

Microfinance Investment in Sub-Saharan Africa: Turning Opportunities into Reality

The 48 countries of sub-Saharan Africa (SSA) represent 14 percent of the world's population and include seven of the 10 fastest growing nations in the world: the Democratic Republic of Congo (DRC), Ethiopia, Ghana, Mozambique, Nigeria, Tanzania, and Zambia. Overall, SSA is stabilizing and growing, with fewer conflicts¹ and banking crises² since the 1990s and early 2000 (Beck, Maimbo, Faye, and Triki 2011) and more foreign direct investment (FDI) flows. FDI inflows to the region rose from \$23 billion in 2006 to \$38 billion in 2010, according to the UNCTAD statistics database.³ The increase is due to a number of factors, including consistent gross domestic product growth rates, increased political stability, a growing middle class, and reforms that reduce barriers to entry (World Bank 2011).

Yet despite healthy economic prospects, the region has the lowest share of banked households in the world (12 percent) and the highest share of poor people, with 50 percent of the population living on \$1.25 a day or less (CGAP and World Bank 2010). More work needs to be done to expand financial access, and many governments and international funders are keen to contribute. Equity and debt capital continues to be important in developing financial services for low-income populations in the region. However, local equity is not available in most countries, and local debt funding is scarce. SSA microfinance relies heavily on deposit funding, mostly composed of short-term deposits, while many smaller institutions cannot attract sufficient deposits to finance growth. The region received 11 percent of global microfinance funding commitments in 2010.⁴ In terms of cross-border investment, it received among the lowest levels in the world—\$1 billion out of a total of \$13 billion as of December 2010 (Reille, Forster, and Rozas 2011).

This Brief examines public and private foreign investment in SSA microfinance retailers, and the key challenges that limit investment. The findings are based on CGAP data on cross-border funding flows, publicly available resources, and interviews with more than 30 investors and other stakeholders conducted in the first quarter of 2012.⁵

Is there less demand for cross-border investment in SSA than in other regions?

SSA has a large number of financial service providers, including credit unions, nonbank financial institutions (NBFIs), banks, savings banks, savings groups, postal savings banks, and mobile network operators. As of

2010, 193 microfinance institutions (MFIs) from SSA were reporting to MIX, with a high concentration of MFIs in East Africa and West Africa. Microfinance providers reporting to MIX in SSA reach nearly one-quarter of all depositors globally, while accounting for less than 5 percent of borrowers. Local funding, such as deposits, plays a dominant role in the funding structure of MFIs (CGAP and MIX 2012). In addition, local government funding sources are available in many countries in the region. Government programs often operate as funds (e.g., the National Fund for Microfinance in Benin) or are registered as companies with majority government ownership. In some countries (e.g., in Rwanda), the government is an important player in the ownership structures and boards of financial institutions.

New or greenfield⁶ MFIs began appearing in the mid-1990s. The number of greenfield institutions has increased rapidly in SSA over the past three years, due to many reasons, including the scarcity of strong local providers that serve the low-income market. There are currently 40 greenfields in 18 countries (CGAP and MIX 2012). SSA is also a leader in mobile banking services, which are available in 28 countries (Wireless Intelligence 2012; CGAP and MIX 2012)—Kenya is the global leader with more than 18.9 million subscribers as of April 2012, according to the Communication Commission of Kenya. Other providers such as insurance and leasing companies are increasingly serving low-income clients.

However, it is not possible to generalize across all of SSA. SSA has four culturally and economically distinct subregions, and even within these there is great diversity. West Africa has many financial cooperatives (mostly called decentralized financial systems or savings and credit cooperatives). Financial cooperatives also predominate in Central Africa, and they tend to be weak on risk indicators, such as portfolio at risk (PAR)

1 http://www.oecd.org/document/19/0,3746,en_39862406_39906520_49370195_1_1_1_1,00.html

2 There has been a decrease in the number of systematic banking crises from 15 countries in the mid-1990s to less than five countries in 2009 (<http://www.mfw4a.org/events/event-details/financing-africa-through-the-crisis-and-beyond-publication-pre-launch.html>).

