Building on a first decade of social performance

Social Performance Report 2020

10 YEARS
INVESTING DIFFERENTLY
LMDF.LU

Luxembourg Microfinance and Development Fund

In collaboration with

LMDF obtained the:

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Contents

Acronyms

ACP African, Caribbean and Pacific Group of States
ADA Appui au Développement Autonome
AIDS Acquired immunodeficiency syndrome
ALINUS Aligning investors due-diligence and reporting with the Universal Standards
Av. Average
CEO Chief Executive Officer
CERISE Comité d'Echanges, de Réflexion et d'Information sur les Systèmes d'Epargne-crédit
EIB European Investment Bank
ESG Environmental, Social and Corporate Governance
EUR Euro
GDP Gross Domestic Product
HDI Human Development Index
HEFF Higher Education Finance Fund
IFC International Finance Corporation
IT Information Technology
LMDF Luxembourg Microfinance and Development Fund
LUXMINT Luxembourg Microbank Intermediary Scheme
m Million
MFI Microfinance Institutions
MFX Microfinance Currency Risk Solutions, Inc
MIMOSA Microfinance Index of Market Outreach and Saturation
MIV Microfinance Investment Vehicles
MSME Micro, Small and Medium-sized Enterprises
NAV Net Asset Value
NBFI Non-Bank Financial Institution
NGO Non-Governmental Organisation
No. Number
ODA Official Development Assistance
PAR Portfolio at risk
Ptf. Portfolio
SAM Semaine Africaine de la Microfinance
SDGs Sustainable Development Goals
SME Small and Medium-sized Enterprise
SMS Short Message Service
SPI4 4th version of Social Performance Indicators developed by CERISE
SPTF Social Performance Task Force
TA Technical assistance
TCX The Currency Exchange Fund
US United States
USD United States Dollar
USSD Unstructured Supplementary Service Data

Graphs, tables and illustrations

A field visit to a local farmer with the MFI Bimas, in Embu // Kenya

LMDF - Investing for social change

I am a born optimist. Even the grim reality of the current pandemic presents us with an opportunity to reconsider the way we work and the way we reflect our values, notably when it comes to our investments. To make these changes, however, we are reliant on data and evidence; for this reason, I am very pleased to present LMDF's third Social Performance Report. Writing a third report provides some very interesting perspectives:

1. We can look back over the Fund's history and see where improvements have been made

The Fund has always had a clear focus on social performance and its vision and mission have remained constant. The science of measuring social performance, however, has developed considerably over the lifetime of the Fund. This has now enabled the us to implement the SPI4 across all our investment files and to benchmark strengths and weaknesses within institutions and regions. LMDF has also concentrated on aligning itself with the SDGs and its contribution to the global development agenda. Various adjustments have been made to the Fund's own business model, and we see increases in local currency financing, a strong outreach in the most disadvantaged areas and strengthened long-term relationships with partners. Moreover, we also see changes at the MFI level, with improved operational efficiency resulting in lower effective rates being paid by micro-entrepreneurs.

2. We can see the cumulative impact of our financing over the investment period

Long-term commitments are key to progress in the development sphere, where problems are deep rooted and intractable. LMDF has placed a considerable emphasis on building long-term partnerships with its investees and the benefits of this can now be seen. The Fund has reached over 290,000 micro-entrepreneurs directly, with consequent impacts on their families and their communities. Moreover, 72% of these micro-entrepreneurs are in Medium or Low HDI countries, where financial infrastructure may be particularly poor. The Fund has also placed a high emphasis on sub-Saharan Africa, and has nearly quarter of its portfolio there, a considerably higher proportion than we see in many other microfinance investment vehicles.

The report also illustrates that the microfinance sector is in a state of change. Technology was already growing in importance for the sector and these changes have been accelerated by new requirements emanating from COVID. Although there are challenges in implementing technological models in an industry which is so reliant on human relationships, new models are providing opportunities for microfinance to increase its outreach and create new opportunities, notably in the field of agriculture. This comes at a time when increasing outreach will be fundamental as the economic impacts of the coronavirus are increasingly felt by the most vulnerable communities.

This report shows us how much we have been able to do in the last ten years, and how many livelihoods we have changed for the better. Just imagine how much more we can do in the next ten years.

As we so regularly see, with elections or natural events, just a day has the potential to change the world. This report shows us how much we have been able to do in the last ten years, and how many livelihoods we have changed for the better. Just imagine how much more we can do in the next ten years.

Raymond Schadeck
Chairman

A decade of supporting social performance

LMDF has released this 2020 Social Performance Report as part of its 10th anniversary celebrations. Reaching a tenth anniversary provides a good opportunity to reflect on the achievements of the past ten years and to see what has made these possible. Although the Vision and Mission of the Fund have remained unchanged since its launch, numerous other initiatives have been introduced to improve the Fund's social performance over its history.

Reaching the milestone of ten years also provides an opportunity to look forward to the next ten years, and what these mean for microfinance.

This report considers data across the years. As this is the 3rd Social Performance Report which we have produced, we are now beginning to have more comparable data and a better ability to see trends and the evolution of the Fund. We expect this to improve still further in our next report.

Reaching the milestone of ten years also provides an opportunity to look forward to the next ten years, and what these mean for microfinance. There have already been substantial changes to microfinance models, and these are expected to develop further in the coming years.

The COVID pandemic which hit, just as this report was being finalised, will also spur on further changes. The likely long-term impact of the disease, and its economic consequences on the poorest communities, serves to reinforce the continuing need for microfinance to support vulnerable communities.

This report has 5 chapters, which are detailed below.

How LMDF works (Chapter 1)
This chapter looks at the core aims of the Fund. It revisits LMDF's vision and mission, and more broadly, the aims of microfinance. It demonstrates that the Fund has stayed true to its vision – and has succeeded in channelling money to MFIs operating in emerging geographies, with 72% of institutions in countries rated Low or Medium in the Human Development Index. This has a consequent effect on outreach, with LMDF succeeding in reaching 72% female and 23% agricultural micro-entrepreneurs. Nonetheless truly measuring the impact on the lives of such entrepreneurs is a challenge and is the focus of the rest of the report. When working with marginalised communities, the provision of responsible financing is core; and LMDF's processes are designed to ensure supportive relationships: 74% financing is in local currency, 52% MFIs that we have financed remain in our portfolio today and careful analysis is undertaken of market saturation before disbursement. This progress would not have been possible without our Investment Adviser and key partner, ADA, with which we have now worked for 10 years, disbursing over 170 loans, in 37 countries and reaching 296,000 micro-entrepreneurs.

SPI4 Analysis (Chapter 2)
There has been a fundamental change since the last social performance report was written, in that SPI4 analysis is now integrated into all investment files. This has enabled the Fund to formalise its social performance. This more complete sample has resulted in lower SPI4 scores than in previous years, although SPI4 scores still exceed the benchmark. Treating clients responsibly and balancing financial and social performance were particular areas of strength. Tier 3 institutions and those based in Africa had a tendency towards weaker scores in SPI4 analysis, while cooperatives have shown a surprising strength in the LMDF portfolio. Moving forwards, the Green dimension of the SPI4 will clearly become more significant, although it is disappointing how little attention it has received to date, given the important role MFIs can have in supporting resilience in poorer communities.

