

PPP NEWSLETTER

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CONSULTANTS FOR MICROFINANCE AND MICROENTERPRISE

Perfect Point Partners SRL, B. Següencoma, Av Michel # 7572 La Paz-Bolivia Tel/Fax ++591-2-2118118

WELCOME

Dear reader,

Once again, I invite you to share our work experiences in the microfinance world, as well as the contributions to microenterprise and entrepreneurship in Bolivia. I also invite you to read the article about the perception of the managers of the main Bolivian microfinance institutions (MFIs) on financial performance indicators versus social performance ratios currently used. Then, we present to you our views on the performance of the microfinance institutions for which we worked in 2007 (2008?) - 21 Bolivian MFIs that are not regulated by the Bolivian Superintendency of Banks and Financial Institutions (SBEF).

Moreover, you can also be acquainted with the vision of our expert consultant Christian Ruehmer, about the financial crisis experienced in the developed world the past few months, and their impact on the microfinance industry.

Finally, in PPP News you will be up-to-date with Perfect Point Partners SRL latest news, our new clients, consultants and future work.

I hope you enjoy this version of our Newsletter. I wish you a nice holiday season, much success and happiness in 2009.



Perfect Point Partners SRL Team La Paz – Bolivia: Rolando Pereira, Fabiana Pastor, Jorge Velasco, Renata Bejarano, Mauricio Morón - Benítez



Fabiana Pastor
General Manager

Financial Performance and Social Ratios in Bolivian MFIs

It is important for microfinance institutions to have ratios to measure the social and financial performance, in order to be comparable with other institutions and show to creditors the results and impact on the served clients. It is also increasingly important to conduct the annual business plans, taking into account efficiency, productivity and risk management ratios to address the new market challenges, such as the financial crisis in the leading economies, which is expected to have a negative worldwide impact on finance and investment in 2009.

In that sense, we wanted to hear the opinion of Bolivian MFIs operators about the importance of measuring the social and financial performance. In this vein, we conducted interviews with senior managers¹, summarizing their perceptions and recommendations to the sector.

QUESTION 1. What kind of financial performance and productivity ratios are used in your institution?

In general, the IMF's use the suggested ratios by their respective associations (ASOFIN, FINRURAL) so that they can be compared and help the MFIs to monitor their activities with other similar institutions. The organizations also employ a group of ratios for internal comparisons; they are very varied, with a changeable sophistication level according to the characteristics of each IMF.

"Also, FFP FIE S.A. considered in decision-making, the behavior of productivity and financial ratios published by: ASOFIN, Superintendency of Banks SBEF, Bolivia Central Bank BCB, Financial Institutions, Rating Agencies and other international institutions."

QUESTION 2. Does your MFI use operating efficiency ratios, regarding to staff productivity? Which ones? Description.

In the MFIs the staff productivity is measured by identical indicators that reflect the operational efficiency in terms of: number, volume and quality portfolio by employee/credit officer.

ECOFUTURO FFP: "Yes, we use some indicators such as: Clients per employee, clients per Credit Officer, Portfolio pe employee, Portafolio per Credit Officer, Financial Income per Credit Officer, Personal Expenses/Total Administrative expenses..."

QUESTION 3. Does your MFI use efficiency ratios according risk management (liquidity, market, credit and operational)? Which one?

In the scope of risk management there is not a trend, each IMF's uses different strategies, most related only to credit risk. Few institutions have a risk monitoring system through the use of ratios.

¹ Julio Cesar Herbas Marketing and Productos National Manager - Banco Sol, José Morales Marketing Manager –ECOFUTURO FFP, Ricardo Suño General Manager – DIACONIA, Viviane Romero General Manager – PRO MUJER, Daniel Rodríguez National Manager De Banca PYME Banco BISA, Waldo Claros Financial and Operation Manager – ANED, Fernando López Financial and Operation Manager – FIE FFP, Roberto Zenteno National Subgerente SME Bank BNB, Isabel Rueda Education and training Manager - CRECER, Kattia Lopez Promotion Sub director - Microfinanciera Rural Campesina MIRUCA.