3 North Africa data were deducted from total.

4 Global commitments were US\$24–27 billion (2011 CGAP Funder Survey).

5 We define foreign investment as commercial or quasi-commercial investment in equity and debt. Cross-border funding refers to debt and equity; we did not analyze cross-border funding through guarantees, grants, technical assistance, or loans to government. Demand analysis is based on MIX data (www.mix.org).

6 A greenfield MFI is a new institution built from scratch, usually using standard operating procedures disseminated by a holding company or international network (CGAP and MIX 2012).

and write-offs (CGAP and MIX 2011). NBFIs tend to dominate East Africa, with a growing number of microfinance providers reaching large scale. Southern Africa has a smaller microfinance market than the other subregions, with banks accounting for a majority of depositors and borrowers.

MFI performance lags behind other regions

Several strong and well-performing MFIs operate in SSA, but on average, MFIs perform worse there than in other regions, with weaker asset quality (higher PAR and lower reserves for delinquencies) and a higher cost structure. In 2010, PAR greater than 30 days was almost 5 percent, the highest of all regions, while median operating costs were 32.6 percent of loan portfolio, well above that of other regions (CGAP and MIX 2012 and MIX Cross-Market Analysis Database 2010 data).

SSA has a large number of smaller MFIs that are often less profitable. For example, by asset size, SSA has fewer Tier 1 and Tier 2 MFIs.⁷ SSA has a total of 25 Tier 1 MFIs compared to Latin America and the Caribbean (LAC) with 105 and Europe and Central Asia (ECA) with 62. This can be explained by a number of factors, including smaller average loan sizes, difficult operating environments, and in many cases less access to capital for growth with small and dispersed capital markets. Also, a number of weak MFIs in the region are under government administration, including 17 MFIs in West African Economic and Monetary Union (WAEMU) member countries at the end of 2011 and three in Cameroon at the end of 2010.⁸

Weak management and governance are other important demand-side challenges. Most microfinance providers suffer from human capital deficiencies at all levels, attributable largely to weak educational systems and the high costs of attracting better educated staff. It is challenging to find skilled senior managers, especially in finance, internal audit, and law. In terms of governance, the main challenges include conflicts of interest and lack of management accountability (given the closeness of senior management to board members). Many of the investors interviewed cited lack of transparency and insufficient reporting as some of the main challenges of doing business in the region. There are poor reporting standards, limited availability of information on MFIs, and concerns about the reliability of external audits of MFIs, which are often conducted by auditors who lack microfinance experience. Transparency is especially challenging for younger and less sophisticated Tier 3 MFIs.

What are the main market level barriers?

While there is great variance across the region's 48 countries and four subregions, the lack of market infrastructure and market information stand out as significant barriers in most countries. For example, while 26 countries in SSA have public credit registries, only six of these cover microfinance (CGAP and MIX 2010). Also, local stock markets are weak or nonexistent, which limits equity investors' exit options.

Progress has been made on the regulatory side. Most countries in SSA have no restrictions on foreign investments in the banking sector.⁹ Seventeen countries have adopted national microfinance strategies, and 27 have adopted microfinance legislation to date (CGAP 2010d). Between 2007 and 2009 alone, 14 countries drafted, adopted, or revised microfinance laws/regulations, including a new law for decentralized financial systems for the WAEMU region, which replaced the PARMEC law.¹⁰ Also, 29 countries have specialized microfinance laws, and in 15 others, microfinance is regulated under banking or NBFIs laws. Despite this progress, some regulations are inadequate, and implementation, including licensing, remains challenging, especially in West Africa. Additional approval requirements create long delays, branch licensing is cumbersome, and there can be frequent and confusing changes in capital and other regulatory requirements. Supervisory capacity is often a challenge, and weakly regulated institutions threaten the development of a sound market for investment.¹¹

Finally, macroeconomic instability, as well as political instability and interference, help to explain the low level of investment in several countries. While regional conflicts have diminished and investments are growing in stabilizing post-conflict countries, such as DRC, there is still unease about investing in other post-conflict countries, such as Sudan. The overall business environment remains unfavorable in countries such as Chad, Niger, Burundi, or Central African Republic, while issues with corruption, oil subsidies, and instability hamper investments in Nigeria.