The Impact of LMDF (Chapter 3)
The Fund has always viewed the SDGs as a

Fundesurco offers a variety of loan products to support clients in rural areas // Peru

core means to evaluate its impact. This year, a more thorough benchmarking exercise has been conducted, demonstrating LMDF's particular contributions to Goal 1: No Poverty, Goal 4: Quality Education, Goal 5: Gender Equality, Goal 8: Decent work and economic growth, Goal 10: Reduced Inequalities and Goal 17: Partnerships for the Goals. Within this, a particular success has been the achievement of financing 296,000 microentrepreneurs since inception, with 15% living in low HDI countries and 57% living in Medium HDI countries. LMDF has shown itself to be one of the MIVs which is better to reach areas most in need, and this is evidence by its particular focus on Africa, where financial inclusion levels remain low, and where LMDF holds 29% of its investments, versus a benchmark of 8%.

The Impact of COVID (Chapter 4)
Just as the Social Performance Report was being finalized, the COVID 19 Pandemic struck. This had considerable repercussions on the Fund's clients. This chapter analyses the impact COVID has had on entrepreneurs, finding substantial changes to their financial situation, but also more recent signs of positive trends. The crisis has also meant substantial upheaval for microfinance institutions, which have traditionally had models reliant on high levels of contact. As a result, MFIs are fast integrating technology in their operations, which may mean substantially different ways of operating in future.

The Future of Microfinance (Chapter 5)
Microfinance has clearly evolved considerably from the basic credit model which became so widespread, following its success in Bangladesh. Over 70% of the Fund's portfolio MFIs now offer services beyond credit, from microinsurance, to micro savings. Yet even these are now normal and a more profound evolution can now be seen in the industry. LMDF has already started to invest in leasing models, enabling micro-entrepreneurs to buy new assets, and in MFIs with an SME offering, yet such models have a different social impact, and the appropriate ways to assess them still need to be developed. Meanwhile global changes are also causing the industry to evolve. Technology is making a notable difference – but challenges remain integrating the human touch into more high-tech business models. Climate change is also causing the industry to think what measures are most needed to support vulnerable populations facing new challenges. It is clear that the industry needs to evolve faced with this evolving environment.

The trends discussed in the last chapter certainly mean that the industry is set to change over the coming decade. We will look forward to seeing how social performance evolves, but we expect to stay true to our Vision and Mission which have been constant over the past 10 years.

In the meantime, we hope you enjoy reading this report and are always happy to discuss it with you further.

Apricot Wilson
Head of Impact

IDH has been operating in Honduras for more than 40 years supporting entrepreneurs across the country // Honduras

Chapter 1:
How LMDF works

Vision

LMDF aims to contribute to the alleviation of poverty by supporting organisations that empower people and stimulate entrepreneurship, with a particular focus on the most excluded. The Fund facilitates access to responsible finance by building sustainable links between investors, microfinance institutions and ultimate beneficiaries.

Mission

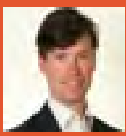
In order to realise its vision, LMDF

- Constitutes an attractive investment proposition by balancing stable financial returns to investors with the provision of responsible financial services to the poor.
- Specialises in facilitating the growth of promising emerging microfinance institutions which address the financial needs of marginalised communities and individuals in developing countries.
- Enables the development of micro-entrepreneurs in areas where unmet needs are largest, particularly among women, youth and rural populations.
- Is accessible to public, institutional and retail investors and is accountable for reaching both social and financial objectives, and transparent in its reporting.

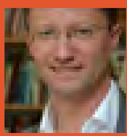
10 Years of LMDF

2009

Launch of LMDF with as founding members the Ministries of Foreign Affairs and of Finance, ADA, BIL, BGL BNP Paribas, Spuerkees, Banque de Luxembourg, Fortuna Banque, CBP, Le Foyer, etika and LaLux



LMDF starts with Kaspar Wansleben as the Manager



Axel de Ville is elected Chairman

2010

First investment made in Africa

2011

The Fund receives for the first time the LuxFlag Label

Development of the Principles for Investors in Inclusive Finance

2012

Jennifer Popescu-Urbain joins the team and works in communications and shareholder relations

2013

The Fund passes EUR 10m in microfinance portfolio

Kenneth Hay is elected as Chairman

2014

LMDF becomes founding member of the Inclusive Finance Network Luxembourg

2015

PRI Principles for Responsible Investment

LMDF becomes signatory of the Principles for Responsible Investment

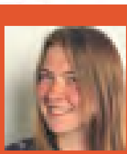
Luxembourg Microfinance and Development Fund | 5th ANNIVERSARY 2010-2015

LMDF celebrates its 5th Anniversary

2016

European Investment Bank

The EIB starts a partnership with LMDF



Apricot Wilson joins the team and works in risk and ESG

2017

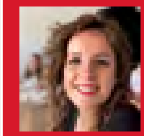
LMDF disburses its 1st investment in Central Asia and its 100th transaction

Miguel Maeztu joins the team and works in investments

2018

LUXEMBOURG GREEN EXCHANGE

LMDF joins the sustainable finance platform

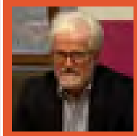


Carla Navarro Díaz joins the team and works in communications

2019

ada

ADA celebrate its 25th anniversary



Raymond Schadeck is elected Chairman

2020

10 YEARS INVESTING DIFFERENTLY LMDF.LU

LMDF celebrates its 10th Anniversary

Microfinance – A building block for prosperity

The problems faced by those working in development are not short-lived or easy to solve. How can you begin to resolve something as deep-rooted in a society as poverty? It is clear that there is no single answer, but various solutions need to be put in place to provide opportunities for everyone to live decent lives.

LMDF works to ensure that financing is available to those who would otherwise be excluded from the financial system.

This is where LMDF believes that it has a significant role to play. Along with the institutions which support healthcare, food security, education and the other factors which are needed to ensure a decent life, LMDF works to ensure that financing is available to those who would otherwise be excluded from the financial system.

LMDF's Contribution

The Fund's key contribution is to provide financing to emerging microfinance institutions (MFI). It seeks to ensure that financing reaches areas most in need – notably those geographies which are lower on the Human Development Index (HDI), or which are in particular target geographies (African, Caribbean and Pacific (ACP) regions or Official Development Assistance (ODA) priority countries). It also looks to work with institutions which are new to receiving financing, or international financing, as it views the catalysing effect of stimulating growth as particularly significant. Where possible, the Fund's financing work is combined with technical assistance from ADA. Another focus is on ensuring that these inputs are delivered responsibly, and this is an area of attention in the rest of this chapter.

Key metrics as June 2020

- Proportion of the portfolio invested in ODA countries: 96%
- Proportion of the portfolio invested in ACP countries: 30%
- Proportion of MFIs receiving financing for first time: 16%*
- Proportion of MFIs receiving international financing for first time: 45%*

*This is defined as LMDF being among the first three lenders (or international lenders) to the institution.

LMDF's Outreach

As a result of the financing provided by LMDF, microfinance institutions are able to grow and offer new underlying loans. LMDF has a particular focus on who these underlying loans support - the outreach of the institution. Where possible, LMDF looks to work with institutions that are able to disburse the new loans to communities who are most excluded. These include the young, women and those in rural areas. The loan size to GDP ratio also provides an indication of whether loans are reaching those who are among the poorest in society.

