

ADA DISCUSSION PAPER | N°1



Does foreign ownership in microfinance interfere with local development?

ADA, December 2009

The “ADA Discussion Paper” is a periodical published by ADA.

This publication was prepared by Axel de Ville, Quentin Lecuyer and Sophie Wiesner, in collaboration with KPMG Luxembourg.

This publication is protected by the law from the 18th of April 2001 of the Grand-Duchy of Luxembourg concerning copyright, databases and related laws.

It is strictly prohibited to reproduce an article from this publication, in whole or in part, without the written consent of the authors.

The articles represent the authors’ opinions; the latter are therefore solely responsible and liable for their works.

ADA is a non-profit organization specialized in microfinance. For over 15 years, ADA has shared its expertise with partners from North and South in order to create qualitative and innovative tools which may facilitate poor people’s access worldwide to responsible financial services. With their knowledge and competence, ADA’s experts contribute to the improvement of the microfinance sector.

To subscribe, please send an email to: discussion.ada@microfinance.lu
The paper can also be downloaded at: www.microfinance.lu



GRAND-DUCHÉ DE LUXEMBOURG
Ministère des Affaires étrangères

Direction de la coopération au développement

**This edition was published
with the support of the
Ministry of Foreign Affairs –
Luxembourg Development
Cooperation.**

ISBN: 978-2-9599715-3-2

**Concept and layout:
Bizart**

**Copyright © ADA –
December 2009**

THE ADA DISCUSSION PAPER SERIES

“Does foreign ownership in microfinance interfere with local development?” is the first issue of the new ADA Discussion Paper series. Each Discussion Paper raises a topic of interest directly related to the microfinance sector and aims to initiate a debate between practitioners and academics from the field. It is further complemented by a follow-up document which, where appropriate, summarises the various reactions from the different actors.

We hope that the exchange of ideas with ADA, especially through these Discussion Papers, will continue to promote fruitful developments within the microfinance sector. And we hope that you will actively participate in this exchange by sharing your experiences and opinions with us at: discussion.ada@microfinance.lu

EXECUTIVE SUMMARY

In recent years, the microfinance sector experienced a switch from more traditional to more advanced sources of funding and has notably attracted new foreign equity investors, including development agencies, non-governmental organizations or foundations, as well as various types of commercial investors and development funds.

The authors of the present paper identified a trend towards foreign ownership in a sample of MFIs over the last few years, and consequently explore the possible consequences of such a trend. Above all, they examine the question of whether foreign ownership in microfinance interferes with the establishment of locally driven MFIs and thus with the overall local development. They further seek to initiate a discussion between the professionals of the sector on this interesting subject.



TABLE OF CONTENTS

Figures, Tables and Boxes	6
Prologue	7
Introduction	8
1. A Selection of MFIs from the MIX-Market Database	9
2. Foreign Ownership in Microfinance	11
2.1 The Overall Evolution of Foreign Ownership in Microfinance	11
2.2 Foreign Ownership in Microfinance – with a Focus on MFIs	13
2.2.1 An Analysis by Categories of MFIs	13
2.2.2 An Analysis by Regions of the MFIs location	14
2.3 Foreign Ownership in Microfinance – with a Focus on Foreign Investors	16
2.3.1 An Analysis by Types of Foreign Investors	16
2.3.2 An Analysis by Foreign Investors' Countries of Origin	19
3. Does foreign ownership in microfinance interfere with local development?	21
Conclusion	25
Epilogue	27
Bibliography	38

FIGURES, TABLES AND BOXES

Figure 1:	The regional split of the sample	10
Figure 2:	The evolution of local and foreign equity	11
Figure 3:	Foreign equity as a percentage of total equity and its distribution between MFIs	12
Figure 4:	The evolution of equity investments by categories of MFIs	13
Figure 5:	The evolution of equity investments by regions of the MFIs location	14
Figure 6:	The percentage of foreign equity in total equity by regions of the MFIs location	15
Figure 7:	The evolution of foreign ownership by types of investors – Global sample	17
Figure 8:	Foreign ownership by types of investors – Global sample	18
Figure 9:	Foreign ownership by types of investors – Focus group	18
Figure 10:	Foreign ownership by investors' countries of origin	20
Figure 11:	The development of the ownership structure of an MFI in Latin America	23
Figure 12:	The development of the ownership structure of an MFI in Asia	24
Table 1:	Characteristics of the sampled MFIs by regions	10
Table 2:	The evolution of local and foreign equity	12
Table 3:	The evolution of equity investments by categories of MFIs	14
Table 4:	The evolution of equity investments by regions of the MFIs location	15
Table 5:	The evolution of foreign ownership by types of investors – Global sample	17
Table 6:	The evolution of foreign ownership by types of investors – Focus group	19
Table 7:	Foreign ownership by investors' countries of origin	20
Box 1:	A list of the sampled MFIs	9
Box 2:	A list of the MFIs in the focus group	16

PROLOGUE by Kimanthi Mutua, Managing Director of K-Rep Bank, Kenya

Two decades ago, it was difficult to imagine that the microfinance sector would be where it is today. Attracting capital from private sources, commercialization, transformation of microfinance institutions into regulated financial institutions, and much more, were just dreams. Today, they are a reality.

Many challenges and obstacles on this journey were surmounted through concerted efforts, underpinned by sharing knowledge, skills, ideas and information on best practices. This is one thing that the microfinance sector does very well.

In 2006, at the sidelines of the European Microfinance Week in Luxembourg, many participants welcomed the good news that there was an increasing diversification of the funding sources and various new investors entering the microfinance sector. This is certainly a major accomplishment which has addressed one of the crucial issues, confronting the sector. But it also comes with its own challenges. One that occupied my mind recently, is the changing ownership profile of microfinance institutions, as they transform into commercial regulated entities and/or attract capital from new investors. What is the impact of this change? It probably has both positive and negative consequences, but has not yet attracted attention among microfinance professionals.

I am pleased therefore to see that the idea to conduct a study on this subject, which was born at the European Microfinance Week in Luxembourg, when I raised this question, is now taking shape.

I hope that the result of this study, conducted by ADA, which has revealed a trend towards more foreign equity investments in microfinance and which pointed out some possible consequences of this trend, will generate interesting discussions and debates on the subject.

INTRODUCTION

In recent years, the microfinance sector has undergone profound changes in terms of funding. The increasing number of transformations from non-regulated into regulated microfinance institutions (MFIs), as well as the growing needs of these entities, have led to a switch from more traditional sources of funding, such as subsidies, grants, donations and savings, to more advanced sources of funding, such as debt and equity.¹ Furthermore, development agencies, non-governmental organizations (NGOs) or foundations, and also various types of commercial investors and development funds have shown more and more interest in new funding methods in the microfinance sector, especially in equity investments.² However, until now, the true extent and the consequences of foreign ownership in microfinance have not yet been explored in much detail.

The present paper tries to make an effort in this direction.

The first part presents the sample of MFIs used and explains the method by which this sample was selected. The second part analyses the evolution of foreign ownership regarding the sample of MFIs during the sample period and tries to find out whether the patterns found are the sign of a more general trend or whether one can only talk of occasional phenomena. The third part then explores the possible consequences of a trend towards foreign ownership in microfinance, by especially examining the question whether foreign ownership in microfinance interferes with local development. In addition to an analysis of empirical data and a literature review, case studies are used to complete the picture.

The present paper does not attempt to explore foreign ownership in microfinance from all possible perspectives or to provide a detailed examination of the respective dataset. Its purpose is to initiate and to stimulate a discussion on this increasingly important topic between professionals and academics alike, by highlighting some empirical evidence and subsequently outlining related arguments. All readers are cordially invited to contact ADA with any ideas, comments or questions they may have.

¹ See Busch / Rhyne (2006).

² See Goodman (2005); Coppoolse (2007).

1. A Selection of MFIs from the MIX-Market Database

The sample of MFIs used in this paper is based on a selection taken from the Microfinance Information Exchange (MIX) Market database.³

The paper considers only formally regulated financial entities, i.e. banks and non-banking financial institutions (NBFIs)⁴, which have a clearly defined ownership structure in terms of equity. Other types of MFIs, such as NGOs and cooperatives, are not considered.