Despite these concerns, many of the interviewed investors say that they have a higher country risk threshold for SSA and are prepared to invest in most SSA countries, motivated in part by their development mission and their commitment to the region. In fact, some public development finance institutions (DFIs) indicated that they are prepared to invest in almost all SSA countries at this time if they find investible opportunities. New greenfield

7 Tier 1 is defined as MFIs with assets greater than \$30 million, Tier 2 assets \$5–30 million, and Tier 3 less than \$5 million (CGAP 2010).

8 La Banque Centrale des Etats de l'Afrique de l'Ouest (BCEAO) and the Commission Bancaire de l'Afrique Centrale (COBAC).

9 Aside from some restrictions in Nigeria and Ethiopia where the law precludes a foreign national from undertaking banking business.

10 The decentralized financial systems bill was passed in Guinea Bissau and Senegal in 2008, in Mali and Burkina Faso in 2009, in Niger in 2010, in Togo and Cote d'Ivoire in 2011, and in Benin in January 2012, according to CGAP's Financial Inclusion Regulation Center (www.cgap.org/p/site/c/regulation_center/).

11 West Africa and Cameroon were cited by investors as particularly problematic.

operations in post-conflict countries, such as DRC, Cote d'Ivoire, and Liberia, corroborate this.

Are international investors structured well to serve the SSA market?

More than 70 public and private foreign investors have debt and equity investments in SSA microfinance, compared to 94 in LAC and 64 in ECA. Public DFIs account for about two-thirds of the roughly US\$1 billion of total SSA cross-border investment. Several DFIs have direct investments in SSA retail providers, and they also provide wholesale funding to microfinance investment vehicles (MIVs) that invest in the region. Private investors include MIVs and other intermediaries, such as holding companies. Oikocredit, Blue Orchard, Triodos, responsAbility, and Regmifa managed the largest microfinance investment portfolios for the region, with individual portfolios ranging between US\$40 million to US\$72 million at year end 2011, according to CGAP research. Some of the funds (e.g., Oikocredit, Norwegian Microfinance Initiative's Frontier Fund, Regmifa, etc.) and the DFIs also provide technical support alongside their investments.¹²

Debt represents a large part of the total direct investments in the region (38 percent for DFIs and 70 percent for MIVs, as of December 2010), with a growing portion of funding in local currency. For example, in 2010, 49 percent of all direct DFI debt investment was in local currency, and this figure has risen since. Also, most MIVs have more than 50 percent of their SSA portfolio in local currency (compared to 30 percent globally), and several have a strategy to increase such funding to 100 percent, according to our research.

For some DFIs (e.g., FMO, Proparco, IFC), equity represents more than 50 percent of the volume of their SSA portfolio and is higher than the overall share of equity on their global portfolio. This higher proportion of equity investments is driven by two main factors: (1) these DFIs want to provide patient, longer term capital to help MFIs develop into larger and stronger institutions, and (2) greenfields, which are the main investment targets of some DFIs, require significant equity capital.

