



Sustainability of microfinance in the European Union

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Outline

- ❑ What is sustainability
- ❑ Examples from Europe
- ❑ Strategies for sustainability



What is sustainability



Definition of sustainability

- Sustainability: long term continuity of a microfinance institution
- Traditional definition of financial sustainability: charging interest rates and fees that cover costs
 - Operational self-sufficiency: operational revenues cover operational costs, financial costs and provisioning costs
 - Financial self-sufficiency: operational revenues cover direct and indirect (inflation and subsidies) costs
- Increasing focus on triple bottom line: sustainability in terms of economic, social and environmental performance



Economic sustainability

Income	Costs
Interest and fees	Operational costs
	Financial costs
	Provision

Measure these elements on average portfolio (or assets) to compare among periods and among institutions.



Portfolio Yield %

Income from portfolio / AVERAGE gross portfolio

%

Indicates the capacity to generate income



Operating Expense Ratio - %

Operating Expenses/ AVERAGE gross portfolio

%

Measures the costs for the MFI to provide its services



Provision expense ratio %

**Cost of provision for bad loans/
Average gross portfolio**

Loan Loss Provision Expenses / Average gross portfolio

Expenses for the MFI to anticipate future losses



Funding Expense Ratio %

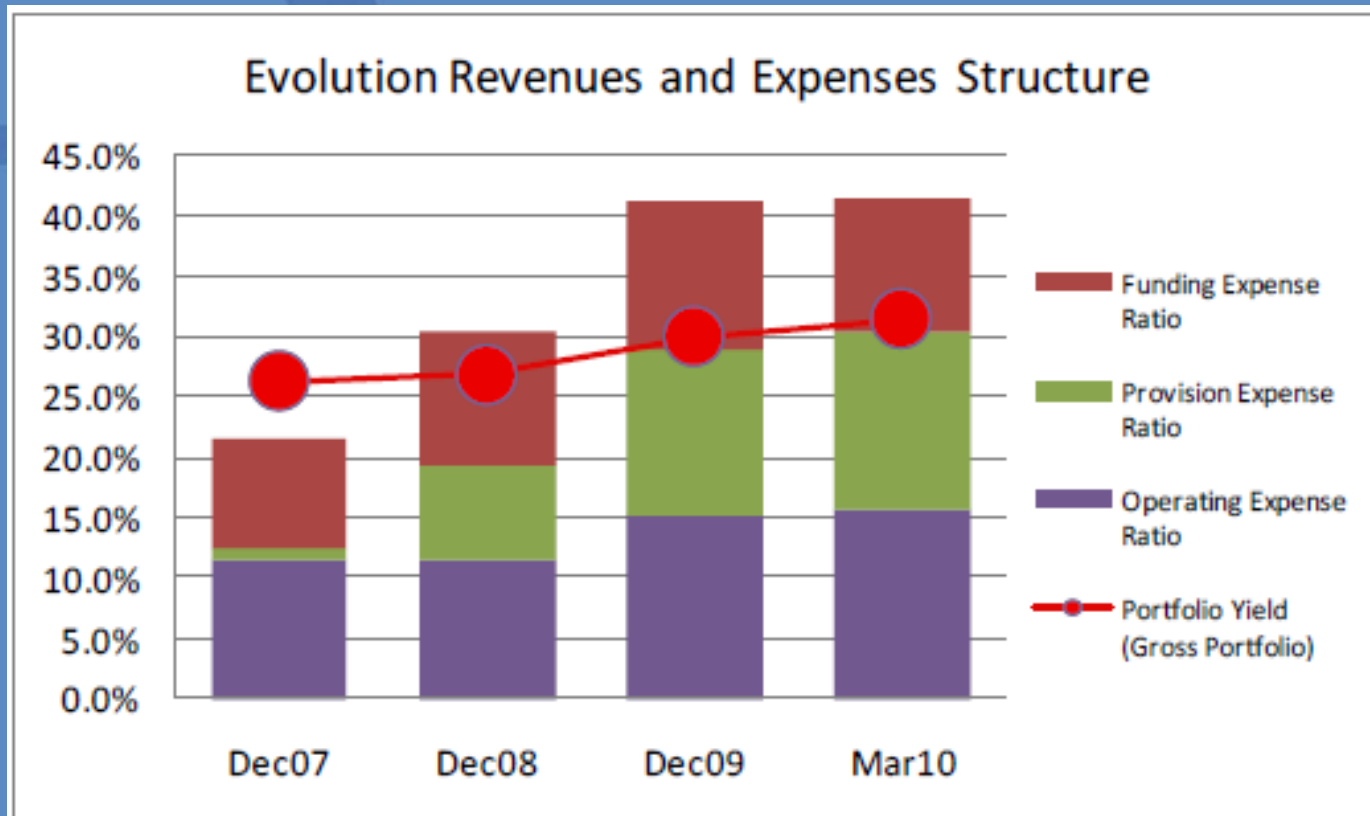
Expenses on funding liabilities/
AVERAGE gross portfolio

