affiliated institutions. The original institutions in these cases were not established as banks, although some have acquired banking licenses as part of the transformation of the network into a more commercial structure.

The objective of *Benchmarking the Financial Performance, Growth, and Outreach of Greenfield Microfinance Institutions in Sub-Saharan Africa* was to study the impact of greenfields on the quality, breadth, and depth of financial services usage in Sub-Saharan Africa. To get at those concepts, the researchers relied on the best available indicators that proxy for growth, financial performance, and outreach to typically underserved market segments of a set of twenty-six greenfield microfinance institutions that entered Africa, beginning in 2005.

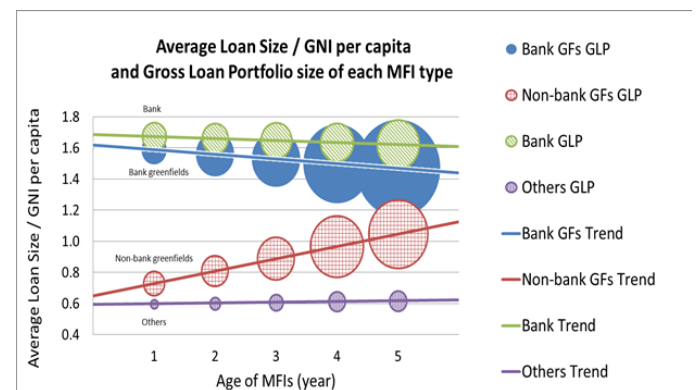
The analysis compares four types of financial institutions: formal greenfields, organic greenfields, local commercial microfinance banks (microbanks), and others, a category that includes credit unions, cooperatives, non-governmental organizations, other organic financial institutions (NBFIs), and rural banks. The data was collected from MIX Market and IFC, tested first in a model that compared greenfields to all other MFIs operating in Africa and secondly in a model that compared them only to MFIs operating in the same countries as the greenfields. The empirical results are presented below in four subsections: Outreach, Financial Performance, Growth of Deposits and Loans, and Costs and Portfolio Yields.

## Outreach

To determine outreach, the researchers looked at average loan size divided by GNI per capita, regarding a smaller average loan size as a proxy for outreach to the poor since the poor typically absorb credit in smaller amounts than wealthier borrowers. In the simplest models that include microfinance institutions from all African countries, the positive significant coefficient on the formal greenfield dummy indicated that average loan sizes in their first year of operations are substantially larger (by 80-110% of per capita GNI) than that of other microfinance institutions (MFIs). A similar gap is found for commercial

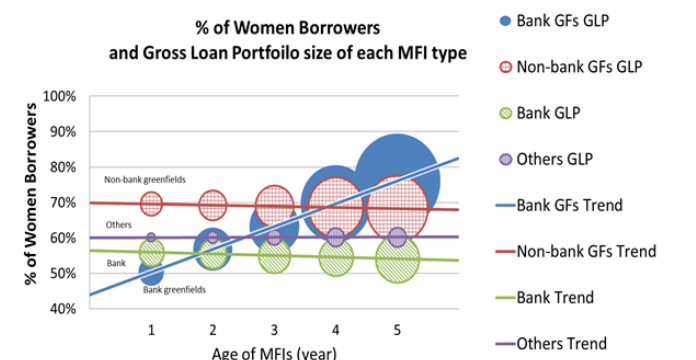
microbanks. The estimates indicate therefore that formal greenfields and commercial microbanks make substantially larger loans than the MFIs in the catch-all 'others' category. These tendencies are strong for microbanks but slightly were weaker for formal greenfields when the sample was restricted to MFIs in the countries where the greenfields operate. The analysis also showed that the average loan size increases over time for organic greenfields, by roughly 8% of per capita GNI in each year after establishment. By contrast, the average loan size for formal greenfields declined slightly over time.