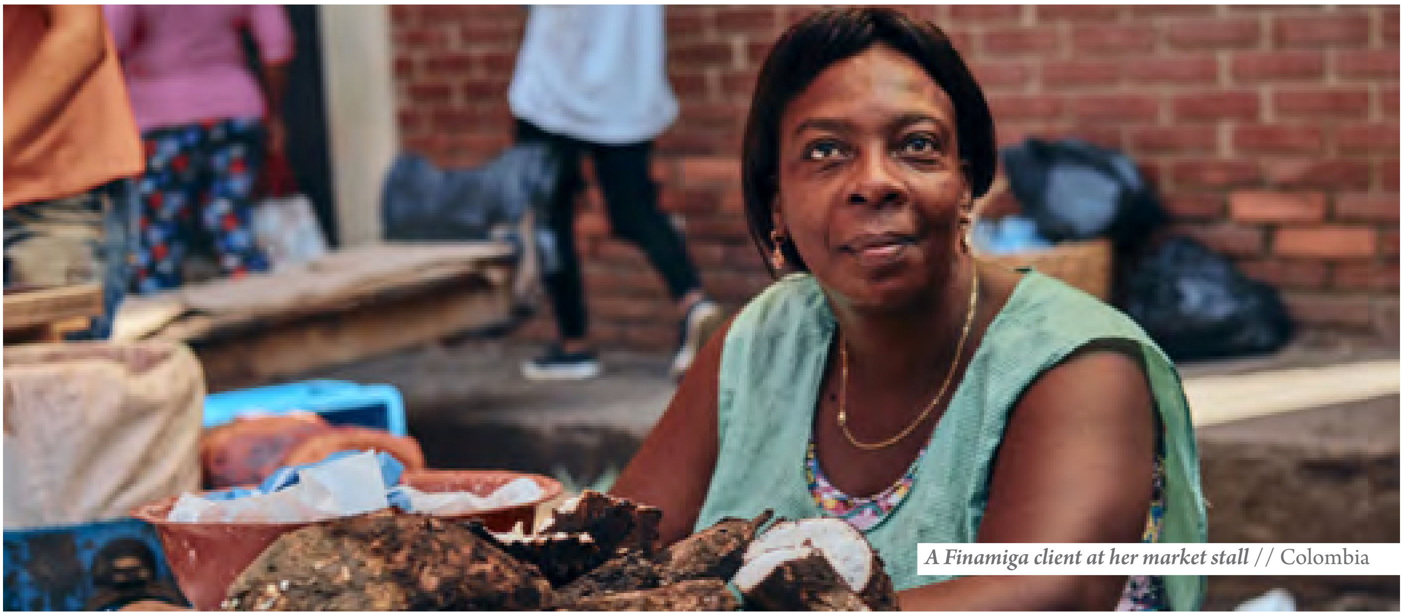
Key metrics as June 2020

- Proportion of agricultural micro-entrepreneurs supported: 23%
- Proportion of female micro-entrepreneurs supported: 72%
- Proportion of young entrepreneurs supported: 26%**
- Loan size to GDP ratio: 0.48

** (Just 5 institutions provide data on this although we are encouraging more institutions to report on this metric). We expect the proportion to be lower across our portfolio.

LMDF's Social Impact

The outcome of these loans is something that has been much discussed in various randomised trials to assess the impact of microfinance.
It is generally agreed that microfinance does enable entrepreneurship and does generate new businesses. It also enables those involved in businesses to accumulate assets which can provide an insulating effect in case of financial difficulties. There is evidence to show improved consumption patterns in households receiving microfinance.


A Finamiga client at her market stall // Colombia

These factors are all difficult for MFIs to measure, and even harder for microfinance investment vehicles to measure. We are often reliant on impact studies such as the study produced by the EIB on page 61. Another potential outcome is the strengthening of financial systems, which is again a metric which is challenging to concretely measure.

However, LMDF does obtain data on portfolio growth, which gives an indication of how our partner MFIs have grown.

It is interesting to note that growth in portfolios has exceeded the growth in the number of clients. This suggests that MFIs have focused on developing their existing clients' businesses and allowing them to grow, as well as onboarding new businesses.

Key metrics as June 2020

- Growth in MFI portfolios (annualised avg. 2011-2020): 19%
- Growth in number of clients reached by MFI (avg. 2011-2020): 15%

The impact of this financing, i.e. the long-term permanent positive change that it can bring about, is still harder to ascertain. For the benefits of income security to be maximised, it is important that microfinance is delivered as part of other initiatives to strengthen the local infrastructure, such as improvements to healthcare and education (although microfinancing can also be part of these initiatives). Combined with other initiatives, the benefits of microfinance can be very widespread, ranging from well-being, to empowerment, to educational achievement. It is in the nature of impact that the results are long-term and often qualitative and intangible. LMDF examines its impacts against the SDGs in Chapter 3 of this report, but realises there are still many challenges to overcome when it comes to impact measurement in microfinance.

Combined with other initiatives, the benefits of microfinance can be very widespread, ranging from well-being, to empowerment, to educational achievement.

The effect of financing is reinforced when it continues over the long term. For this reason, LMDF places a particular emphasis on long-term partnerships and seeks both to find institutions with which it can work over the years and investors who are willing to support the Fund for the long-term.

Partnerships for impact

LMDF has always worked in partnership with its Investment Adviser, namely ADA, to ensure that impact is at the centre of the investment process. The relationship between the two organisations is very close: LMDF was originally born out of ADA's LUXMINT financing programme and continues to be based in the same building as ADA, the Maison de la Microfinance. Illustration 1.1 highlights how ADA and LMDF work together to ensure high levels of social performance are integrated into each stage of the investment process.

ILLUSTRATION 1.1:
STAGES OF THE INVESTMENT PROCESS

Scoping opportunities

ADA scopes new investment proposals, paying attention to core financial and social metrics, governance, and outreach

Country Analysis

LMDF conducts an in-depth country analysis looking at 4 key areas: Politics, Economics, Development and Financial Inclusion. Based on this, the Investment Committee defines a maximum exposure.

Due Diligence Mission

ADA spends several days on-site conducting a thorough analysis of the MFI. This involves meeting clients, interviewing management teams, analysing processes and reviewing financial statements

Investment Committee

A full investment file is presented at the Investment Committee with members from a variety of backgrounds. Investment terms are agreed

Disbursement

LMDF prepares contracts for MFIs which incorporate both social and financial covenants. Where possible, loans will be disbursed in local currency.

Monitoring

ADA and LMDF receive quarterly monitoring reports from MFIs. Follow up visits are conducted regularly.

Predominantly ADA
Predominantly LMDF

Source: LMDF analysis

ADA and LMDF members spent time in the field in Kenya to learn more about developments in agricultural financing // Kenya

ADA ASBL- APPUI AU DÉVELOPPEMENT AUTONOME

Appui au développement autonome (ADA) is Luxembourg's leading NGO specialised in microfinance. It has a 25-year history, and is co-funded by the Luxembourg Directorate for Development Cooperation and Humanitarian Affairs and falls under the High Patronage of Her Royal Highness the Grand Duchess of Luxembourg.

Through this collaboration, ADA and LMDF have jointly:

(1) disbursed over 170 loans to MFIs;
(2) worked in over 37 countries with considerable need for improved financial systems; and
(3) directly reached over 296,000 micro-entrepreneurs.