Despite a high growth rate,¹³ SSA investment is only a small part of the global microfinance portfolios of international investors, with investments in the region accounting for only 9 percent and 5 percent, respectively, of the DFI and MIV global microfinance portfolios.¹⁴ The lower level of funding in SSA compared to other regions is less about the number of public and private investors

Box 1. Making pricing work: The high costs of offering local currency loans

Investors have made noticeable strides in providing local currency funding to SSA financial institutions. However, finding affordable hedging instruments or local currency equivalent funding is often difficult. In particular, several investors noted difficulties finding price-competitive hedge rates for East Africa, the subregion where microfinance investments had been concentrated to date. Recently, high inflation in Kenya and Tanzania has dramatically pushed up interest rates, and consequently hedging costs. In Kenya, the inflation rate quadrupled to 18.9 percent during 2011. SSA had the most volatile hedge rates over the year ending September 2011 (MFX Solutions 2011).

High hedging costs have contributed to a recent reduction in the volume of loans closed for East African MFIs. Larger and more sophisticated MFIs are taking hard currency loans at lower rates, while smaller MFIs with less access to local funding are forced to pay much higher rates on properly hedged loans. Most investors anticipate that the cost of hedging in East Africa, and in a few other SSA countries, will not return to reasonable levels until 2013.

present in the region, and more about the demand and market issues noted earlier. Also, many countries receive little or no foreign investments: DFI and MIV investments are reaching less than half of the region's 47 countries. Over half of all DFI direct MFI investments in SSA go to 10 institutions, and 56 percent of all direct DFI investment is concentrated in five countries. For example, Kenya received 22 percent of the total DFI investment and 40 percent of known MIV investments.¹⁵

Minimum investment thresholds preclude investments

Given the less developed nature of several SSA country microfinance markets, the institutions often need smaller transaction sizes, which can be less attractive to investors who are concerned about maximizing staff productivity. Also, many unregulated institutions usually have ownership structures that investors cannot buy into for equity participation, and such institutions pose a higher risk because they are not supervised. On the other hand, in some parts of the region (e.g., West Africa), cooperatives are the main service providers¹⁶ and capital investments are challenging or often not possible.

Many specialized funds have a focused SSA strategy and are willing to make smaller investments, as low as US\$500,000.¹⁷ Whereas several of the leading global

¹² Technical assistance programs tend to focus on management capacity, management information systems, MFI transformation, new products, and risk management systems.

¹³ Fifty-one percent and 58 percent for the DFIs and MIVs, respectively, in 2010 (2011 Funder Survey, 2011 Symbiotics MIV Survey).

¹⁴ In contrast, LAC accounts for 19 percent of DFI investments and 35 percent of MIV investments; ECA accounts for 32 percent of DFI investments and 40 percent of MIV investments (CGAP 2011 Funder Survey and Symbiotics 2011 MIV Survey).

¹⁵ CGAP Cross-Border Funder Survey 2010 and CGAP MIV Survey 2010 and 2009 data.

¹⁶ Twenty percent of SSA MFIs reporting to MIX are cooperatives, particularly prominent in West Africa.

¹⁷ Investors interviewed noted that investments in SSA are commonly \$500–750,000.

fund managers with significant SSA portfolios seem to favor a business model that targets larger or Tier 1 MFIs and MFIs that are members of microfinance networks or holding companies, some of the newer and specialized regional niche funds are targeting smaller or emerging MFIs. But incurring transaction costs for the sake of a small deal raises issues of cost-effectiveness, and managing small transactions spread over many countries heightens the challenge. Among transaction costs, due diligence in the field is more expensive for investees that are less transparent. Overall, the investors noted that their interest rate spreads are about the same in SSA as in other regions, so the high cost of doing business in the region means that their net returns are lower. One of the largest private microfinance investors in SSA is a global fund, Oikocredit, with a decentralized structure and local presence in more than 12 SSA countries. Oikocredit has successfully built a cost effective way to reach smaller Tier 2 and Tier 3 MFIs in SSA. Keys to its success have been a commitment to the region and to reaching underserved markets, a strong regional presence with 12 SSA offices, and a flexible business model that allows it to consider small transactions in the short term with the hope of growing these relationships and making them more profitable in the longer term. According to Oikocredit, it has made loans as small as €50,000, while its average microfinance loan size in SSA is €540,000.