With respect to geographical coverage, the paper concentrates on Latin America & The Caribbean, East Asia & The Pacific, Middle East & North Africa, South Asia, as well as Sub-Saharan Africa, which are the regions where ADA is most active.⁵ Furthermore, in order to ensure the quality of the data being analysed, only the so called “five diamonds” MFIs from the MIX-Market database were selected. The “five diamonds” qualification is granted to MFIs with financial statements audited for at least two consecutive years and with due diligence and/or benchmarking reports, such as external ratings. The MFIs with this qualification thus offer the highest information standard, in terms of the level of information they disclose and in terms of the level of transparency they display.

Lastly, only MFIs with a portfolio of at least USD 1 million were kept. By retaining the main players and the most advanced microfinance institutions in the field, the results are, however, still expected to reflect the developments that take place in the whole microfinance sector.

The mentioned criteria result in a sample of 39 MFIs, which are listed in Box 1. The regional split of the sample is illustrated in Figure 1; and some characteristics of the selected institutions, according to regions, are shown in Table 1.

A LIST OF THE SAMPLED MFIs

BOX 1

Latin America & The Caribbean			
AMC de R.L.	CMAC Maynas	EDPYME Edyficar	PROCREDIT Bolivia
Bandesarollo	CMAC Sullana	EDPYME Proempresa	PROCREDIT Ecuador
BANGENTE	CMAC Tacna	FIE	PROCREDIT Nicaragua
CMAC Arequipa	CMAC Trujillo	FINCA Ecuador	PRODEM
CMAC Cusco	EDPYME Confianza	FINDESA MiBanco	SOGESOL
CMAC Huancayo	EDPYME CrearArequipa		
East Asia & The Pacific			
AMK	CEB	HKL	TPC
AMRET	CREDIT	PRASAC	VFC
Middle East & North Africa			
AMC	JMCC		
South Asia			
BASIX	SHARE		
Sub-Saharan Africa			
CRG	Faulu Uganda	FINCA Uganda	SOCREMO
TEBA			

³ See www.mixmarket.org.

⁴ NBFIs are institutions similar to banks, but offer some different services and underlie some different regulation and supervision rules.

⁵ This classification of world regions corresponds with the one used by the World Bank. Whenever this paper mentions Latin America, East Asia, North Africa, Sub-Saharan Africa or South Asia, it refers to these categories.

FIGURE 1 THE REGIONAL SPLIT OF THE SAMPLE

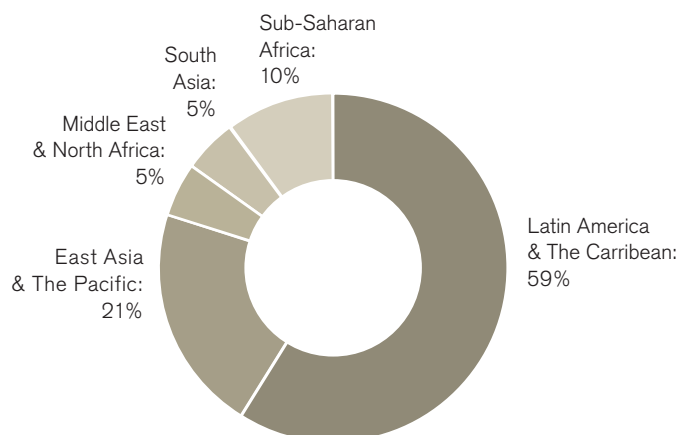


TABLE 1 CHARACTERISTICS OF THE SAMPLED MFIs BY REGIONS

	Banks	NBFIs	Nr. of MFIs	Total Equity*	Gross Loan Portfolio*	Active Borrowers
Latin America & The Caribbean	6	17	23	478 142	2 945 252	1 626 760
East Asia & The Pacific	0	8	8	44 370	144 554	597 336
Middle East & North Africa	0	2	2	9 428	15 344	34 571
South Asia	0	2	2	14 321	147 741	1 131 955
Sub-Saharan Africa	1	3	4	23 937	28 542	209 053
Total	7	32	39	570 198	3 281 433	3 599 675

* in thousand USD

The MFIs in the sample come mainly from Latin America & the Caribbean (59%), East Asia & The Pacific (21%), as well as from Sub-Saharan Africa (10%), and only to a lesser extent from South Asia (5%) and from The Middle East & North Africa (5%). Together, they hold an aggregate equity capital of USD 570 million and an aggregate loan portfolio close to USD 3.3 billion, serving more than 3.5 million customers.

Both in terms of the number and in terms of the financial size of institutions, the sample is dominated by Latin America (and more precisely by Peru, which is represented by 11 out of 23 Latin American MFIs). This is not surprising, because the region's microfinance sector enjoys the longest history of commercial viability, and because its MFIs tend to be formally regulated entities with a clear equity structure. However, in terms of the client base, South Asia, although represented by only 2 institutions in the sample (which are both located in India), comes very close behind Latin America. And this is understandable as well, because of the high population density of this region.

2. Foreign Ownership in Microfinance

With the described sample at hand, the paper compares the ownership structure of MFIs at the end of 2002 and 2007.⁶ The analysis is thereby performed from different viewpoints. Firstly, the paper examines the overall evolution of foreign ownership in microfinance (Section 2.1). Secondly, it looks at foreign ownership from the perspective of MFIs, i.e. it analyses the respective evolution by different categories of MFIs, and by different regions in which these MFIs are located (Section 2.2). Thirdly, the paper focuses on foreign investors, i.e. it examines the evolution of foreign ownership by different types of foreign investors and by these investors' different countries of origin (Section 2.3).

2.1 The Overall Evolution of Foreign Ownership in Microfinance

Due to the general growth of the microfinance sector⁷, both local and foreign equity investments in MFIs increased from 2002 to 2007. However, as can clearly be seen in Figure 2, although local equity levels were still higher than foreign equity levels, the proportion of foreign equity in MFIs increased much faster than the proportion of local equity in MFIs, during the respective period.

THE EVOLUTION OF LOCAL AND FOREIGN EQUITY

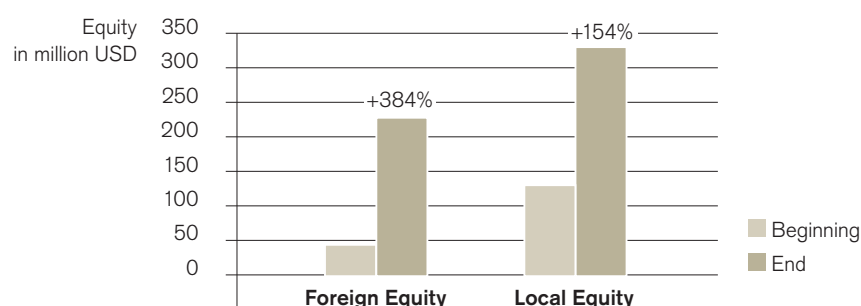


FIGURE 2

In fact, as Table 2 shows, local equity grew by 154%, amounting to USD 329 million in 2007, whereas foreign equity grew by even 384%, amounting to USD 229 million at the end of the period. Moreover, the total equity of the sampled MFIs tripled between 2002 and 2007. At the beginning of the period, it amounted to USD 177 million and reached USD 558 million at the end of the period.

Over the sample period, the proportion of foreign equity in MFIs increased much faster than the proportion of local equity in MFIs (namely by 384% as compared to 154%)

⁶ To be more precise, for 25 MFIs, the equity structure of 2002 is compared to that of 2006; for 6 MFIs, the data of 2003 is compared to the data of 2006; and for 5 MFIs, the data of 2002 is compared to the data of 2007. Furthermore, for 4 MFIs, the equity structure of 2003 is contrasted to that of 2007; and for 1 MFI, the equity structure of 2004 is contrasted with those of 2006. For the sake of simplicity, however, the paper only speaks of the years 2002 and 2007 when referring to the respective beginning and end dates in question. The information on the equity structure of the MFIs is collected from financial accounts, external audits and the like, or from the activity reports of the MFIs.

⁷ See for example Forster / Reille (2008).