Besides its work as the Fund's Investment Adviser, ADA provides a broad range of services to support MFIs including Technical Assistance, Training and Tools to support the mangement of MFIs.

A long-term perspective

It is not just the partnership with ADA that has been so long lived. LMDF also looks to finance its MFIs over the long term. Although the initial loan contract may only be for two or three years, LMDF hopes that it will be the beginning a long-term partnership.

Change does not happen overnight. Problems in many of the societies with which we work are deep rooted and in order for the situation to improve, institutions need to be patient and committed.

Over a third of our MFIs have received more than one loan from the Fund, and some have received 5 loan cycles, with partnerships going back to the first years of the Fund.

This is particularly important in the development sphere. Change does not happen over night. Problems in many of the societies with which we work are deep rooted and in order for the situation to improve, institutions need to be patient and committed. This is why we also ask that our investors look to invest for a period of at least three years.

Despite the importance of long-term partnerships, in recent years we have noticed that some of our older partners, are now exiting our portfolio. When the previous social performance report was written, in December 2017, 56% of MFIs with which LMDF had ever worked remained in the portfolio. Looking at Table 1.1, it is possible to see that the majority of institutions financed in the early years have now left the Fund's portfolio.

Much of the reason for this is a success story. Several of the institutions which had previously been long-term partners of the Fund have now evolved to become large Tier 1 microfinance institutions. These institutions often have other sources of funding open to them and LMDF prefers to target its financing towards emerging microfinance institutions which otherwise struggle to obtain funds, and which may not previously have worked with international investors.

Over a third of our MFIs have received more than one loan from the Fund, and some have received 5 loan cycles, with partnerships going back to the first years of the Fund.

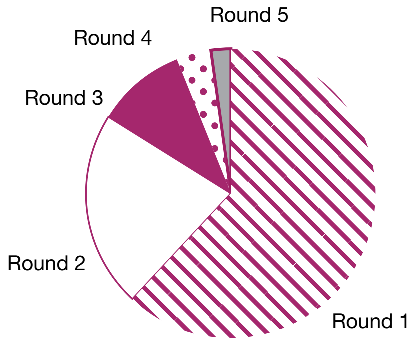
Yet even within these success stories, LMDF is aware that support may still be needed. This may not be the financing that LMDF had previously offered, but may instead be technical assistance packages offered by ADA. These are organised in accordance with the developing and evolving needs of microfinance institutions.

TABLE 1.1:
% OF MFIS WHICH REMAIN IN LMDF'S PORTFOLIO BY YEAR OF INITIAL INVESTMENT

Year of investm.	Remaining in pft.
2009-10	4%
2010-11	8%
2011-12	10%
2012-13	10%
2013-14	13%
2014-15	25%
2015-16	29%
2016-17	42%
2017-18	67%
2018-19	94%
2019-20	100%

Source: LMDF analysis

GRAPH 1.1:
NUMBER OF FINANCING ROUNDS RECEIVED BY PARTNER MFIS



Source: LMDF analysis

Sinapi ABA Trust predominantly supports female clients // Ghana

Understanding interest rates in microfinance

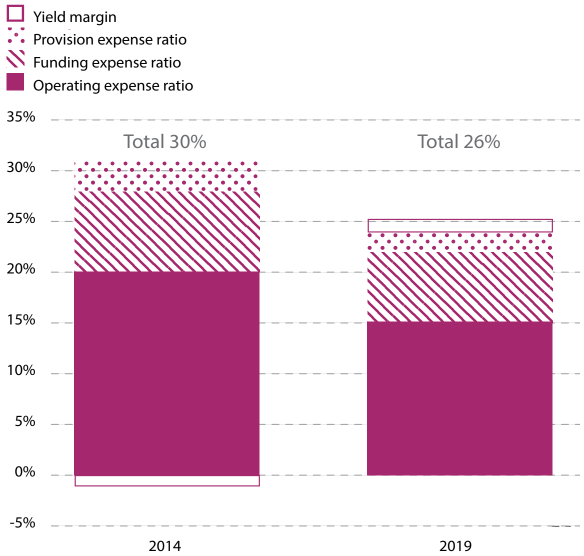
In Luxembourg, negative interest rates are increasingly common. In fact, this is a problem which we face when it comes to managing the Fund's liquidity position. Given the low interest rates which we are used to, it can be very difficult to understand why the interest rates charged to micro-entrepreneurs may be so high. The portfolio yield averages 26%- this can be considered as average interest rates on all loans, stripping out the effect of interest rates in each individual country.

MFIs have made substantial improvements in efficiency since 2014 enabling a lower interest rates to be charged to micro-entrepreneurs.

Actually 26% portfolio yield is a very promising trend. It shows that MFIs have made substantial improvements in efficiency since 2014 when a similar exercise was conducted. This results in micro-entrepreneurs paying less interest to receive financing.

Nonetheless, given the relatively high rates of interest paid by micro-entrepreneurs it is important to consider the rationale. Two perspectives on this are provided below.

GRAPH 1.2:
PORTFOLIO YIELD BREAKDOWN IN 2014 AND 2019



Source: LMDF analysis

1. Financial stability for MFIs
MFIs are social businesses and strive to operate in a financially sustainable manner. This implies that the interest rate on microloans must cover MFIs' costs of providing the loans, refinancing the portfolio and providing for bad loans. In addition, the pricing should include a reasonable profit margin to finance future growth.

This had previously been a challenge for LMDF's partner MFIs and when we conducted research into the microfinance interest rates back in 2014, despite the relatively high interest rates charged by MFIs, the average yield margin was -0.5%, suggesting that our MFIs were, on average, making small losses after taking operating costs, risk costs and financing costs into account. When the same research was conducted in 2019, MFIs now had a small positive to average yield margin, permitting them to finance future growth better.

Yet what is causing a partner MFI to go from an average interest rate of 25.9% to this relatively weak profitability? The main expense is operations which accounts for 60% of the total rate.

There are several reasons why MFIs have such comparatively high operating costs. Business models for MFIs are based on proximity to their clients who operate mostly in the informal economy. Clients are often visited on a weekly basis. Second, MFIs of limited size need to amortise necessary fixed costs such as IT systems, management or branches over a large number of very small transactions. Yet we are seeing that these costs are reducing. Technology is supporting efficiencies and economies of scale are supporting these trends across many MFIs.

The other expenses include the financing costs. This has stayed remarkably stable for LMDF's partner MFIs over the years at just over 7%. Risk costs and provisions, i.e. the cost of losses on underlying loans which MFIs have had to write off as unrecoverable, have also stayed relatively stable at just over 2%.


Although MFIs have high operating costs, we have noted strong improvements in efficiency over the past 5 years // LMDF

When analysing the cost structure of an MFI, it is important to keep two questions in mind: 1) What is a reasonable profit margin for an MFI, or when does it exploit clients for its own interests. 2) Does an MFI operate as efficiently as it should if costs are borne by the end clients through the interest rate charged?

We are confident that the answer to these questions, in the case of LMDF, is that MFIs do not generate excessive profits on the back of the poor and that operational efficiency is, on average, good, as evidenced by the work we shall see from our MFIs in the rest of the report.

