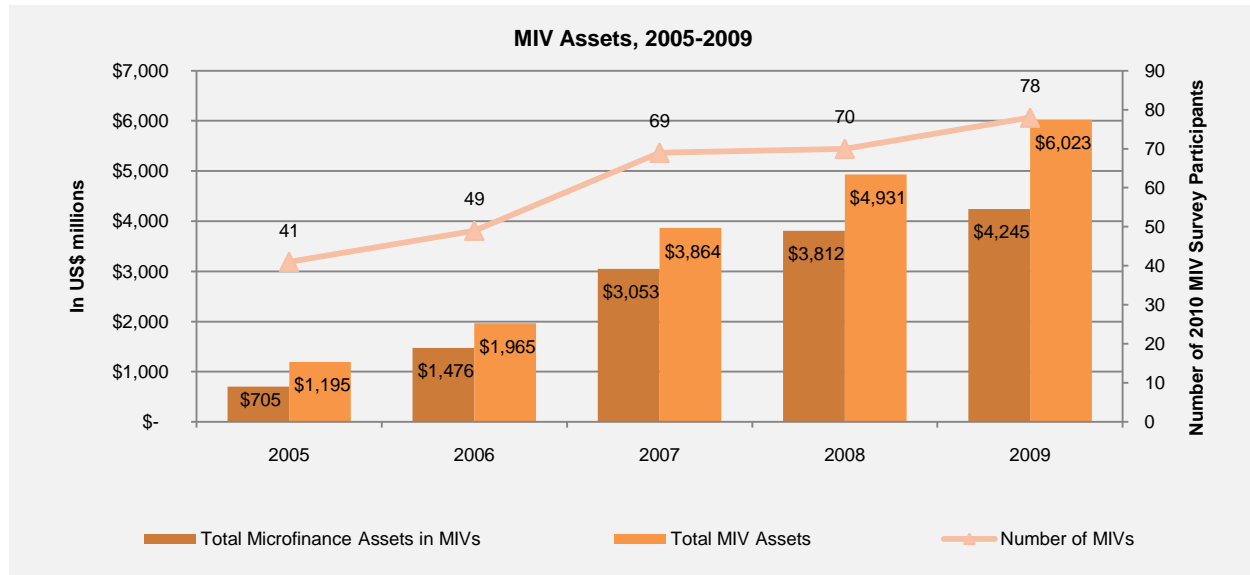


State of Microfinance Investment

Summary: The MicroRate 2010 MIV Survey



Executive Summary

MicroRate's 5th annual Survey of microfinance investment vehicles (MIVs) measures the development of a relatively new category of funds and other intermediaries that mobilize investments in rich countries and channel them to microfinance institutions (MFIs) in the developing world.

It is one of the little noticed triumphs of development that large amounts of money are by now flowing from investors in Europe and the USA via MIVs to microfinance institutions in countries like India, Peru or Uganda, to name just a few. Ultimately these funds reach millions of poor people as microcredits, allowing them to become productive and earn a livelihood.

In 2009, the assets of MIVs grew by \$1.2 billion to \$6 billion. MIVs thus account for a significant share of funding flows from rich countries directly to the poor.

The 2010 MIV Survey shows that investor interest in microfinance funds and similar intermediaries remains strong despite the worldwide recession. MIVs grew by 22% in 2009. But strong interest in microfinance from investors is meeting much weaker demand for funding from microfinance institutions themselves. Microfinance assets – the part of a Fund invested in MFIs – grew only 11%

in 2009, which left MIVs with rapidly increasing and ultimately unsustainable levels of liquidity.

By the end of 2009, too many MIVs were chasing too few investment opportunities; rates had once again dropped to levels where they no longer compensate fully for the risks associated with lending to some of the world's poorest countries.

Lending to MFIs by government-owned development institutions (DFIs) is not covered by this Survey, but MicroRate has observed, that they strongly increased their lending for microfinance in 2009. DFIs are once again crowding out private funding for microfinance as they did before the global crisis of 2008.¹

Survey Overview

In 2008 and 2009, MIV growth has slowed drastically compared to growth rates before the recession. In these two years MIVs grew at the slowest pace since the start of MIV Surveys in 2005.

In 2009, investment in Latin America and the Caribbean (LAC, 37% of microfinance assets) eclipsed Eastern Europe and Central Asia (ECA, 35%) as the largest MIV investment region.

¹ "Role Reversal: Are Public Development Institutions Crowding Out Private Investment in Microfinance?" MicroRate. 2007.

This change indicates that investors moved away from ECA during the financial crisis towards the more mature LAC market. The share of investment in South Asia remained constant in 2009 (9%). East Asia and the Pacific (EAP) showed the highest growth (124%), but the Region only represented 7% of microfinance assets. Sub-Saharan African investment, with 6%, of microfinance assets, also grew at an astonishing rate of 45% in 2009.

MFI Demand

Growth of MFIs has slowed, but it continues to be quite strong. A sample of MFIs tracked by MicroRate grew by 22% during 2009, compared to 49% in 2007 before the financial crisis erupted. MicroRate has observed that MFIs tend to borrow first from local sources; they resort to MIV funding to cope with peaks in growth. When MFI growth slows as it has in 2008 and 2009, demand for MIV funding decreases disproportionately.

Investor Demand

Investors' willingness to place their funds with MIVs remained strong in 2009, despite the effects of the global recession. MIVs raised more money from investors than they were able to place with MFIs. Investors remain optimistic about microfinance compared to other investments.

Liquidity & Development Institutions

In 2009, MIVs held over \$1 billion in liquid assets (17% of MIV assets) compared to \$459 million in 2008 (10% of MIV assets). While a certain level of liquidity was prudent to cover redemption requests, the rapid build-up of liquidity in 2009 was unprecedented and reflects weak demand for loan funding from MFIs.

A special liquidity facility (the "Microfinance Enhancement Facility-MEF") announced by two large DFIs in late 2008 achieved its goal: to assure the microfinance industry that funding would not dry up as a result of turmoil in financial markets. But though well intended, because of poor timing it added to the difficulties of MIVs. By the time the Facility began disbursements in 2009 the feared funding shortage had given way to an oversupply of funds.

Conclusions & Future Implications

MicroRate believes the current cooling off period could be considered a blessing in disguise: in 2007, just before the crisis erupted, MIVs had grown by nearly 100%. This was not sustainable. The drop in demand for MIV funding in 2009 could be seen as an opportunity for MIVs to strengthen their organizations, and focus on delivering the products and services that microfinance institutions truly require. The main danger posed by excessive liquidity is that it could push some MIVs into relaxing their lending standards.

Even though many MIVs expect demand to recover rapidly, it is likely that growth will continue at a slower, more sustainable pace in 2010 than in the past.

About the MIV Survey

The 2010 MIV Survey marks MicroRate's the fifth annual MIV Survey tracking the evolution of the sector. The Survey covers 78 of the 88 MIVs (89% response rate) with data collected as of December 31, 2009.

The 2010 MicroRate MIV Survey will be released at the end of July 2010, please visit, www.microrate.com to view the presentation when it is published. To receive and advanced copy of the 2010 MIV Survey, please contact Becca Waskey (Becca@microrate.com)

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