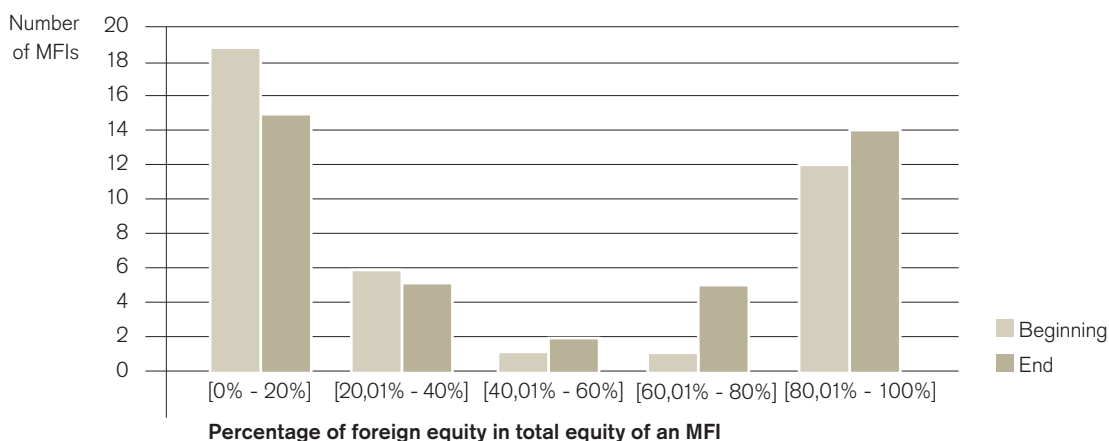
TABLE 2 THE EVOLUTION OF LOCAL AND FOREIGN EQUITY

Type of Equity	Beginning*	End*	Difference*	Evolution
Foreign Equity	47 203	228 665	181 462	384%
Local Equity	129 765	328 916	199 151	154%
Total Equity	176 968	557 581	380 613	215%

* in thousand USD

By looking at the percentage of foreign equity in total equity in 2007, another interesting fact becomes obvious. As Figure 3 reveals, there is a bimodal distribution of foreign ownership between MFIs: Foreign shareholding in an MFI is either insignificant (first column with 0–20% foreign equity) or very important (last column with 80,01–100% foreign equity). Not many MFIs occupy a middle place. In fact, in 2007, 11 MFIs out of the 15 MFIs in the first interval had no foreign shareholder at all (against 16 MFIs out of 19 MFIs at the beginning of the period); and 6 MFIs out of the 14 MFIs in the last interval were 100% owned by foreign shareholders (against 7 MFIs out of 12 MFIs at the beginning of the period). One possible explanation is that 7 of the purely domestic MFIs were community credit institutions (CMACs); and although these public MFIs may theoretically be purchased by foreign investors, they do not face the same options as private MFIs.⁸ Another possible explanation is that foreign investors often try to exert as much control over an institution as possible. Thus, when they invest, they try to invest a large amount and to hold a significant share in the MFI⁹.

FIGURE 3 FOREIGN EQUITY AS A PERCENTAGE OF TOTAL EQUITY AND ITS DISTRIBUTION BETWEEN MFIs



Foreign shareholding in an MFI is either insignificant (0%-20%) or very important (80,01%-100%). Not many MFIs occupy a middle place.

⁸ See Maisch et al. (2006).

⁹ See for example Abrams / Ivatury (2005) and Lauer (2008).

2.2 Foreign Ownership in Microfinance – with a Focus on MFIs

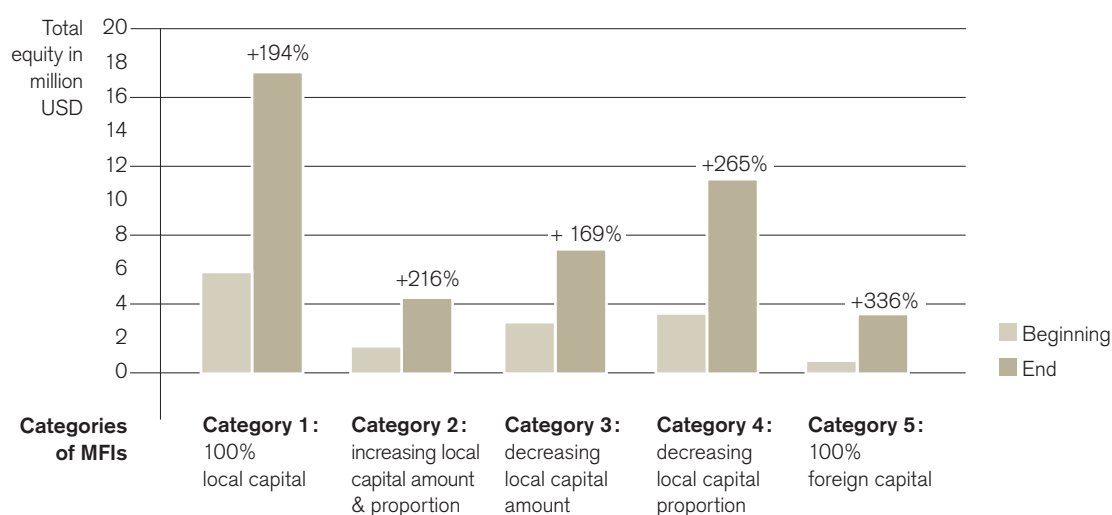
2.2.1 An Analysis by Categories of MFIs

The paper first analyses the evolution of foreign ownership in microfinance by looking at different categories to which the MFIs in the sample belong. Thereby, Category 1 comprises all MFIs with a 100% local capital and Category 2 all MFIs with an increasing local capital amount and an increasing local capital proportion. Category 3 is made up of all MFIs with a decreasing local capital amount and Category 4 of all MFIs with a decreasing local capital proportion. Finally, Category 5 consists of all MFIs with a 100% foreign capital.

Now, as Figure 4 shows, in 2002, Category 1 of MFIs completely under local ownership was the largest category in terms of equity, whereas Category 5 of MFIs completely under foreign ownership was the smallest category. However, from 2002 to 2007, Category 5 increased by 336%, which represents the biggest increase of all five categories, whereas Category 1 increased by only 194%. Furthermore, when looking at Categories 3 and 4, we also see a rise in the equity of MFIs with a decreasing local capital amount and in the equity of MFIs with a decreasing local capital proportion, namely by 169% and 265% respectively.

THE EVOLUTION OF EQUITY INVESTMENTS BY CATEGORIES OF MFIs

FIGURE 4



A closer look at the figures in Table 3 reveals that the total equity of MFIs in Category 1 (completely under local ownership) in fact amounted to USD 220 million in 2007; whereas the total equity of MFIs in Category 5 (completely under foreign ownership) amounted only to USD 48.3 million. The MFIs from Category 3 (with a decreasing local capital amount) experienced both a decrease in local equity and an increase in foreign equity from 2002 to 2007. The MFIs from Category 4 (with a decreasing local capital proportion), on the other hand, actually experienced a high increase in the amount of local equity, but an even higher increase in the amount of foreign equity over this period – to be precise, from USD 9.6 million up to USD 55.5 million.

The category of MFIs with a 100% foreign capital was the smallest category at the beginning of the period, but experienced the biggest increase of all categories until the end of the period.