BISA BANK SME: "Within the lending sector we work with the above mentioned financial ratios, and in parallel the bank has a risk department, which is responsible, among other things, to analyze and update economic information from different productive and commercial sectors that we work with."

QUESTION 4. Which other financial performance and productivity ratios has your institution developed? (other than those required by regulators)

In general, IMFs develop new ratios to monitor specific situations (changing environment, new funding requirements, requirements of the directory), and the organizations can change or stop using them over time.

BANCO SOL: "We have also Customer Service ratios, financial size, operational dimension, internal dimension ratios."

QUESTION 5. Does your organization use social performance ratios?

This group of indicators is related to the orientation of each IMF, , but there is a widespread trend towards **Social Responsibility**, for which standardized ratios are used.

CRECER: "The desertion rate and client retention rate are considered as social performance indicators. We have poverty ratios among the served clients. We also have as poverty ratios, the average loan per group member and the percentage of customers with loans equal or less than \$us. 100".



QUESTION 6. Does your MFI consider important this kind of ratios (social)?

While all institutions consider important to measure their social performance, only those organizations with a social mission make an effort in developing and preparing ratios for this purpose.

"For FFP FIE S.A. Corporate Social Responsibility (CSR) is a philosophy that regards the business activity as the pursuit of business success from the relationship with the organization responsible for the environment at a human and environmental levels. "FIE (no se entiende)

PRO MUJER: "Of course, a microfinance institution with a strong focus on social development must be constantly monitoring that their results are consistent with the mandate and purpose of its vision and mission. This is part of the social performance management. "

QUESTION 7. Who are the users of this type of ratios (social)?

Non-profit financial institutions, or "Development Financial Institutions", are funded mostly by cooperation agencies, which monitor primarily the social performance. Social ratios are also used within the institutions, as a motivational factor as well as to show the public the achievements in the social area.

DIACONIA: "The investors, they are concerned about the social matter; they are not only interested in the financial part of the institution, but also in the social impact that we are doing."

QUESTION 8. Learned lessons regarding the elaboration and use of financial and social performance ratios, that you consider important

The use of ratios is very important to monitor and adjust the MFI operations in relation to the achievement of goals and objectives, therefore, the development of indicators should be simple and timely, according to the possibilities and reality of each institution.

ANED: "If you make a big basket of financial ratios, social ratios, etc., they will not be useful. You have to choose the best ratios that adjust to your institution, they should be ratios that will help us to evaluate ourselves with our characteristics. They have to be ratios that we can achieve, in terms of costs, inputs, time, etc.. "

QUESTION 9. Are we comparable with foreign MFIs? Why?

It is possible to compare the Bolivian microfinance institutions with foreign organizations, considering the regulatory environment of each country and the business orientation of the MFIs, whether commercial or social. It is also important to consider state of development of the microfinance industry in each country (competition, demand for financial services, market saturation).

MIRUCA: "Not all the countries have as much public information, as stratified or as standardized as in Bolivia. Anyway we can compare, however, we have to realize that the legislation of each country is different."

STUDY OF OPERATIONAL EFFICIENCY:

At the end of 2007, we concluded a consultancy work with 21 Bolivian MFIs.² It seems important to us to analyze the results on the measurement of financial performance and operating costs per product, derived from the costing analysis (activity based costing ABC). Figure 1 shows one of the most representative financial and efficiency ratio: administrative expenses to total assets.

As it can be observed, the ratio is relatively homogeneous amongst microfinance institutions, whether they are Credit Unions (red color) or Development Financial Institutions (IFDs in spanish)

² Product Costin in 21 MFIs (FONDESIF/PASA Comisión Europea): Cooperativas de Ahorro y Crédito: C. Cooprole, C. Cantera, C. Aiquile, C. S.C. Borromeo, C. Solano, C. San Bartolome, C. Comarapa, C. Madre Y Maestra, C. Magisterio Rural, C. San Roque, C. La Trinidad, C. Cristo Rey, C. Progreso, C. Llallagua, IFDs: FUNDOBEM, CIDRE, ANED, DIACONIA, FONDECO.