2.Micro-entrepreneurs' Perspective: The case for diversity, reducing vulnerability and reliability

Pricing in microfinance is complex and it is insufficient to look at the supply side only. This second perspective looks at what we know about the demand side, i.e. how micro-entrepreneurs use microfinance, why they accept to pay—what appears to us to as—high interest rates and what alternatives are available to them.

Answers can be found in three fundamental needs that drive the financial activities of the poor: First, poor people with limited access to formal financial providers crucially need a diversity of financial services and providers. Diverse services, formal (MFIs, banks, etc.) and informal (family, friends, colleagues, money lenders, etc.), help match irregular, unpredictable and low incomes with daily needs (food, shelter, education, health, etc.).

The continued existence of money-lenders, even in environments where there is ample access to microfinance, illustrates the importance of a diversity of providers. Money lenders are probably much more expensive than microfinance in terms of interest charged but they are accessible and do not require lengthy forms and loan documentation to be filled out. They are also likely to be located just around the corner—and hence complement the offering of an MFI, which may be located further away and may only be accessible through periodic visits from loan officers.

We are confident in the case of LMDF, that MFIs do not generate excessive profits on the back of the poor and that operational efficiency is on average very good.

Second, poor households are most vulnerable if faced with emergencies. If the household wants to avoid making enormous sacrifices such as the fire-sale of assets, poor people need flexible financial products to cope with their exposure to risks. Here, savings and insurance services are particularly important.

Third, poor people need reliable financial services. Within the countless uncertainties and exclusions which characterise poverty, access to reliable and fair financial services is very important and matters much more than the price.

Beyond these three fundamental needs, we should not forget the nature of the informal economy in which micro-entrepreneurs operate. The fact that even after paying back a microloan with a relatively "high" interest rate poor people are still able to make some money should imply that the rate of return on the cash they invested in their businesses is remarkably high. One often overlooked fact is that for most of these activities, the principal input is the time and skills of the micro-entrepreneur him/herself.

The importance of local currency lending

It is not just where you lend, but how you lend which is important when working in many of the challenging geographies where LMDF operates. In most instances, the ordinary working people are not operating in Dollars or Euros. They are instead using their local currency such as the Rupiah, Quetzals, Shillings... , to name a few.

One of the best ways for MFIs to protect themselves from currency volatility is to receive a loan in local currency. Thus, when possible, LMDF disburses loans in local currency.

Receiving a loan in Dollars or Euros may work very well for these people, until such a time as the currency depreciates by 30%, 40% or even 50% in a very short space of time. The client is exposed to a loan which would technically require them to pay 30%, 40% or even 50% more on each repayment date. Moreover, these repayments are due at a time when the economy is likely to be under considerable stress. Local micro-entrepreneurs remain highly vulnerable if the loans offered are in hard currencies and such loans may hamper rather than enhance financial inclusion.

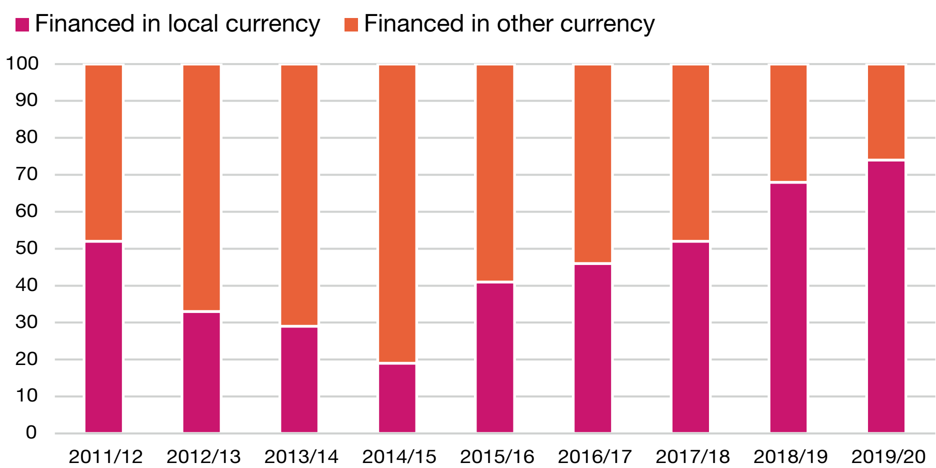
But what about the local microfinance institution? Are they able to manage such currency risk? Often there are options open to MFIs. They may be able to use back-to-back loans: a loan received in a hard currency is deposited in a local bank and the local bank then provides the equivalent local currency amount. Alternatively, MFIs can raise local currency savings to shield them from the effects of fluctuating exchange rates. In some cases, various derivative instruments may also be available to provide a hedge.

One of the best ways for MFIs to protect themselves from currency volatility is to receive a loan in local currency. Thus, when possible, LMDF disburses loans in local currency. Yet this could leave LMDF exposed to currency volatility, and its mission is to finance entrepreneurial activities, not speculate on currency moves.

For this reason, LMDF uses a particular solution developed for the sector, MFX Currency Risk Solutions. This provides access for microfinance investment funds to hedging solutions with commercial banks or The Currency Exchange Funds (TCX – a Dutch based global fund offering hedging solutions for over 70 currencies from developing and frontier countries). Through this facility, LMDF has access to a range of derivative instruments to mitigate currency risk, including cross currency forwards and cross currency interest rate swaps. This has enabled LMDF to disburse loans in currencies ranging from the Sierra Leonean Leone to the Nicaraguan Cordoba.

As of 31st March 2020, 74% of the portfolio was provided in local currency of the MFI country.

GRAPH 1.3:
PROPORTION OF FINANCING PROVIDED IN LOCAL CURRENCY OF THE MFI COUNTRY



Source: LMDF analysis

Responsible lending practices: Ensuring financing reaches those in need

One of the key deficiencies in microfinance is the tendency for market saturation. Clients may be plied with offers for credit, resulting in considerable concerns regarding over-indebtedness. This has often been at the root of microfinance crises, such as the Andrha Pradesh crisis in 2010. The case study of Cambodia, a market in which LMDF has decided not to disburse further deals since mid-2018, is included below. LMDF makes considerable efforts to ensure that the financing it provides fits with the mission of working where unmet needs are largest.

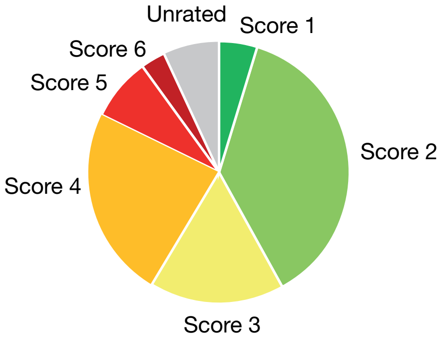
Market Analysis

One of the first steps to ensuring that, as a creditor, we are adopting responsible lending practices, is to conduct careful market analysis. We assess each country we invest in from multiple dimensions, but one of the key dimensions is its MIMOSA score.

Microfinance Index of Market Outreach and Saturation (MIMOSA) analyses the degree of penetration of financial services within a market, and whether these are higher than would be predicted given the size and development status of the market.[1]

Half of investments are made in unrated markets (where there is insufficient interest in the microfinance industry for a MIMOSA review to have been conducted) or markets where credit disbursement is substantially below the amount which would be indicated through market analysis.