TABLE 3 THE EVOLUTION OF EQUITY INVESTMENTS BY CATEGORIES OF MFIs

Period	Category 1		Category 2		Category 3		Category 4		Category 5	
	Beginning	End	Beginning	End	Beginning	End	Beginning	End	Beginning	End
Local Equity*	75 068	220 413	4 578	17 288	20 915	5 437	29 203	85 778	0	0
Foreign Equity*	0	0	12 050	35 194	14 447	89 605	9 628	55 524	11 078	48 342
Other Equity*	0	0	0	0	0	78	33	570	0	0
Total Equity*	75 068	220 413	16 628	52 482	35 362	95 120	38 864	141 872	11 078	48 342
Evolution Amount*	145 345		35 854		59 758		103 008		37 264	
Evolution Percentage	194%		216%		169%		265%		336%	

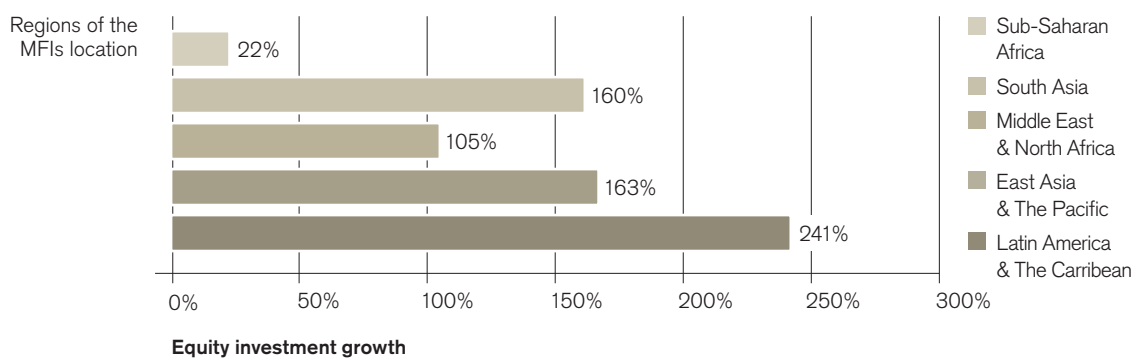
* in thousand USD

2.2.2 An Analysis by Regions of the MFIs location

In addition to the analysis by categories of MFIs, the paper also examines the sample by different regions of the MFIs location. Figure 5, which shows the percentage of growth of total equity for each region, gives a good overview of the development from 2002 to 2007.

Obviously, equity investments increased most dramatically in Latin America, by about 241%, whereas the evolution ranged from 163% to 160% and down to 105% in East Asia, South Asia and North Africa, respectively – with Sub-Saharan Africa lagging far behind with an evolution of only 22%.

FIGURE 5 THE EVOLUTION OF EQUITY INVESTMENTS BY REGIONS OF THE MFIs LOCATION



As Table 4 also confirms, the majority of total equity amounts were concentrated in Latin America. Foreign and local equity investments, which both boomed in Latin America, added up to a total of USD 478 million in 2007. East Asia and South Asia occupied the second and the third place in terms of total equity amounts; and Sub-Saharan Africa in fourth place before North Africa in fifth place.

During the sample period, equity investments increased most dramatically in Latin America. Furthermore, the majority of equity amounts were concentrated in this region.

THE EVOLUTION OF EQUITY INVESTMENTS BY REGIONS OF THE MFIs LOCATION

TABLE 4

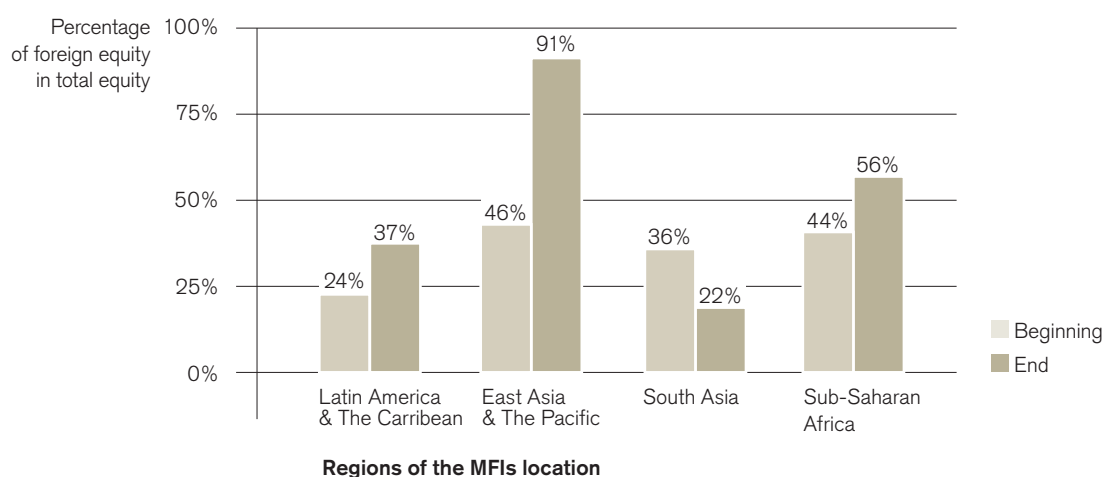
Regions	Beginning*	End *	Difference *	Evolution
Latin America & The Carribean	140 195	478 142	337 947	241%
East Asia & The Pacific	16 900	44 370	27 470	163%
Middle East & North Africa	4 602	9 427	4 825	105%
South Asia	5 508	14 321	8 813	160%
Sub-Saharan Africa	9 797	11 969	2 172	22%
Total	177 002	558 229	381 227	215%

* in thousand USD

Now, by looking at the percentage of foreign equity in total equity in the MFIs of each region, as represented in Figure 6, we again see large differences between Latin America, Asia and Africa. The level of foreign ownership in the 23 MFIs from the Latin American region amounted to 37% in 2007 (and would even increase up to 64% without the completely local and public CMACs). However, foreign ownership in the 8 MFIs from the East Asian region reached 91% at the end of the period. Thus, whereas in Latin America, there are more MFIs with a lower level of foreign ownership, in East Asia, there are less MFIs with a higher level of foreign ownership. Furthermore, in the Sub-Saharan Africa region foreign ownership increased to reach 56% in 2007, but in the South Asian region it decreased to end up at only 22% at the end of the period. In the North African region, the percentage of foreign equity in total equity remained stable at 0%.

THE PERCENTAGE OF FOREIGN EQUITY IN TOTAL EQUITY BY REGIONS OF THE MFIs LOCATION

FIGURE 6



In the 23 MFIs from the Latin American region, foreign equity as a percentage of total equity amounted to 37% at the end of the period; but in the 8 MFIs from the East Asian region, it reached even 91% at the end of the period.

2.3 Foreign Ownership in Microfinance – with a Focus on Foreign Investors

2.3.1 An Analysis by Types of Foreign Investors

This paper analyses foreign ownership in microfinance not only with a focus on MFIs, but also with a focus on foreign investors. As one of the most important steps, the evolution of foreign ownership is thereby examined by different types of foreign investors, with a distinction between commercial investors, development funds, development agencies, and NGOs or foundations. Microfinance development funds are thereby defined as vehicles that have specifically been created to invest in microfinance. Development agencies are understood as financial and non-financial institutions, created by governments and supranational bodies, to promote the economic development in developing countries. And NGOs or foundations are understood as institutions which are usually created by the private sector, with the help of donations from corporations or individuals, and which help to improve the economic and social welfare of people in developing countries.¹⁰

The first section of this chapter explores the development of foreign ownership of MFIs according to types of investors, using the global sample of MFIs. In order to illuminate some further aspects of this study, the second section studies a specific focus group, consisting of all MFIs from the original sample that hold at least a 30% share of foreign equity at the end of the period – i.e. 24 MFIs out of the original 39, which are listed in Box 2. The different evolutionary paths of the global sample and of the focus group are then compared.

BOX 2 A LIST OF THE MFIs IN THE FOCUS GROUP

Latin America & The Caribbean			
Bandesarollo	EDPYME Proempresa	FINDESA	PROCREDIT Ecuador
EDPYME Confianza	FIE	MiBanco	PROCREDIT Nicaragua
EDPYME Edyficar	FINCA Ecuador	PROCREDIT Bolivia	PRODEM
East Asia & The Pacific			
AMK	CEB	HKL	TPC
AMRET	CREDIT	PRASAC	VFC
South Asia			
BASIX			
Sub-Saharan Africa			
Faulu Uganda	FINCA Uganda	SOCREMO	

a) Global sample

The evolution of foreign ownership of all MFIs from 2002 to 2007 by types of investors is shown in Figure 7. As becomes obvious, commercial investors made up the largest group of investors in 2007, followed by NGOs or foundations. Development funds and development agencies, on the other hand, made up smaller, but not at all negligible groups of investors.

¹⁰ The respective categorization corresponds with Goodman (2005).