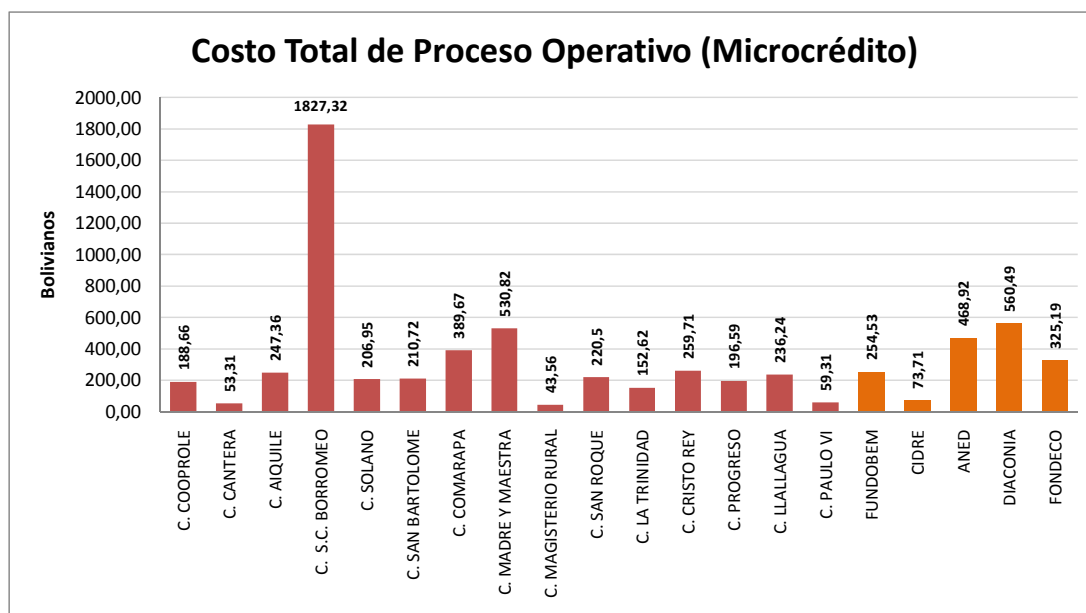
Figure 1: Administrative expenses relation to 31 Dic.2006



Source: Perfect Point Partners SRL

Credit Unions have an administrative expenses ratio in relation to assets of about 5.6% on average (except Llalagua CU). DFIs show a slightly higher ratio, equivalent to 10.1% on average. This is due to the similarity of the composition of administrative expenses between types of institutions.

Figure 2: Operating Process Total Cost (Microcredit to USD 500)



Source: Perfect Point Partners SRL

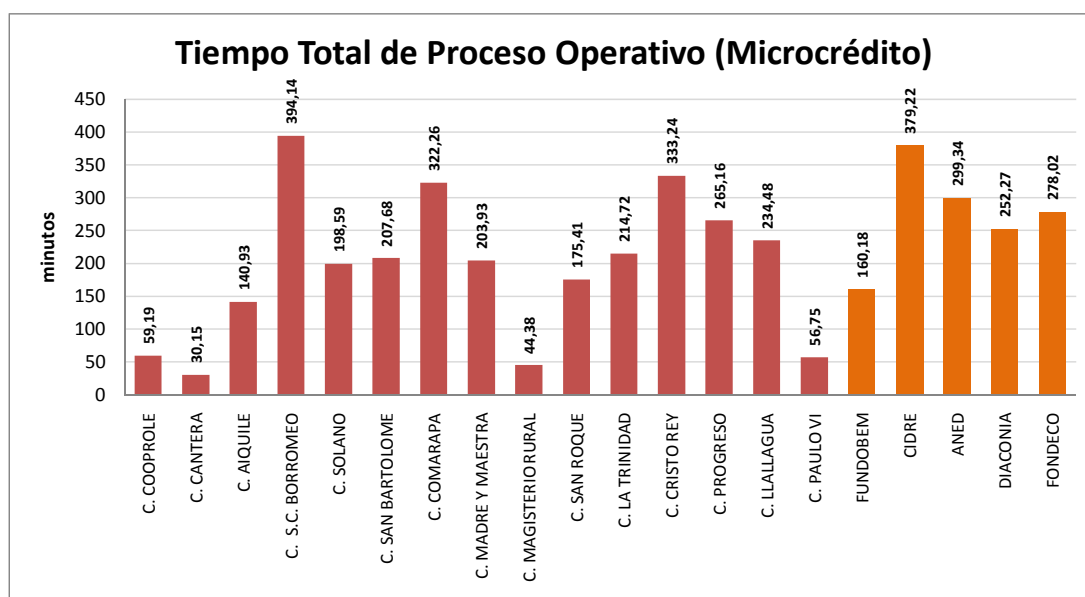
Figure 2 shows as well that the total operating cost per product (microcredit) is relatively