The figure below, and those that follow, use circles to represent the median size of the gross loan portfolios of each type of MFI. Thus, Figure 1 indicates that, while formal greenfields made larger loans than all MFIs other than microbanks, their average loan size declined slightly, while they were growing their loan portfolios much more swiftly than other MFIs. In contrast, organic greenfields were growing their portfolios, but at a slower rate, and increasing their average loan sizes so that by the end of their fifth year of operations, they tended to extend loans that were closer in size to those of the formal greenfields. Microbanks and those in the 'others' category also tended to grow their portfolios, but at slower rates, while maintaining their average loan sizes (large for microbanks, small for those in the 'others' category).



As a second measure of outreach, the researchers looked at the share of lending to women since women are typically less economically empowered than men in developing countries and thus tend to be underserved by formal financial institutions. The basic models showed no strong tendency for one MFI type to lend more to women than others. The basic models also showed a strong association between higher operating costs and more lending to women, in line with other findings in the literature. Some MFIs attempted to compensate for this by charging higher interest rates to women. A more complicated set of models, which interacts operating costs, capital costs, and portfolio yields with MFI type, indicated that the positive association between operating costs and lending to women in the basic models is driven by MFIs other than greenfields. Unlike the basic models, those full interaction models revealed a strong link between capital costs and lending to women for both types of greenfields (but especially for formal greenfields), which suggests that their investment in retail branch networks has led to deeper outreach. Positive significant coefficients for the interactions between MFI type and age in the basic models indicate that formal greenfields increased their lending to women over time (see Figure 2).

In short, the outreach regressions show that some greenfields

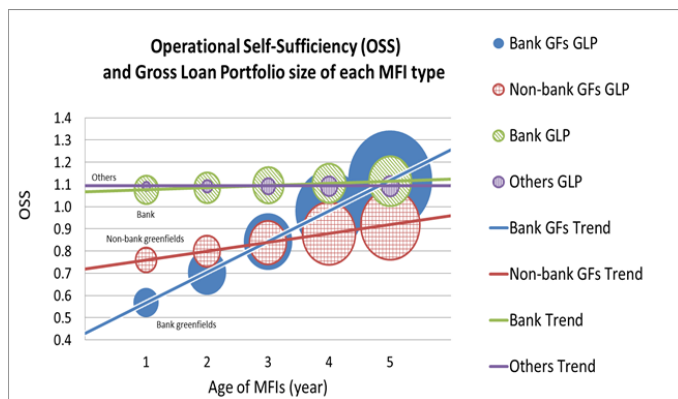


deepened their outreach over time relative to other African MFIs. Organic greenfields tended to make smaller loans than all MFIs other than those in the 'others' category at their inceptions, though their

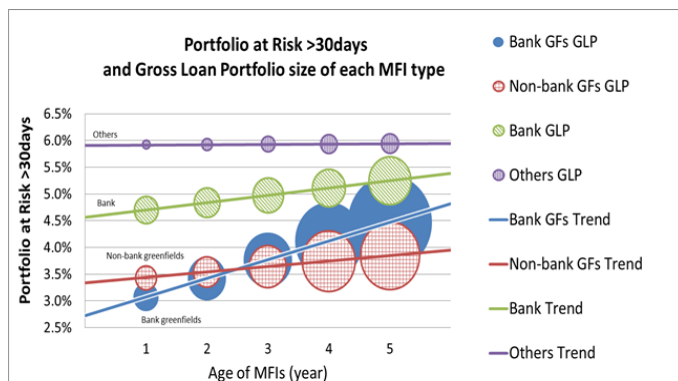
loan sizes grew somewhat over time. Formal greenfields began by making loans of similar size to microbanks, though average loan size declined slightly over time. A negative relationship between operating costs and their average loan size for formal greenfields suggests that some of them are incurring the high costs associated with making smaller loans while others are not. The findings regarding lending to women are more clear-cut: formal greenfields lent more to women over time, and both types of greenfields showed a positive association between capital costs and the share of lending to women, suggesting that the build-out of retail branching led to deeper outreach to female clients.

### Financial Performance

The regressions that use Operating Self-Sufficiency as the dependent variable show a strong tendency for weaker initial financial performance by greenfields than by other MFIs, but sustained improvement over time. The pattern holds for the greenfields in both the basic models and those with full interactions, though it is stronger in the full interaction models for formal greenfields than for organic greenfields. The coefficient for the formal greenfields and age interaction is highly significant and large, indicating that initial financial underperformance was completely erased within five to six years for formal greenfields. Organic greenfields show a similar pattern, though initial financial under-performance was smaller and subsequent yearly improvement less pronounced.