GRAPH 1.4:
LMDF'S PORTFOLIO BY MIMOSA SCORE



Source: LMDF data and MIMOSA indicating degree of market saturation (September 2019)

However, 10.7% of the portfolio is in markets where penetration is over 100% of its predicted level. This includes our heritage position in Cambodia and positions in Peru. The latter positions are subject to considerable discussion, and prior to disbursing, the investment team verifies that MFIs are supporting niches in the Peruvian economy, rather than adding to the mounting concerns of over-indebtedness.

Half of investments are made in markets which are unrated or where credit disbursement is substantially below the amount which would be indicated through market analysis.

Other factors are also considered in the market analysis, including any segments of the population that are disproportionately marginalised, with the aim of ensuring that the MFIs with which we work have a particular focus on such groups. The analysis also considers the legal framework in the country to monitor how markets are regulated, and how they may evolve.

Institutional Analysis

Seeing the dynamics of the country on paper is one thing, but spending time with the institution and ensuring that their practices do not contribute to over-indebtedness is quite another. Even prior to going out on a due diligence mission, analysts spend time reviewing the company's numbers: particular attention is paid to the institution's growth rates. If these are higher than expected for the context, analysts will be sure to question how these are being achieved and ensure that clients are not being pushed into taking on loans. The analysts will also review the evolution of loan sizes, to ensure that clients are being provided with manageable loans. On site, all these practices are further reviewed.

[1] To be precise, markets defined as Category 1 have penetration rates at least 30% below what would be anticipated, Category 2 have penetration rates 0-30% below, Category 3 have markets withe penetration 0-50% above the predicted level, Category 4 have markets 50-100% above the predicted level, and Category 5 are over 100% of the predicted level.

A brewing business in operation supported by ACEP BF // Burkina Faso

Time is spent discussing client protection with management and we are always very pleased to hear that institutions are signatories to the Smart Campaign[1] (16% institutions are Smart Certified organisations), or have endorsed the Client Protection Principles (88% institutions). The reality of practices adopted by loan officers may be different from those expressed by management and therefore it is also important to spend time in the field ensuring that the practices highlighted by management are truly adopted.

88% of LMDF's portfolio MFIs have endorsed the Client Protection Principles.

We are particularly interested in understanding whether MFIs will disburse to clients who have other loans outstanding, and how they assess this debt burden. The results of the due diligence are compiled in a file, which also incorporates the ALINUS (see Chapter 2) as a means of assessing and benchmarking broad social performance, including client protection.

Monitoring

Work has in no way finished when the loan is disbursed. One of our duties as investors is to ensure that our institutions continue to maintain their strong social practices and their high levels of client protection during the period of our loan and beyond. For this reason, all our institutions have social covenants. These are developed with the institution's particular dynamics in mind and may require the institution to work on client protection (for instance by obtaining a client protection certification) or on efficiency and implementing new processes to make things easier and more transparent for clients. In the majority of cases, however, we look for institutions to improve the transparency of their social performance, either by conducting a Progress out of Poverty survey, a full SPI4 or a social rating. This enables institutions to learn more about their practices and to make new improvements. We work closely with ADA to ensure that regular site visits also occur, to verify that the high standards of practice that we expect as investors are maintained.

[1] *The Smart Campaign encourages responsible behaviour from financial service providers towards their end clients, most notably through the Client Protection Principles.*

ADISA supports indigenous communities - such groups are disproportionately excluded from financial opportunities // Guatemala

OVER-INDEBTEDNESS AS A KEY RISK FOR RESPONSIBLE MICROFINANCE: OBSERVATIONS FROM A GUEST WRITER ON CAMBODIA

Being responsible in terms of lending practices and monitoring social performance is crucial. A guest writer provides his views on the Cambodian market and the hazards of less responsible lending practices. LMDF took the decision in mid-2018 not to make any further investments in Cambodia until the situation improves in mid-2018.[1]

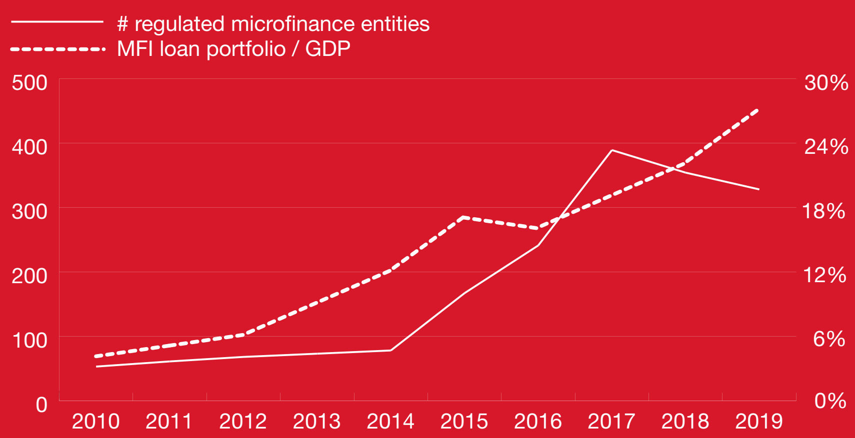
After the Paris Peace Agreements of 1991 ended decades of armed conflict in Cambodia, numerous international agencies and NGOs arrived in the country to assist in its recovery. Some of them had a loan programme for the poor and, over time, helped in particular by strong economic growth, liberal capital markets and a dollarised economy, these programmes have blossomed into an important driver of Cambodia's economy. The chart below illustrates the development of two parameters in Cambodian microfinance that are relevant for the present article: the number of regulated microfinance entities and the size of their loan portfolio, between 2010, the year after the global financial crisis, and 2019. Their spectacular growth has been made possible by the massive entry of domestic and international commercial investors, which have by now largely replaced the original development agencies and NGOs.

Cambodia's microfinance sector has provided capital and employment to the domestic economy, but its consequences have not all been benign. The potential for trapping loan clients in too much debt is probably the most serious concern.

This concern starts with intense competition between microcredit providers. An early consequence of this has been a relaxation of lending standards. The first parameters to be relaxed have been the loan term and the repayment modalities. Clients usually like to have a long term, with the bulk of repayment towards the end and the possibility to pay back early, so as to have more financial flexibility. MFIs tend to go along to please clients, but also to reduce pressure on loan quality, as least in the short term. A loan over three years with annual principal instalments makes repayment problems surface later than a loan over one year with monthly instalments.

The next parameter to become more lenient has been the loan amount. As clients can and do borrow from multiple sources, why not satisfy all their needs in one go and at the same time prevent competitors from getting business? Moreover, after years of strong growth and low default, both clients and MFIs have become more optimistic in assessing future repayment capacity, thus enabling a larger loan amount. This optimism has also tended to erode loan assessment and collateral requirement, which also pleases clients who prize convenience. In its most extreme form, this

GRAPH 1.5: GROWTH IN CAMBODIA'S MICROFINANCE SECTOR



Data sources: Cambodia National Institute of Statistics, National Bank of Cambodia and International Monetary Fund.
Regulated microfinance entities comprise microfinance institutions (MFIs), some of which can collect deposits from the public, and rural credit operators. The loan portfolio comparison to GDP considers microfinance institutions only, as aggregate data on the portfolio of rural credit operators are not available. The 2019 loan portfolio to GDP ratio is provisional. Besides MFIs and rural credit operators, several banks and leasing companies are active in microfinance also, as well as informal money lenders, shops that sell on credit, plus relatives and friends who lend a helping hand. The true size of Cambodia's microfinance sector is much bigger than this chart shows, but is unfortunately unknown.

striving for convenience has culminated in immediate lending, where a client can instantly obtain a loan against an identity document. This form of lending, practiced by informal money lenders, has been known to prevent clients from voting in elections.