homogenous among MFIs (with some exceptions). It is understood that the microcredit operating cost of a process (less than USD 500) is related directly to salary expenses (direct costs) and the time spent on each operative phase - from promotion to disbursement - and the indirect cost (overhead).³ Thus, the average operating cost (excluding Borrromeo SC CU) is equivalent to Bs. 246.3 (USD 35.2). Considering this observations, it can be concluded that the disbursement time of microcredit (up to USD 500 or even? Bs. 4000) is similar between MFIs analyzed, also their price levels (active rates) and its direct costs (salary).

The activity cost analysis (ABC) calculates the average total time that took each IMF in executing the entire operational process (from promotion to disbursement). As Figure 3 illustrates the total time in minutes for a microcredit process (up to \$ 500) ranges from 30.1 minutes to 394.14 minutes in the analyzed MFIs. The difference is explained by the different methodologies used by the MFIs. Among the most important: a) Individual Credit b) Solidarity Groups c) Village Banking.

Although all methodologies involve five operative process phases: 1) Promotion, 2) Application and Evaluation, 3) Approval, 4) Disbursement, and 5) Monitoring; each methodology consists of different activities that translates in varying times and costs for each phase of the process. Other factors that influence the cost of the processes are the collateral required, the type of evaluation and the people involved for disbursement.

Figure 3: Microcredit Operative Process Time (Less than 500 USD)