%

Measures the total cost of interests and commissions paid by the MFI in order to finance its loan portfolio



Analysis of sustainability

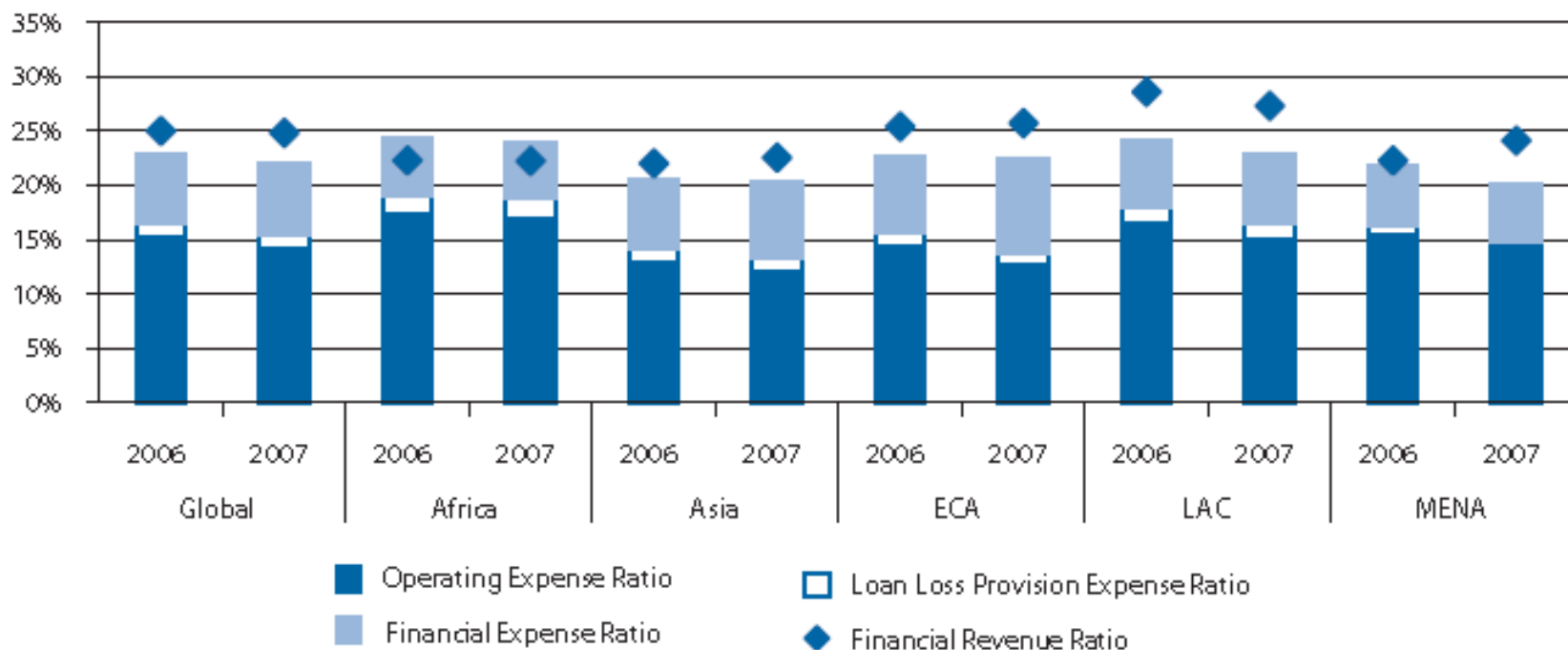


Omro - Romania



Sustainability

Figure 9: Breakdown of Returns



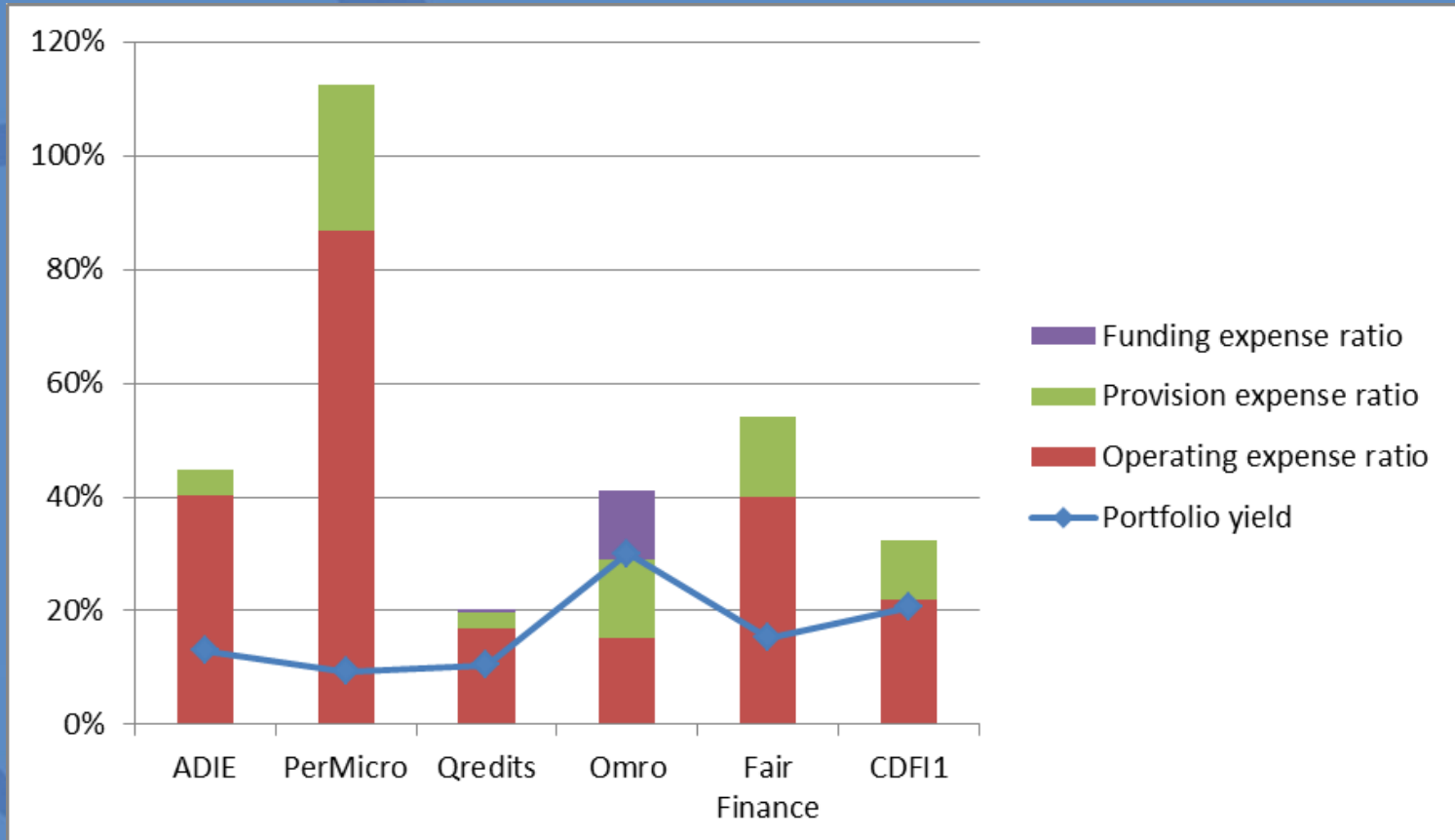
Source: MIX 2006-07 MFI benchmarks. Results represent medians. ECA: Eastern Europe and Central Asia; LAC: Latin America and the Caribbean; MENA: Middle East and North Africa.



Examples from Europe



Examples from Europe





Some conclusions

- Major problems: limited availability and low quality of data;
- Wide variety of experiences;
- Sustainability is a wide concept: institutional sustainability in the long term is the crucial aspect (including subsidies sustainability);
- The different microfinance models have still to be clearly identified and defined;



Strategies for sustainability



How to improve sustainability

- Income drivers:
 - Higher interest rate (legal and cultural limits)
 - Subsidies:
 - Start up subsidies (in the initial phase)
 - Subsidies to reach economies of scale
 - Permanent subsidies: long term access to subsidies (sustainable subsidy). Positive externalities of microfinance justify a regular subsidy from the government: microfinance as a complement for welfare services. Central/local government providing support to MFIs for provision of welfare service
 - Cross selling: distribution of other financial products
 - Diversification of loan products



How to improve sustainability

- Operating costs
 - Increase loan size;
 - Use voluntary staff (different positions);
 - Exploit economies of scale: increase in scale (do they really exist? Is there enough potential demand?);
 - Use external support/actors to reduce the costs of credit process; (i.e. network of reference for client identification and selection, banking structure for cash management, etc.);
 - Use strong MIS to increase efficiency;
 - Increase staff/loan officer productivity;
 - In-kind support (offices, etc.);
 - Non financial services:
 - Type of non financial services;
 - How to finance them.



How to improve sustainability

- Loan loss provision
 - For sustainability has to be low: crucial to have a decent portfolio quality (how to have complete information on portfolio quality?);
- Financial costs
 - Not really relevant in Western Europe at the moment (except few cases);
 - Maintain a low debt/equity ratio;
 - Nevertheless increasing scale requires access to debt and financial costs increase;
- Capitalization
 - Increase capitalization as a way to sustainability: it might not be enough;



THANK YOU!

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