THE EVOLUTION OF FOREIGN OWNERSHIP BY TYPES OF INVESTORS – GLOBAL SAMPLE

FIGURE 7

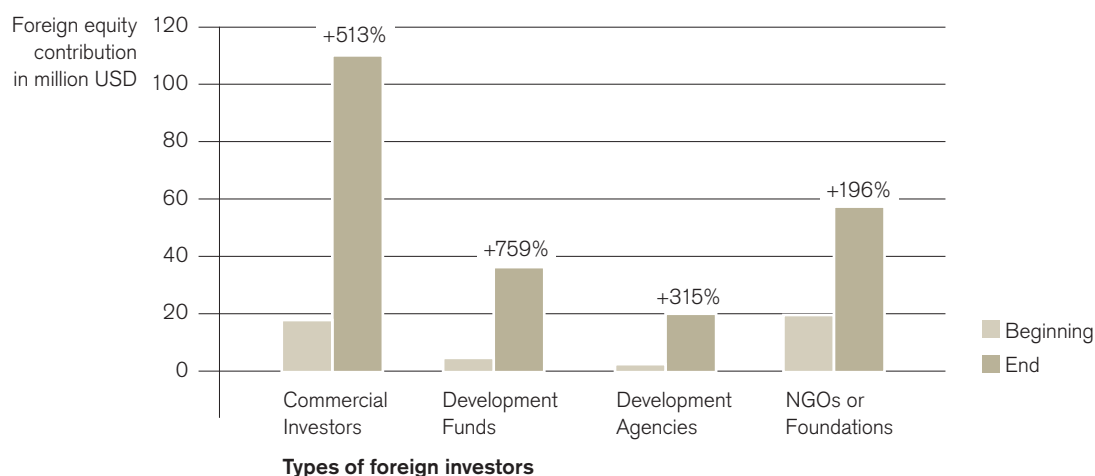


Table 5 presents the evolution of foreign ownership in greater detail.

Even if commercial investors, with their equity contribution of USD 113 million, made up a much larger group than development funds, with their equity contribution of 37.8 million, in 2007, the group of development funds grew much stronger than the group of commercial investors, from 2002 to 2007, namely by 759% as compared to 513%. And similarly, even if NGOs or foundations, with their equity contribution of USD 57.7 million, made up a much larger group than development agencies, with their equity contribution of USD 20.2 million, in 2007, the group of development agencies grew much stronger than the group of NGOs or foundations, from 2002 to 2007, namely by 315% as compared to +196%. The group of development funds thus experienced the largest increase in terms of foreign equity investments, and NGOs or foundations experienced the smallest increase in terms of foreign ownership.

THE EVOLUTION OF FOREIGN OWNERSHIP BY TYPES OF INVESTORS – GLOBAL SAMPLE

TABLE 5

Types of investors	Beginning*	End*	Difference*	Equity Evolution
Commercial Investors	18 442	112 979	94 537	513%
Development Funds	4 399	37 802	33 403	759%
Development Agencies	4 869	20 203	15 334	315%
NGOs or Foundations	19 494	57 681	38 187	196%
Total Foreign Equity	47 204	228 665	181 461	384%
Total Local Equity	129 765	328 916	199 151	154%
Total Equity	176 969	557 581	380 612	215%

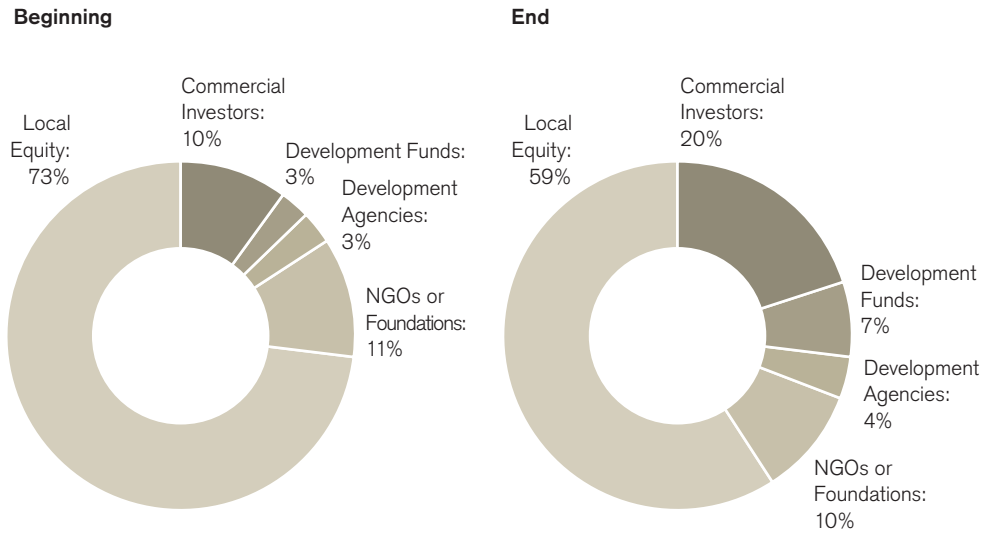
* in thousand USD

Development funds were the smallest equity contributors at the beginning of the period, but increased their foreign ownership in MFIs by almost 760% until the end of the period, which represented the stongest evolution of all groups.

b) Global sample and focus group

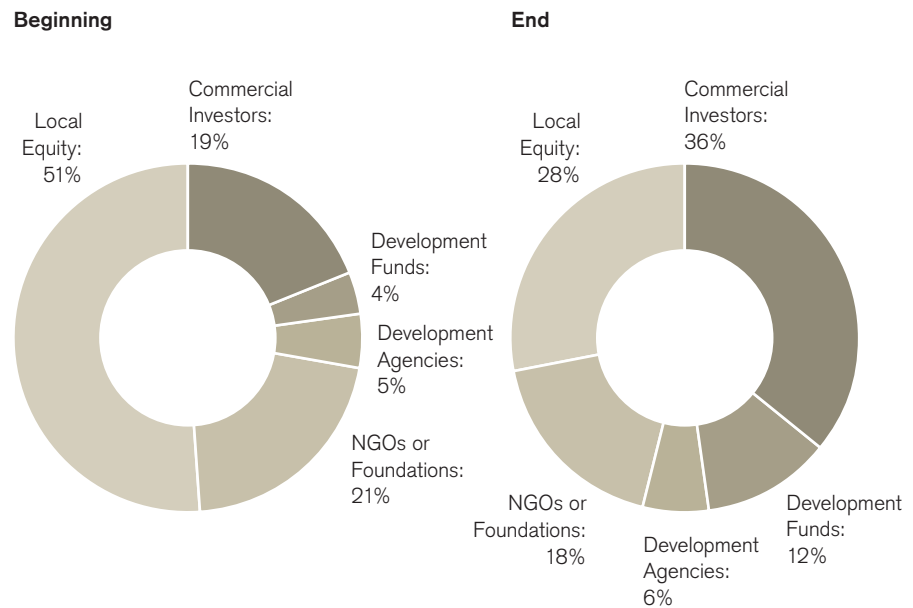
A comparison of the evolution of foreign ownership between global sample and focus group (with the focus group consisting of those MFIs with at least a 30% share of foreign equity in 2007), revealed some further points.

FIGURE 8 FOREIGN OWNERSHIP BY TYPES OF INVESTORS – GLOBAL SAMPLE



In the global sample, commercial investments increased from 10% to 20% and development funds investments from 3% to 7%.

FIGURE 9 FOREIGN OWNERSHIP BY TYPES OF INVESTORS – FOCUS GROUP



In the focus group, however, commercial investments grew from 19% to 36% and development funds investments from 4% to 12%.

Figure 8 illustrates the distribution of foreign ownership between different types of foreign investors and its evolution from 2002 to 2007, for the global sample. We can observe that commercial investors experienced an increase from 10% to 20%, and that the group of development funds experienced an increase from 3% to 7%.

Figure 9, then, illustrates the distribution and evolution of foreign ownership for the focus group. And here, we can observe that the engagements by commercial investors increased from 19% to 36% and those by foreign development funds from 4% to 12%.

Furthermore, we see a slight increase in the contributions of development agencies and a slight decrease in the contributions of NGOs or foundations in both groups. And what is most obvious, the proportion of local equity decreased from 73% to 59% for the focus group, and from 51% to 28% for the sample group.

As Table 6 shows in greater detail, in 2007, foreign equity from commercial investors amounted to just over USD 112 million in the MFI focus group, and foreign equity from development funds amounted to USD 37.4 million. Furthermore, NGOs or foundations accounted for USD 57.5 million, and development agencies accounted for USD 19.2 million of the foreign equity of the MFIs in the focus group. And finally, local equity in the MFI focus group amounted to USD 88.4 million, in 2007.

