



## e-MFP Action Group of Investors in Tier 2/3 MFIs Position Paper on supporting smaller MFIs to advance financial inclusion

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# POSITION PAPER

Access to finance plays a central role in developing a country's real economy and in improving populations' living conditions. Smaller microfinance institutions (MFIs) are key players in broadening financial inclusion in less developed microfinance markets, and in providing financial services to specific underserved segments of the population in more mature markets.

Those smaller MFIs, referred to as tier 2 and tier 3 (see Box 1 for more detailed information regarding the tier definition) often struggle to mobilize adequate resources to finance their growth or innovative products and services. Numerous studies have revealed that funding in microfinance is strongly concentrated on the most mature tier 1 institutions. The e-MFP Action Group of Investors in Tier 2 and 3 MFIs gathers

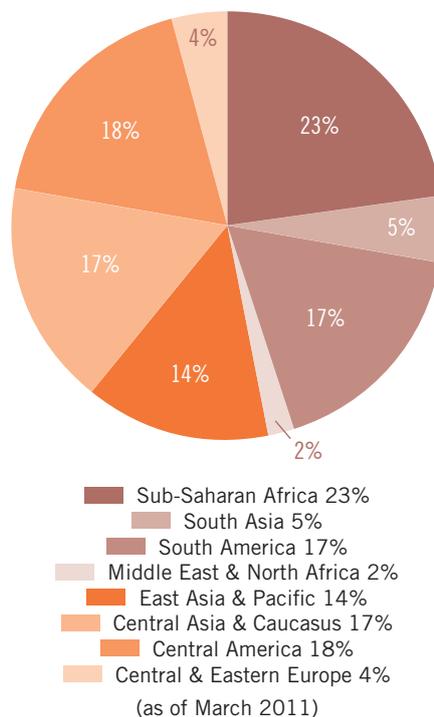
committed investors willing to support and develop these types of institutions. The group's objectives are to collect and disseminate data on this microfinance segment, share best practices, facilitate collaboration during different stages of the investment cycle and provide appropriate technical assistance.

Investments in tier 2 and 3 microfinance institutions require particular attention to appropriate structuring and monitoring. The MFIs are often small and fragile, exposed to specific local context and economic activities. These MFIs may have less developed governance structures and operational processes. Often, a "stand-alone" investment is not a sustainable approach, thus requiring technical assistance and coordination among key stakeholders.

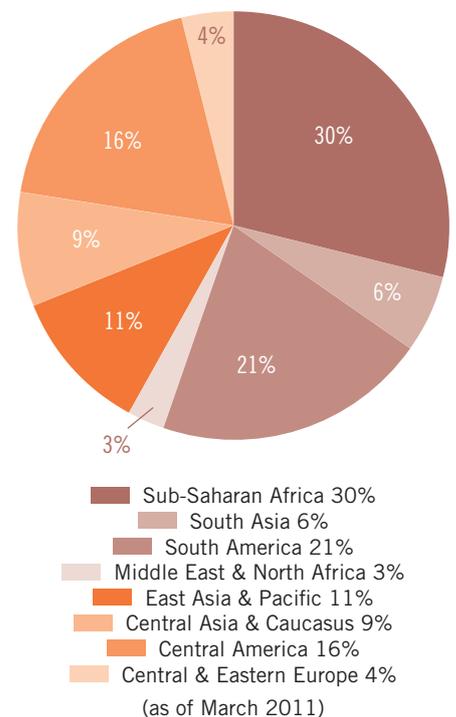
### Investment in tier 2/3 MFIs

The e-MFP Action Group of Investors in Tier 2/3 MFIs includes most investors active in this segment. Members meet regularly and have agreed to conduct an internal survey to share and harmonize information. To date 8 investors have contributed to compile a Directory of tier 2/3 investments. Members are active in the following regions:

Distribution of tier 2/3 investments by region



Distribution of tier 2/3 MFIs by region



### e-MFP Action Group members:

- ADA
- Alterfin
- Cordaid
- Etimos
- Grameen Credit Agricole Microfinance Foundation
- Incofin
- LMDF
- Oikocredit
- PlaNis responsAbility
- Terrafina Microfinance
- SIDI
- Triple Jump

## Key messages and facts:

- Total investments by the group amounts to EUR 100 million in 241 tier 2/3 MFIs.
- 23% of investments and 30% of MFIs are in Sub-Saharan Africa, the region furthest behind in terms of financial inclusion. This compares with 5% invested in Sub-Saharan Africa by all microfinance vehicles<sup>1</sup>.
- The group's geographic focus is: Sub-Saharan Africa followed by Central America, Central Asia, and South America & East Asia.
- Average investment per MFI is EUR 336,000 which is significantly below the MIV average (The average MIV investment amount was 1.7 million in 2010<sup>2</sup>).
- Majority of investments are in debt instruments, while only 3% are in equity, partly a consequence of the prominence of the NGO legal form among tier 2/3 MFIs.

## Working together to develop the microfinance sector

The Group strongly believes that to work with tier 2 and tier 3 MFIs and to gain efficiency it requires:

- A strong and effective collaboration on an on-going basis. This is particularly useful in situations where there is a difficult investment climate or crisis.
- Establishing joint actions to address issues such as technical assistance provision, harmonization & exchange of tools for data collection, joint due diligence & monitoring and exchange of information. In order to facilitate this, the Action Group is progressively building a Directory which encourages further dialogue and exchange opportunities.
- Participating in related initiatives, documenting and disseminating best practices and case studies and ;
- Raising awareness and knowledge dissemination regarding foreign exchange hedging solutions for investors focused on tier 2/3 MFIs.

All members are committed to achieve such objectives.

### BOX 1: What do we mean by tier 2 or tier 3 MFIs?

The Action Group uses the term tier 2 and 3 MFIs to refer to specific types of microfinance institutions in the market. The origin of the term 'Tier' comes from a working paper series published by Grameen Foundation USA in 2004. This paper classifies MFIs in four tiers and defines tier 2 MFIs as successful but smaller, younger, or simply less well known MFIs, at or near profitability. At the time the working paper was published, these MFIs were mostly NGOs, since then some of them have changed legal structure or are considering conversion. Grameen Foundation's paper defines Tier 3 MFIs as approaching profitability but having understandable shortcomings as they are nearly all young institutions, lacking capital, having weak MIS, or other inadequacies. Tier 3 MFIs are mainly NGOs.

Other definitions are based on quantitative thresholds. Luminis, for example defines tier 1 MFIs as having more than USD 30 million in assets, tier 2 between USD 5 and 30 million and tier 3 as having less than USD 5 million. CGAP diverges slightly and considers tier 1 MFIs to have assets in excess of USD 50 million, tier 2 between USD 3 and 50 million and tier 3 below USD 3 million.

The Mix Market database does not work with tiers but works with "peer groups". Peer groups represent groups of institutions that share common traits, such as legal status, country of operations, scale of lending operations, or age. These groups are organized and categorized based on the peer group methodology applied in microfinance benchmarking analysis and available throughout the MIX Market site for benchmark comparisons.

Simple Peer Groups look at MFIs based on a single characteristic. Compound Peer Groups use a more complex set of variables to analyse MFI performance.<sup>3</sup>

The e-MFP Action Group of Investors in Tier 2/3 MFIs is working on a coherent definition and uses – for the moment – a quantitative "working hypothesis" of microfinance portfolio size below USD 20 million. Once enough data is gathered the Action Group will analyse other criteria using the compounded Mix Market's peer group methodology.

<sup>1</sup> The State of Microfinance Investment 2011 in <http://www.microrate.com>

<sup>2</sup> Ibid.

<sup>3</sup> Mix Market at <http://www.mixmarket.org/about/faqs#benchmarks1>