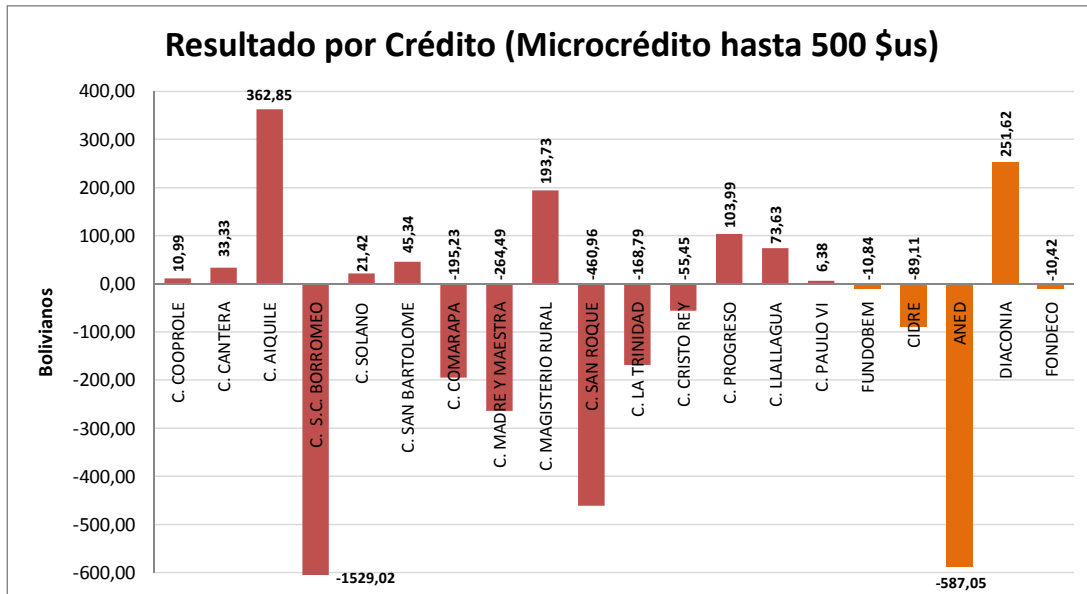
Source: Perfect Point Partners SRL

Figure 4 shows the analysis of profitability for microcredit products (less than USD 500). Although a similarity of interest rates is observed in the MFIs, the cost of credit risk and operating costs of the process differ significantly, affecting the profitability of the product in most cases.

Many MFIs set their interest rates without considering the real cost of the operating process, which significantly affects the final level of margin per loan and thus rapid growth, especially in smaller disbursed credits . By analyzing this cost, managers can make decisions and segmentation of interest rates by disbursed amount, continuity of product, sensitivity and used capacity analysis.

³ The concept of cost per credit product included in the PPP costing model the following values: Financial cost, Credit Risk (forecast by default) and the cost of operative process.

Figure 4: Result by Microcredit (Less than USD 500)



Source: Perfect Point Partners SRL

COPING WITH A CRISIS

Article by Christian Ruehmer for the MFC Newsletter MicroCapital Monitor The Microfinance Newspaper, December 2008 Volume.3 Issue.12



The world of developed financial markets seems broken. 18 months ago the “subprime crisis” started, a few banks were failing. Since then, bad news on the markets were published daily. However, over the last weeks, the situation escalated with banks failing on a daily basis, Iceland’s financial system collapsed, liquidity disappeared completely.

What do Microfinance Institutions (MFIs) have to do with this? According to studies, microfinance is uncorrelated with other financial markets. Portfolios grow fast and public interest increased. Investors were chasing MFIs to allocate their funds and conferences were organized all over the world. Microfinance is deemed to be different. The

worst case expectation is that the crisis might increase funding cost and provisions slightly.

The dangerous nature of this crisis is that it spreads slowly. But when it hits, it hits hard and the consequences are brutal. Stock markets remained relatively stable for months into the crisis but suddenly they fall worse than ever. Banks file for bankruptcy over weekends. It is no longer just a “subprime crisis”.

Let us assume that MFIs are not as unaffected as commonly expected. What will happen?

Here are some potential trends:

- 1) Private funding sources do not slow down, they dry up completely! Currently the best companies of the world have problems finding liquidity, even short term. Existing microfinance funds will have problems raising more debt. New investors will be unable to convince their committees to invest in microfinance as this is not the time of broadening of investment horizons. Therefore, do not expect major new fund inflows for the next 18-24 months.
- 2) Remittance payments will shrink. According to FOMIN/BID⁴, in 2008 remittance to Latin America shrank by 1.7% in real terms.
- 3) In line with the overall economy, client's economic conditions worsen, defaults increase. Also due to the crisis, clients will feel less obliged to pay loans.

Given those trends, the following can be expected:

- 1) More banks will be failing. This will also happen in developing countries. Depending on the quality of crisis management, bank runs are likely.
- 2) Similar to the US and Europe also in those countries "bail-outs" will happen. Nationalization becomes an option.