THE EVOLUTION OF FOREIGN OWNERSHIP BY TYPES OF INVESTORS – FOCUS GROUP – TABLE 6

Types of investors	Beginning*	End*	Difference*	Equity Evolution
Commercial Investors	18 174	112 333	94 159	518%
Development Funds	3 870	37 407	33 537	867%
Development Agencies	4 447	19 146	14 699	331%
NGOs or Foundations	19 428	57 470	38 042	196%
Total Foreign Equity	45 919	226 356	180 437	393%
Total Local Equity	47 786	88 428	40 642	85%
Total Equity	93 705	314 784	221 079	236%

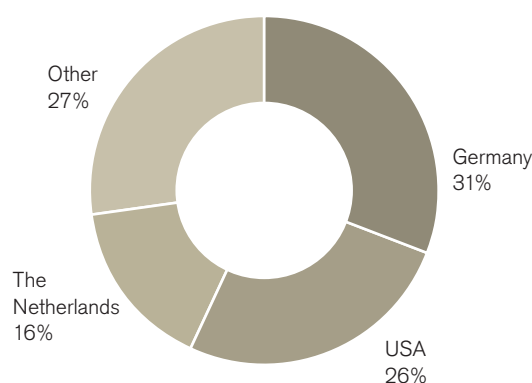
* in thousand USD

2.3.2 An Analysis by Foreign Investors' Countries of Origin

Just as it is crucial to look at the different types of investors engaged in foreign ownership of MFIs, so it is important to have an eye on the different countries from which these investors originate.

The distribution of foreign ownership between the different investors' countries of origin, as of 2007, is represented in Figure 10.

FIGURE 10 FOREIGN OWNERSHIP BY INVESTORS' COUNTRIES OF ORIGIN



At the end of the period, Germany, the USA and The Netherlands together represented 73% of the overall amount of foreign equity investments in MFIs.

Figure 10 clearly shows that there were three countries most engaged in foreign ownership in microfinance in 2007, in terms of the amounts invested, i.e. Germany, the USA and The Netherlands. Taken together, these three countries represented 73% of the overall amount of foreign equity investments in MFIs in 2007.

TABLE 7 FOREIGN OWNERSHIP BY INVESTORS' COUNTRIES OF ORIGIN

Country	Foreign Equity Amounts			Number of Investors		
	Beginning*	End*	Evolution	Beginning	End	Evolution
Germany	12 588	69 960	456%	3	4	33%
USA	21 055	60 400	187%	11	17	55%
The Netherlands	2 812	35 525	1163%	4	11	175%
International**	3 630	10 911	201%	6	8	33%
Belgium	1 373	9 897	621%	3	5	67%
France	3 573	8 859	148%	6	7	17%
Luxembourg	119	432	263%	1	2	100%
Other countries***	2 087	33 330	1497%	6	11	83%
Total	47 237	229 314	386%	40	65	63%

* in thousand USD

** International investment are those which originate from more than one country

*** Other countries include: Venezuela, United Kingdom, Sri Lanka, Canada, Switzerland and Italy

Table 7 gives the detailed amounts of foreign equity investments in the sampled MFIs by different foreign countries. In 2007, Germany, ranking first, invested USD 70.0 million, the USA, in second place, invested USD 60.4 million, and The Netherlands, in third place, invested an amount of USD 35.5 million. Furthermore, Table 7 also shows the exact numbers of investors from the different foreign countries. As can clearly be seen, for Germany this number increased by only 1 from 2002 to 2007, whereas The Netherlands experienced an increase from 4 to 11, and the USA an increase from 11 to 17 during the respective period. Foreign ownership in microfinance, in terms of the number of investors and in terms of the amounts invested, is thus distributed quite unequally between the foreign investors' different countries of origin.

3. Does Foreign Ownership in Microfinance interfere with Local Development?

Our data analysis does by no means allow conclusions to be drawn for the whole microfinance sector. Nevertheless, as there appears to be a clear trend towards foreign ownership in our sample, both after an analysis with a focus on MFIs and after an analysis with a focus on foreign investors, the question of the possible consequences becomes important. Before considering these consequences, however, let us just make a few remarks on the actual aim of microfinance and on the traditional evolution of MFIs in terms of funding.

As practitioners and academics agree, microfinance initiatives must always be well embedded in the local context in which they are supposed to work. Just as the clients' activities and needs are always linked to their own circumstances, so must the MFIs' set-up and offers be adapted to the situation of the specific region or to the characteristics of the specific population group on which they focus. It is also generally agreed, that microfinance institutions of all types try to exert a positive influence on this local context. To be precise, they try to fulfill a double-mission of, on the one hand, maintaining a financially sustainable organization and of, on the other hand, reaching out to the poor.¹¹ However, as is sometimes neglected, microfinance initiatives also have a further intrinsic objective, namely to establish autonomous locally driven MFIs servicing empowered local clients, thereby trying to construct healthy local financial markets and to develop a fruitful local economic environment.¹²

Entities (co-)funded by public money assisted MFIs in their initial phase, but also in their maturation phase, in which they eventually transformed from a project into an association or a private company, and in which they, above all, tried to gain access to a broader range of funding sources. New possibilities in terms of funding are, of course, crucial for an MFI's development. However, they do not only have positive effects, but also involve important negative risks. And foreign equity, which, as we have seen, makes up an increasingly important part of the new funding sources, is no exception in this respect.¹³

So, let us now consider the question of consequences: What exactly are the mentioned positive effects and negative risks of foreign equity funding? And how should one invest in microfinance in order to maximize one's impact in terms of local development – especially, but not only, as an entity (co-)funded by public money?

A very important objective of microfinance initiatives is to establish autonomous locally driven MFIs that strengthen the overall local development. Yet, in the realization of this aim, funding sources play a crucial role.

¹¹ This double mission is also called the "double bottom line" of microfinance. See Christen et al. (2004).

¹² This point is, for example, made by Reddy (2007) or CGAP (2008).

¹³ See Lauer (2008).

It is almost accepted as a general principle that foreign equity investments, in contrast to local equity investments, have the positive effects of not only offering MFIs much larger sums of money, but of also providing them with more expertise in terms of products and services, and with more knowledge in terms of governance.¹⁴ Nevertheless, from a development point of view, which also takes into account the aforementioned aim of establishing locally driven MFIs that strengthen the overall local development, it might be questioned whether this can and should indeed be accepted as a general principle. In fact, there are some obvious negative risks of foreign ownership and of foreign governance that must also be pointed out.

In most cases, foreign ownership means that the strategic decisions concerning an MFI are taken by foreign entities. This, however, involves the risk that the foreign owners impose their orientation on the MFI, even if it is to the detriment of local development (for example in times of a crisis, as we face it at the moment). So, in the long run, a locally driven strategy of the institution is not necessarily guaranteed.¹⁵

Furthermore, in many cases, foreign ownership also means that the operational decisions concerning an MFI are taken by foreigners. And this, in turn, involves the risk that the foreigners do not adapt their activities to the local context, that they do not invest enough in the professional training of locals and that they do not open up possibilities for a future autonomy of the MFI. So also, in the long run, locally driven operations of the institution are not necessarily assured.¹⁶

Finally, it has to be considered that MFIs often repatriate large sums of money to their foreign owners' countries in the form of dividends, loan interest payments and the like. And even if this money will be reinvested, temporarily, it will not be available for the fostering of the MFI and of other economic entities in the long run.

The availability of surpluses and, most importantly, of locally driven strategies and operations are crucial for an MFI. Without them, local recognition of the MFI could diminish which would be detrimental for an MFI as it is for any financial institution. It could also destroy positive impacts that have already been achieved by the institution. So, even if foreign equity has already led to innovations within an MFI, the respective new orientation, or the respective new products and services may not be accepted by the clients any more. Funds raised locally, through the collection of savings, the issuance of debt, but also the attraction of local equity, may thus be more reliable in the long run than the use of foreign funds. In fact, local ownership and local governance, once established, even seem to start a "virtuous circle", such that MFIs with some local equity and some local shareholders seem to be more successful in attracting further local investors and in integrating further local team members. And this would indeed mean a big step towards the establishment of locally driven MFIs that strengthen the overall local development.¹⁷

¹⁴ See Deshpande et al. (2007), Busch / Rhyne (2006).