Regarding loan portfolio quality, the basic models indicate that both types of greenfields had shares of at-risk loans (i.e., delinquent for thirty days or more) 3-4% lower than MFIs in the 'others' category at inception, though some models also indicate that their share of at-risk loans crept up slightly in subsequent years (Figure 4). The share of at-risk loans also increased slightly over time for microbanks according to some models. In general, however, greenfields have maintained lower shares of at-risk loans than other MFIs since 2005.



In all, there are no indications that the portfolio quality of greenfields was worse than that of other MFIs, and some indications that it was better. One possibility is that portfolio quality was maintained by making larger loans to wealthier borrowers, in line with hypotheses from the banking literature that foreign entrants cherry-pick the best clients. But the results on outreach cast some doubt on that interpretation. They suggest that greenfields, and especially formal greenfields, lent more to women over time and made loans of similar size to other MFIs, particularly microbanks. At the same time, we see a correlation between deeper outreach and higher non-performing loans (NPLs) for greenfields over time, which ostensibly reflects the risk of issuing smaller loans - though both types of greenfields began

from very low NPL levels like most de novo entrants, so some increase was probably inevitable.

### Growth of Deposits and Loans

For many of the greenfields that entered Africa since 2005, the strategy focused on establishing a substantial retail presence to provide a relatively full menu of services (including loans, savings, and transactions services) quickly, and then continuing to grow that presence over time. Regressions that use the log of the gross loan portfolio (in \$U.S.) as the dependent variable indicate that they have been successful. All MFIs showed growth in their loan portfolios as reflected in a positive significant coefficient for the age variable, and also in the gradually increasing size of the circles in the figures presented thus far. In the basic models, the formal greenfields and age interaction is positive and highly significant, indicating that those greenfields expanded their loan portfolios at a rate faster than all other MFIs. That coefficient is also very large, indicating that greenfields were able to achieve loan portfolios on par with those of existing microbanks within 4-5 years of entry. The interaction with age is also significant in some models for organic greenfields, though its size is much smaller than for formal greenfields.

The capital costs variable is also significantly positively associated with loan portfolio size across models. The interactions between capital costs and the greenfield dummies are also highly significant, suggesting that greenfields that made heavy capital investments tended to have large loan portfolios, both relative to other MFIs and to other greenfields. The relationship is especially pronounced for organic greenfields. However, the strong association for organic greenfields is based on a small number of institutions, especially for the models that use the overlapping sample of countries. Still, the evidence indicates that all greenfields that incurred substantial capital costs during this period grew their loan portfolios more swiftly than other MFIs.

We acknowledge that larger loan portfolios do not necessarily imply that greenfields were serving more customers than other MFIs, but the findings (above) on average loan size and unreported regressions that use the number of loan (or deposit) accounts as the dependent variable suggest that, while their loan sizes were somewhat larger than MFIs in the 'others' category (but smaller than microbanks), greenfields showed substantial account growth relative to other MFIs which was significantly linked to capital costs.

Collecting retail deposits on a large scale was another important aspect of the greenfield strategy, and regressions that use log of total deposits (\$U.S.) as the dependent variable confirm the patterns found in the portfolio size regressions. In particular, tight associations between capital costs and total deposits are found for organic greenfields, and yearly increases in total deposits were significantly larger for formal greenfields than all other MFIs. The patterns are consistent with the notion that greenfields were effective in establishing a strong retail presence within a short period, and that total deposits were substantially greater for greenfields with heavy capital investment, especially among organic greenfields.