There is no time to complain about the situation. Let others be distracted with that. Act now with a series of prudent measures. As a qualified microfinance banker you need to be able to sail not only on bright days but also in storms. There is the chance to show that your MFI is a useful institution for your clients even in bad days. I suggest acting along the line of the following points:

- 1) Acknowledge that there is a serious crisis of incomparable size. Don't only look at defensive tactical solutions. Also focus on more strategic ways to solve shortages. Socially Responsible Funds might be able to support you in the short term as market based funding ceases, but the industry's growth plan was based on the supply of market based funds. Alternatives need to be developed.
 - a. Improve the long term liquidity planning. Ensure you negotiate extensions of funding early enough in order to avoid surprises. Some funding sources like CDOs might not be extendable.
 - b. Client deposits tend to be a less volatile funding source. If your regulatory environment allows it, start planning to introduce savings or term deposits.
 - c. Be open for business combinations. An actively pursued consolidation can be positive for all participants and can result in a stronger MFI. A forced consolidation is often too defensive.
- 2) Don't be fixed to past growth goals which were set under different macro-economic conditions.
 - a. There is no need to push organic growth, if opportunities are unavailable. If the economic conditions become too risky, temporarily halt. There is no obligation to lend if the economic basis is not given. This is also true for non-profit/charitable microfinance.
 - b. By accepting a more moderate or even no growth you also reduce pressure on your employees and avoid that the asset quality of your portfolio suffers.
 - c. It might be a good time to review indirect cost. Usually, phases of high growth also let indirect expenses. A review of those expenses and streamlining is necessary.

⁴ "BID estima flujos de remesas a América Latina y el Caribe para 2008", published on Oct 3 2008

- 3) Intensify the collaboration with your clients in order to better understand their financial situation and to support them.
 - a. Offering additional services like financial education and risk management might be helpful to manage through critical situations.
 - b. Products like health insurance can mitigate some problems during times of distress.
- 4) Get support through your network or through experienced consultants. Nobody expects you to be a natural born crisis manager. An external expert can serve as coach and can help steering through a crisis and to avoid losing focus because of a myriad of day-to-day issues coming up.

At this stage it is difficult to estimate to what degree the crisis in the developed markets will spill over to your institution. The severity might also be different from country to country and institution to institution. Yet, it was never more necessary than today to make prudent decisions about how to protect your institution and by that ensure that your clients, the ultimate reason for being a microfinance institution, suffer as little as possible.

Christian Ruehmer works in Microfinance since 2001, he is the founder of Perfect Point Partners (PPP) and focuses on Risk Management and Efficiency Management projects. The company worked on several projects over the last two years in MFC's region.

NEWS:

- Integrated Training Program (ITP) of PPP participates in Global Entrepreneurship Week in La Paz, Bolivia. Prizes are awarded:

Premios Otorgados 1:	Semana Mundial de Emprendedorismo
Actividad:	Concurso Cultura Emprendedora IV Versión
Institución Organizadora	Oficialía Mayor de Desarrollo Humano del Gobierno Municipal de La Paz
Participantes	Jóvenes estudiantes de tercero y cuarto grado de secundaria
Premiados	5 estudiantes del Colegio Ave María cada uno con un Módulo de "Diálogo de Gestiones"
Premios Otorgados 2:	Semana Mundial de Emprendedorismo
Actividad:	Concurso y Feria "Ideas de Negocios y Emprendimientos"
Institución Organizadora	Subprefectura de El Alto, BCCN, Carrera Administración de Empresas UPEA, Fundación Nuevo Norte
Participantes	Estudiantes de Colegios (3 y 4 curso), Institutos y Universidades
Premiados	Colegios: Proyecto "Sueños Felices" - Módulo EL ENTORNO Y LA MICROEMPRESA Instituto: sin ganador Universidad: Proyecto de Chocolates Artesanales y Proyecto Jeans con los módulos: EL EMPRESARIO Y SU GESTION Y NEGOCIACION O LIDERAZGO

- PPP starts the Project: Market Study for Product Design medium to long term in Honduras. Commissioned by RED KATALYSIS. IMFs: BANHCAFE, BANCOVELO, FINSOL, FUNED, CACIL, ODEF.
- In 2008 Perfect Point Partners also began to offer consulting services in Africa with Grameen Foundation. At present we have projects in Ghana and Nigeria and we plan to extend to Kenya and Ethiopia in early 2009. The projects include the analysis and assessments regarding the status of Risk Management and the introduction of reporting and risk management policies. In addition, Christian made a presentation on the theme in Grameen Foundation African Regional Forum in November 2008.

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