¹⁵ See Busch / Rhyne (2006).

¹⁶ This fact is stated quite clearly by Microfinance Insights (2008).

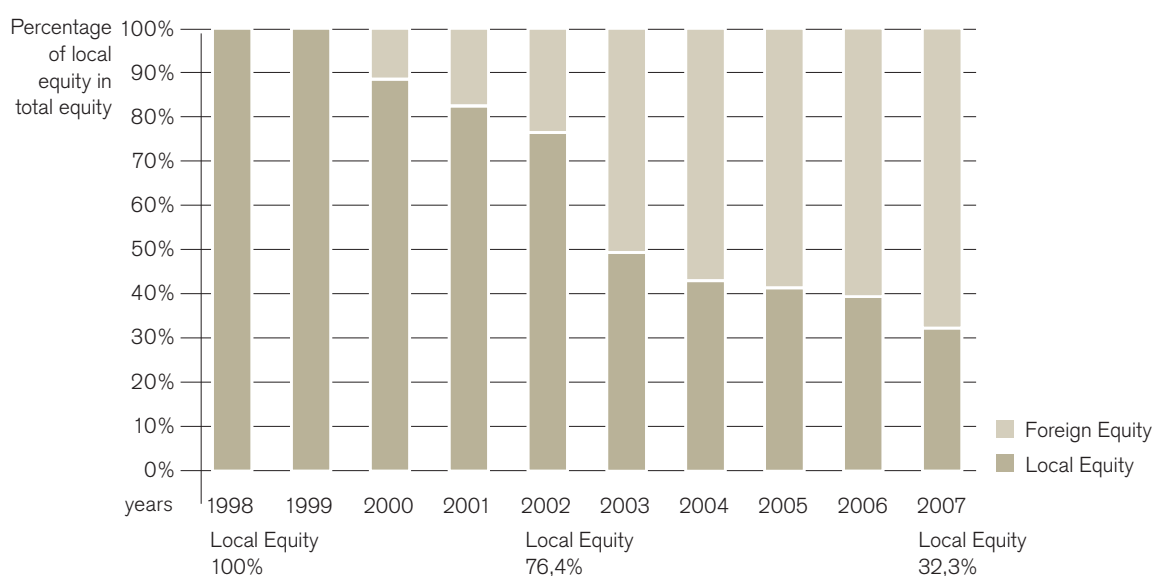
¹⁷ See for example, Clark / Crawford (2007) and Bogan (2008).

The crucial question now arises: why is local ownership in microfinance not more common.

And here the problem reveals its whole force: In many developing countries, MFIs actually do not have any real alternatives to foreign ownership. Local equity is often not available at all, or not available in adequate amounts or under adequate conditions. And local investors are sometimes only attracted by the expected financial returns of microfinance investments, but are not interested in the influence that local ownership and local governance can have for the economic development of their country or their region, in the long run.¹⁸ Thus, MFIs are almost forced to accept foreign equity funding, as shows the case, which is illustrated by figure 11.¹⁹

THE DEVELOPMENT OF THE OWNERSHIP STRUCTURE OF AN MFI IN LATIN AMERICA

FIGURE 11



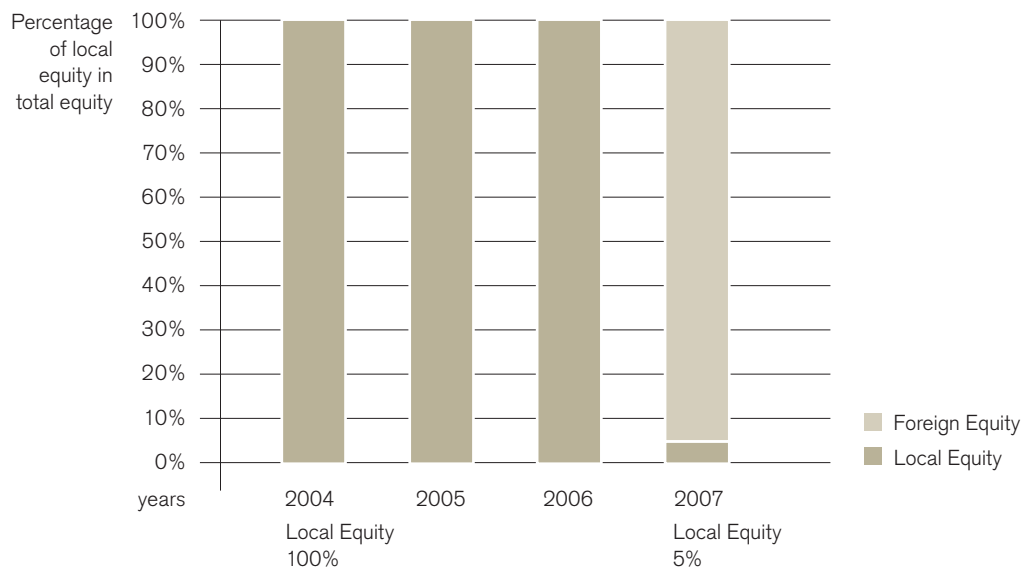
¹⁸ See Deshpande et al. (2007).

¹⁹ This case study is set up on the basis of interviews with the management of the respective MFI and on the basis of data material delivered to us by the MFI.

The question of what types of investors are active in foreign ownership in microfinance, is another important issue not to be neglected in this context. As we have seen, there is an increasing engagement of commercial investors and of development funds in terms of foreign equity, but there is still also a heavy engagement of entities like NGOs or foundations and development agencies. In fact, public money is – in one way or the other – involved in many of the activities of commercial investors and development funds, and it is, of course, involved in most of the activities of NGOs or foundations and development agencies.²⁰

So, contrary to what might be expected, entities (co-)funded by public money do also finance the acquisition of mature institutions – sometimes even the most mature institutions of the whole sector. However, this should not actually be their role.²¹ On the one hand, it involves difficulties with public money indirectly crowding-out direct private investments.²² And on the other hand, it involves the problem that public money is thereby engaged in activities which, as we have explained, carry with them negative risks for the evolution of MFIs, as well as for the overall local development. And as shows the case, which is illustrated by figure 12, such cases do exist.²³

FIGURE 12 THE DEVELOPMENT OF THE OWNERSHIP STRUCTURE OF AN MFI IN ASIA



The foreign equity investments in this case are mainly made up of public funds.

²⁰ See Abrams / Ivatury (2005).

²¹ See Forster / Reille (2008).

²² See Abrams / Stauffenberg (2007).

²³ This case study is set up on the basis of information delivered to us by the respective MFI and on the basis of interviews with the managers of the MFI.

CONCLUSION

As we have seen, the sample of MFIs used in this paper was based on a selection of MFIs from the MIX-Market database and was dominated by Latin America both in terms of the number and in terms of the size of institutions. Of course, the sample was not representative enough to formulate conclusions concerning the whole microfinance sector. However, the analysis highlighted an increasing trend in foreign ownership for the sampled MFIs, which may also concern other institutions, and which therefore merits consideration.

Concerning the overall evolution of foreign ownership, the analysis showed that both local equity investments in MFIs and foreign equity investments in MFIs increased during the sample period. And although the level of local equity was still higher than the level of foreign equity, the proportion of foreign equity in MFIs increased much faster than the proportion of local equity in MFIs, namely by 384% as compared to 154% during the sample period.

The analysis revealed that the evolution of foreign ownership varied according to different categories of MFIs and according to different regions of the MFIs location.

So, Category 1 of MFIs (completely under local ownership) was still the largest category in terms of equity at the end of the sample period, whereas Category 5 of MFIs (completely under foreign ownership) was still the smallest category. Nevertheless, Category 1 of MFIs increased its equity capital by only 194%, and Category 5 of MFIs increased its equity capital by 336% during the sample period.

Furthermore, equity investments in MFIs in the Latin American region grew by 241% during the sample period, whereas equity investments in MFIs in the East Asian region grew by only 163%. Nevertheless, the level of foreign equity as a percentage of total equity amounted to only 37% for the MFIs in the Latin American region, and to 91% for the MFIs in the East Asian region at the end of the period.

The analysis also revealed that the evolution of foreign ownership varied according to different types of investors and according to different investors' country of origin.