Next to the relaxation of lending standards, another early consequence of intense competition has been a proliferation of new loan products that are not obviously linked to an income-generating activity. Housing loans, home appliance loans, education loans are some examples. Although they respond to client needs, they tend to increase client's debt without a commensurate increase in their income. They may thus make a later repayment problem more likely.

After a few such years, nearly everyone who wants to borrow and who is not a blatant credit risk has got a loan. A new phase then begins where MFIs increasingly focus on poaching existing clients from other lenders in order to maintain their high growth. Although this has had the undoubted benefit of lowering client interest rate, it has fuelled the relaxation of lending standards further. To prevent poaching, some lenders have in turn introduced penalty on clients who pay off their loan early. This is a curious instance where more competition has led to less client-friendly practice.

The general tendency has nevertheless been towards higher client-friendliness. Spoilt for choice, encouraged to borrow, too optimistic about their own future prospects, some clients inevitably borrow too much for their own good. When they then encounter difficulty to repay their loan, MFIs' staff may arrange a bridging loan: the client borrows from a money lender to pay off the MFI loan, then the MFI disburses a new, bigger loan to the client to pay off the money lender loan (bigger because interest is added to loan principal). MFI's staff can pretend that the client continues to be of good standing, while the client, though deeper in debt, gets more time to service it and try to turn their fortune around. This mechanism cannot of course go on forever. Some clients do indeed succeed in clearing their debt, but many just sink deeper into it, until at one point the mechanism snaps. The client might run away or simply stop paying, the money lender might decline to cooperate, or the MFI might find it safer to call in the collateral.

Anecdotes of clients in difficulty who lose their land, their home, who withdraw their children from school, whose daughter prostitutes herself etc. emerge and make the news from time to time, but they are unfortunately very hard to prevent. As long as the client repays the loan on time, the lender has little incentive to ask where the money comes from. Even if the lender asks, the client might feel ashamed to tell about their difficulties or wish to preserve their access to future loans. Some acts committed by family members to service the loan might even be unknown to the client, as when the daughter prostitutes herself without informing her parents. So, the lender may notice the hardships a client endures only after they fail to honour their debt.

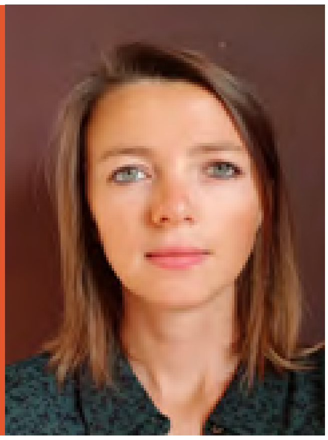
For MFIs, how such distressed clients are treated essentially depends on the field staff. Most major MFIs in Cambodia adhere to a set of internationally recognised Client Protection Principles, but even if their field staff have received thorough training, the nature of their work unfortunately means that not all clients can count on these Principles to protect them. MFI field staff encounter distressed clients regularly, and a certain professional cold-heartedness naturally sets in, akin to a doctor who regularly sees seriously ill patients. Most MFIs allow debt restructuring and even debt forgiveness, but the cards are stacked against the client. If a field officer, who normally knows the clients best, thinks that a client deserves leniency, they need to prepare an elaborate file to convince their superiors. These certainly have good reasons to require elaborate information, as leniency impacts the revenue of the company, but this makes such a file time-consuming to prepare. A client who may qualify for leniency invariably has a sad and complicated story of business failure, tensions and/or health problems within the family to tell. When a field officer manages a large number of clients, it will often be tempting to just push the client to pay, then move on. In the field, client protection demands a high level of compassion and patience, every day. Very few people, even with training, are capable of this.

Under such circumstances, instead of relying on the kindness of lenders, the best way to safeguard the basic rights of distressed clients might be to empower them to protect themselves. Personal bankruptcy, made simple and with a supportive court, might be a way forward. As this could however make lenders more averse to lend to very poor clients, the typical loan could be replaced by a profit-sharing agreement. The lender shares in the client's profit at a higher percentage than the loan interest rate if the business of the client succeeds, but loses any claim if the business fails. Like venture capital, a higher expected return compensates for a higher risk. Cambodia is expected to experience negative economic growth in 2020 for the first time since modern statistical records began in 1988. Microfinance clients are already feeling the impact. Urged on by the government, over ten percent of MFI loans have already been restructured as of August 2020. Responsible microfinance in Cambodia is facing its biggest test yet.

[1] *As of April 2020, the Fund exited its last residual position in Cambodia, although data used in the report predates this.*

Client of a Morrocan MFI in her hairdressing salon // Morocco

Chapter 2:
SPI4 Analysis



Interview with Stéphanie Vrielynck, ADA analyst

In 2018, ADA introduced Cerise's ALINUS tool into its investment due diligence process. ADA's Analyst, Stéphanie Vrielnyck, explains the benefits of this approach.

What is the SPI4 and the ALINUS?
SPI4 is a tool developed by Cerise, an institution with which ADA works a lot. The aim is to be able to audit social performance and to evaluate the extent to which MFIs implement the Smart Campaign (additional initiative to protect clients) and the Universal Standards for Responsible Inclusive Finance.

Adopting the ALINUS has helped us to formalise and to be able to compare our MFIs in terms of their social performance.

This tool makes it possible to analyse social performance and the extent to which institutions formalise their procedures in terms of mission, commitment, social objectives, customer protection, the responsible treatment of customers and employees, and how they balance social and financial performance.

The SPI4 is a complete tool and ALINUS is an abridged version, also created by Cerise, for investors like LMDF and ADA. This shorter format allows it to be used during due diligence missions.

Why did ADA decide to integrate the SPI4 into the investment files?
When investing, ADA and LMDF always try to support institutions financially, but also make sure they are socially responsible. Even before introducing the ALINUS into our due diligence, we had questions regarding social performance which we always asked. However, adopting the ALINUS has helped us to formalise this and to be able to compare our MFIs in terms of their social performance.

How do you conduct an ALINUS?
When we arrive at an MFI, we spend 3-4 days on a due diligence mission. During this time, we meet people at all levels of the institution, starting with the Board, senior management, middle management, agency staff and clients. By speaking to everyone, we gradually get the answers to all the questions in the ALINUS. Once we have finished our day of interviews, we check to see if we have received answers to the questions, and also to see if any answers are still missing. We also find lots of answers in the manuals, Board meeting minutes, MFI documentation, etc. If not, we go back and ask further questions.

Once we have all these elements, we compare the score of the MFI in question with the portfolio of LMDF and Cerise, and the result is included in the report for the investment committee. We also use the report to see if the MFI has any specific needs, which ADA could support through Technical Assistance.

Has the process been useful?
Actually, we have not discovered any surprises when we have been looking at the institutions. In general, performance has been as expected. What has been useful is the formalisation and structuring of social performance measurement that the introduction of ALINUS has allowed. It has also been very interesting from the point of view of benchmarking, comparing how MFIs perform across the portfolio.