Conclusion

Given the macroeconomic and microfinance trends for SSA, the future looks promising. The estimated growth rates for several SSA economies are among the highest globally, which should also lead to increased demand for microfinance and growth of the industry. This will inevitably result in an increased demand for local and international capital to respond to such opportunities. Public and private microfinance investors interviewed for this research are expecting a 20–30 percent increase in their SSA portfolio in 2012. However, turning this opportunity into reality and bringing more access to finance for poor people will require tackling all of the market challenges discussed in this Brief.

Given the smaller size of many SSA MFIs, market fragmentation and the high transaction costs of doing business in the region, investors will either have to accept lower returns, or find business models that can lower the cost of handling large numbers of small transactions. Investors are recognizing this, and more private investors are opening local offices in SSA to lower costs, better understand local issues, and improve market penetration.

References

- Beck, Thorsten, Samuel Maimbo, Issa Faye, and Thouraya Triki. 2011. "Financing Africa: Through the Crisis and Beyond." Washington, D.C.: World Bank.
- CGAP. 2010a. "CGAP MIV Disclosure Guidelines." Washington, D.C.: CGAP.
- . 2010b. MIV Survey 2010. Washington, D.C.: CGAP.
- . 2010c. Cross-Border Funder Survey 2010. Washington, D.C.: CGAP.
- . 2010d. "Policy Issues in SSA Region." <http://www.cgap.org/p/site/c/template.rc/1.11.131908/1.26.3123/>
- . 2011. Cross-Border Funder Survey 2011. Washington, D.C.: CGAP.
- CGAP and MIX. 2011. "Sub-Saharan Africa Microfinance Analysis Benchmarking Report 2010." Washington, D.C.: CGAP and MIX.
- . 2012. "Analysis of Key trends: 2011 SSA Africa Regional Snapshot." Washington, D.C.: CGAP and MIX, February.
- CGAP and World Bank. 2010. *Financial Access 2010*. Washington, D.C.: CGAP and World Bank.
- GSMA. 2012. Wireless Intelligence Mobile Deployment Tracker. <http://www.wirelessintelligence.com/mobile-money/>
- MFX Solutions. 2011. "MFX 2011 Benchmark Analysis Report." Washington, D.C.: MFX Solutions.
- MIXMarket. Cross-Market Analysis data. <http://www.mixmarket.org/profiles-reports/crossmarket-analysis-report>
- OECD and Economic Commission for Africa. 2011. "Mutual Review of Development Effectiveness in Africa Report." OECD and ECA.
- Reille, Xavier, Sarah Forster, and Daniel Rozas. 2011. "Foreign Capital Investment in Microfinance: Reassessing Financial and Social Returns." Focus Note 71. Washington, D.C.: CGAP.
- Symbiotics. 2011. "Symbiotics 2011 MIV Survey Report." Geneva, Switzerland.: Symbiotics.
- World Bank. 2010. "Investing Across Borders 2010 Report." Washington, D.C.: World Bank.
- . 2011. "Global Economic Prospects: Maintaining Progress Amid Turmoil (Regional Annex)." Volume 3, June. Washington, D.C.: World Bank.
- The authors would like to thank Mayada El-Zogbi, Antonique Koning, Alexia Latortue and Rich Rosenberg for their invaluable inputs and guidance. We would also like to acknowledge the contributions of Djibril Mbengue, Anna Nunan, Moses Ochieng, and Corinne Riquet. Finally, we thank the investors who contributed to CGAP's research.*

All CGAP publications are available on the CGAP Web site at www.cgap.org.

CGAP
1818 H Street, NW
MSN P3-300
Washington, DC
20433 USA

Tel: 202-473-9594
Fax: 202-522-3744

Email:
cgap@worldbank.org

© CGAP, 2012

AUTHORS:

Jasmina Glisovic, Senayit Mesfin, and Louise Moretto