In the global sample, foreign equity investments by commercial investors grew from 10% to 20% during the sample period, and those by development funds from 3% to 7%. In the focus group (i.e. in the group of MFIs with at least a 30% share of foreign equity in total equity at the end of the period), however, foreign equity investments by commercial investors grew from 19% to 36% during the sample period, and those by development funds from 4% to 12%. Yet, even if the investments by NGOs or foundations and by development agencies experienced a slower but similar growth rate in both samples, these entities were still heavily engaged in foreign ownership.

What's more, there were three countries most active in foreign ownership in microfinance in terms of the amounts invested, Germany, the USA and The Netherlands. Taken together, these three countries represented 73% of all foreign equity investments in MFIs at the end of the period. Yet, even if the engagements of investors from other countries were much less important, these funders were still heavily engaged in foreign ownership, as well.

In conclusion, the analysis revealed a trend towards foreign ownership in the sampled MFIs.

However, such a trend might not only have positive effects, but might also involve negative risks in terms of development.

So, foreign ownership and foreign governance often mean that the strategic and operational decisions, concerning an MFI, are taken by foreign entities. And this could lead to a loss of the local recognition of an MFI and might interfere with the aim of establishing locally driven MFIs, servicing empowered local clients, thereby constructing local financial markets and developing a local economic environment.

Furthermore, the increasing involvement of all types of investors in foreign equity investment in MFIs, often means that entities (co-)funded by public money also finance the acquisition of mature institutions. And this, in turn, might lead to the problem that public money is precisely engaged in activities, which carry with them the aforementioned negative risks for the evolution of local MFIs and the overall local development.

EPILOGUE by Axel de Ville, Executive Director of ADA, Luxembourg

We are pleased to present the first ADA Discussion Paper on the issue of foreign ownership in microfinance – an issue which might provoke as many different opinions as it might interest actors from the microfinance sector. We do not want to limit ourselves to just highlighting a trend towards foreign ownership in microfinance and to pointing out certain risks associated with this trend, but we would also like to share with you some thoughts for the future.

A first thought is simply that one should be cautious with foreign equity investments in the microfinance sector. It would, for example, be possible for an MFI to define a clear limit which the invested percentage of foreign equity in total equity may maximally reach, so that the respective foreign investors cannot exert complete control over the institution. And it would also be possible for a foreign investor to formulate a clear exit strategy that defines at which stage of an MFIs development he/she has to limit or to withdraw his foreign equity investment in order for the MFI to become an autonomous institution.

A second thought is that it could make perfect sense to foster local ownership in MFIs. MFIs could, for example, try to attract the attention of local equity investors to the potential of their respective microfinance initiatives, and local equity investors could, in turn, try to attract the attention of MFIs to their funding solutions. Furthermore, the clients of microfinance institutions could be integrated into the whole dynamic: MFIs could try to win the clients' trust just as the local owners and the clients could, on the other hand, try to win the MFIs' trust for a possible shareholding co-operation.

Our word of caution concerning foreign ownership in microfinance is applicable especially to entities (co-)funded by public money, yet all other kinds of foreign investors and the MFIs themselves should of course pay careful attention to these matters, too.

And what do you think about ownership in microfinance? Should local ownership in general be considered more thoroughly when evaluating MFIs? And could we perhaps even include local ownership in the set of social performance indicators for MFIs when considering the impact of microfinance in terms of local development? Do the MFIs in developing countries feel it is true that there are often no alternatives to foreign equity funding? Have they made any special efforts to attract local equity investors?

And from the perspective of an investor in an industrialised country (especially a development agency) have you defined exit strategies concerning your foreign equity investments? And are these strategies implemented effectively?

We are curious to know your reactions to this first ADA Discussion Paper and we are very much looking forward to an exchange of experiences. Convinced by the idea of microfinance and its impact in terms of poverty reduction, we nevertheless think that this sector still has to develop in order to fulfill its objective, and we hope that the discussions following this study will contribute to this aim.

So, please do not hesitate to take part in the discussion!

discussion.ada@microfinance.lu

BIBLIOGRAPHY

Abrams, Julie / Stauffenberg, Damian (2007): "Role Reversal – Are Public Development Institutions Crowding Out Private Investment in Microfinance?", MicroRate Inc. 2007.

<http://microrate.com/wp-content/uploads/2009/03/role-reversal-final-3012007.pdf>

Abrams, Julie / Ivatury, Gautam (2005): "The Market for Foreign Investment in Microfinance: Opportunities and Challenges", CGAP Focus Note, No.30, August 2005.

http://www.cgap.org/gm/document-1.9.2574/FocusNote_30.pdf

Bogan, Vicky (2008): "Microfinance Institutions: Does Capital Structure Matter?", draft.

<http://ssrn.com/abstract=1144762>

Busch, Brian / Rhyne, Elisabeth (2006): "The Growth of Commercial Microfinance: 2004-2006", Council of Microfinance Equity Funds.

<http://www.cmef.com/Document.Doc?id=573>

CGAP (2008): Strategic Directions 2008-2013 – Building Local Financial Systems that Work for the Poor: Equity and Efficiency, CGAP.

<http://www.cgap.org/gm/document-1.9.40791/CGAP%20IV%20Strategy%20Building%20Local%20Financial%20Systems%20.pdf>

Christen, Robert Peck / Rosenberg Richard / Jayadeva, Veena (2004): "Financial Institutions with a 'Double Bottom Line': Implications for the Future of Microfinance", CGAP Occasional Paper, No.8, July 2004.

http://www.cgap.org/gm/document-1.9.2701/OccasionalPaper_8.pdf

Clark, Lauren / Crawford, Gil (2007): "A Long-Term Solution to Financial Freedom", Microenterprise Development Review, Vol. 10, July 2007.

http://www.microvestfund.com/news/microenter_dev_%207-16-07.pdf

Coppoolse, Marco (2007): Microfinance – An Emerging Asset Class for Equity and Debt Investors, Microcapital, August 2007.

<http://www.microcapital.org/downloads/whitepapers/Emerging.pdf>

Deshpande, Rani / Nestor, Camille / Abrams, Julie (2007): "MFI Capital Structure Decision Making: A Call for Greater Awareness", CGAP Brief, August 2007.

http://www.cgap.org/gm/document-1.9.2735/Brief_August2007.pdf

Forster, Sarah / Reille, Xavier (2008): "Foreign Capital Investment in Microfinance: Balancing Social and Financial Returns", CGAP Focus Note, No.44, February 2008.

http://www.cgap.org/gm/document-1.9.2584/FocusNote_44.pdf

Goodman, Patrick (2005): "Microfinance Investment Funds – Key Features", ADA Luxembourg.

<http://www.microcapital.org/downloads/resourcepapers/ADA-MFIInvestmentFunds.pdf>

Lauer, Kate (2008): "NGO MFI Transformations: Ownership Issues", CGAP Brief, September 2008.

http://www.cgap.org/gm/document-1.9.6151/CGAP%20Brief_NGO%20MFI_ENG_10-27-08.pdf

Lauer, Kate (2008): "Transforming NGO MFIs: Critical Ownership Issues to Consider", CGAP Occasional Paper, No. 13, June 2008.

http://www.cgap.org/gm/document-1.9.4213/OccasionalPaper_13.pdf

Maisch, Felipe / Soria, Alvaro / Westley, Glenn (2006): "How Should Microfinance Institutions Best Fund Themselves?", Best Practice Series, Inter-American Development Bank, Sustainable Development Department.

<http://idbdocs.iadb.org/wsdocs/getdocument.aspx?docnum=1442202>

Microfinance Insights (2008): "Human Resource Challenges and Solutions. Survey Report", Microfinance Insights, April 2008, Mumbai / India.

<http://www.microfinanceinsights.com/oldsite/Download/HR%20Survey%20Report%20April%2008.pdf>

Reddy, Rekha (2007): "Microfinance Cracking the Capital Markets II", InSight, No. 22, Acción, May 2007.

http://collab2.cgap.org/gm/document-1.9.29216/40679_file_43.pdf

To subscribe, please send
an email to: [discussion.ada@
microfinance.lu](mailto:discussion.ada@microfinance.lu)
The paper can also
be downloaded at:
www.microfinance.lu

Copyright © ADA –
December 2009