This is at odds with findings from the literature on foreign bank entry suggesting that de novo entrants find it harder to establish a retail presence than foreign banks that acquire existing local institutions. In part, this is likely because African commercial microfinance was only first being established during the period that we study, and thus de novo entrants (especially those as well-heeled as many of the greenfields) were not at a great disadvantage relative to MFIs that had begun operations only a handful of years earlier. But the patterns also speak to the distinct, aggressive strategy pursued by the greenfields. They also confirm findings elsewhere in the literature that differences in orientation between commercial MFIs (microbanks and greenfields) and less commercial MFIs (NGOs, cooperatives, and NBFIs) can account for substantial differences in their growth, financial performance, and outreach profiles.

### Costs and Portfolio Yields

For the greenfields, the associations between productivity variables and performance outcomes in the previous sections have differed from those of other African MFIs. Most notably, the capital costs variable's positive links to both growth in deposits and loans, and to the share of lending to women, are evident for greenfields but not for other MFIs. The pattern is consistent with the general greenfield strategy to extend outreach to underserved market segments by establishing deep retail

banking networks. As a corroborating check, however, we ran simple models to explain changes in portfolio yields, capital costs, and operating costs over time for different MFI types. The idea is that if changes in these three productivity variables are driving our results for the greenfields, then the evolution of these variables should be different for them than for other MFIs. In all, the results confirm that heavy capital investment might have been a more crucial part of the formal greenfield strategy rather than a more general strategy among all greenfields since capital costs increased significantly more for formal greenfields than for organic greenfields and other MFIs.

### Conclusion

Our regressions indicate that the greenfield MFIs grew faster than other African MFIs in terms of loans and deposits, and improved their profitability to levels comparable to the better-performing MFIs. These effects were especially pronounced for the set of greenfields that followed the top-down consultant-led model, characterized by centralized leadership through a holding company, and the establishment of a branded retail micro-banking presence spanning multiple countries through the creation of extensive branch networks. Although their loan sizes are a bit larger than that of most African MFIs, their expansion also coincided with an increase in the share of lending to women, a result that is at odds with predictions from the cross-border banking literature that foreign banks tend to focus on relatively affluent clients.

Our results indicate that to this point, the greenfield model, and particularly the formal greenfield model, has been an effective and profitable means of broadening financial inclusion in Sub-Saharan Africa within a short time period. While the existing literature suggests MFIs organized as NGOs and NBFIs, which rely more heavily on subsidized funding sources, are, and will likely remain, more reliable vehicles for reaching the poorest of the poor, the greenfields appear likely to promote sustained gains in financial inclusion on a much broader scale for somewhat more affluent clients.

The full paper, *Benchmarking the Financial Performance, Growth, and Outreach of Greenfield Microfinance Institutions in Sub-Saharan Africa*, is available online at: <http://go.worldbank.org/H43QH8oSSo>

### Contact the Publisher:

Anna Koblanck  
AKoblanck@ifc.org  
+27(0) 11-731-3000

IFC, Sub-Saharan Africa  
14 Fricker Road, Illovo,  
Johannesburg

### Authors

ROBERT CULL is a lead economist in the Finance and Private Sector Development Team of the Development Research Group of the World Bank. His most recent research focuses on fostering financial inclusion in developing countries, particularly in Sub-Saharan Africa.

SVEN HARTEN is the IFC Results Measurements Specialist leading the knowledge and learning agenda of the Partnership for Financial Inclusion. His current research focuses on developing successful business models for microfinance and mobile financial services in Sub-Saharan Africa.

GRETA BULL is the Regional Manager for IFC's Financial Institutions Group Advisory Services in Sub-Saharan Africa, Latin America and the Caribbean, and the Program Manager for the Partnership for Financial Inclusion. Her research focuses on the advancement of financial inclusion.

The Partnership for Financial Inclusion aims to scale up commercial microfinance institutions and advance mobile financial services to bring financial services to 5.3 million previously unbanked people in Sub-Saharan Africa by 2017. It is a \$37.4 million initiative by The MasterCard Foundation and IFC that brings together the intellectual and financial capital of the Foundation with IFC's market knowledge, expertise and client base. The partnership is also joined by The Development Bank of Austria, OeEB, and collaborates with knowledge partners such as the World Bank and CGAP. An important objective of the partnership is to contribute to the global community of practice on financial inclusion, and to share research and lessons learned. This publication is part of a series of reports published by the program.

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