Introducing LMDF's SPI4 results

The Fund has introduced the ALINUS as a fundamental component of each new investment note. This means that, to June 2019, the Fund has data on 44 institutions. This data has been used as a means to see how social performance has evolved over the past 2 years and also to look at notable features of the portfolio.

Performance continues to be ahead of the benchmark, however declines have been seen since 2017, due to selection bias in 2017 and the mix effect.

The first reaction to this data was not entirely positive. Although social performance data, collected through the ALINUS, is ahead of the benchmark, average performance has decreased by 3 points since 2017. Moreover, the deterioration can be seen in nearly every dimension.

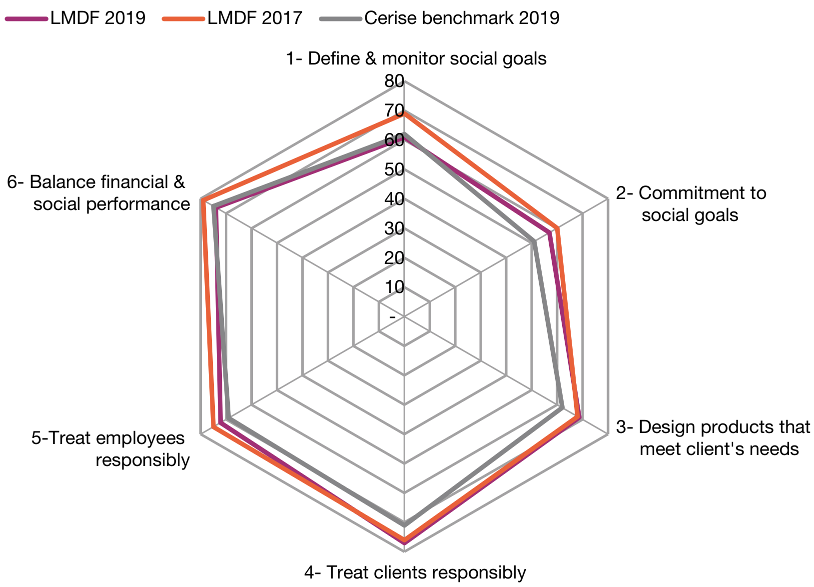
This led the Fund to question why there has been a relative decrease in this dimension of social performance, over the last 2 years, when the Fund has put considerable efforts into enhancing social performance by:

- Instituting the SPI4 metrics into every single investment file via an ALINUS conducted during due diligence
- Systematically checking each investment against benchmark SPI4 performance
- Increasing the focus on reporting social performance metrics

It is fair to say that data is limited and so the statistical significance of this decline is not certain. The very focus on social performance may, however, be partly responsible for the perceived decline in social performance. As can be seen from Table 2.1, the Fund had data for just 19 MFIs. These were MFIs that had completed a full SPI4. Although this was sometimes required by social performance covenants, in other cases MFIs had chosen to conduct an SPI4 and to publicise it. By 2019, conducting an ALINUS was a mandatory part of the investment process.

This means that there is a selection bias among the MFIs reporting in 2017, which may have boosted performance. Meanwhile data from 2019 includes the full investment horizon, even those institutions with

GRAPH 2.1:
ALINUS SCORE OF LMDF'S PORTFOLIO IN 2017 AND 2019 COMPARED WITH CERISE'S 2019 BENCHMARK



Source: Cerise and LMDF

weaker social performance, which may previously have been reluctant to provide SPI4 data.

Other potential reasons for the discrepancy in performance could also be that the mix of institutions has changed. In 2017, over two thirds of institutions were based in Latin America, an area with above benchmark performance, while less than a tenth were in Sub-Saharan Africa, an area with considerably below benchmark performance. In 2019, more than a quarter of the institutions were in Sub-Saharan Africa, while less than a half were based in Latin America. Although this may have had a negative impact on the average SPI4 score, such a transition is consistent with ensuring capital reaches countries lower in the Human Development Index.

Although the benchmark does not use the same Tier 2 and Tier 3 classifications as LMDF, it is clear that the mix of institutions providing data has changed. However, it is difficult to tell what the impact of this would be. In 2017, Tier 3 institutions showed better average metrics on the SPI4 than Tier 2 institutions – this was not expected since Tier 3 institutions tend to have a lower degree of formality and consequently weaker SPI4 scores. In 2019, however, Tier 3 institutions substantially underperformed Tier 2 institutions in their SPI4 scores. The initial discrepancy in 2017 is likely to have resulted from small sample size and the fact that Tier 3 MFIs which were ready to report at that time were not typical of their peer group. A lack of data prevents us from saying whether a change in the proportions of institutions with differing legal statuses has had an impact.

Despite the initial setback of seeing a deterioration in data, on closer analysis, the deterioration may, in fact, be caused by positive progression, the deterioration either stemming from the more comprehensive data set used, or a change in the mix of institutions undergoing the SPI4 process, with more MFIs coming from Africa.

It will be interesting to see how data progresses. When the next social performance report will be produced, the comparable data will not contain the selection bias of 2017 and so it will be easier to confirm how the portfolio has evolved.

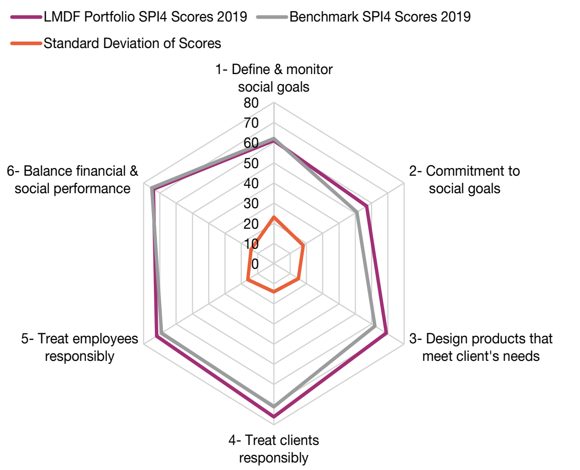
TABLE 2.1:
BREAKDOWN OF MFIS INCLUDED IN THE STUDY OF SPI4 SCORES (LMDF AND BENCHMARK)

	LMDF pft. in 2019	Benchmark 2019[1]	LMDF ptf. in 2017
Total number of MFIs[2]	44	530	19
MFIs by geography[2]	Africa: 12 Asia: 10 Latin America: 22	Africa: 188 Asia: 173 Latin America: 166 Europe: 3	Africa: 4 Asia: 2 Latin America: 13
MFIs by type	Cooperative: 8 For profit: 27 Not for profit: 9	Cooperative: 99 For Profit (bank or NBFI): 225 NGO: 127 Other: 80	No data available
MFIs by size	Tier 1: 1 Tier 2: 31 Tier 3: 12	Large: 208 Medium: 101 Small: 221	Tier 2: 13 Tier 3: 6

[1] Cerise Quality Audits June 2019.
[2] It should be noted that in 2017, when the exercise was originally performed, LMDF worked with Cerise to create a bespoke benchmark with a higher weighting towards small institutions. This time LMDF has not opted to use a bespoke benchmark, but instead used the Cerise benchmark which is available on Cerise's website. This means the weightings are not so directly comparable to the Fund, but the tool is still useful when examining the Fund's social performance.
Source: LMDF and Cerise

Strengths and weaknesses in social performance management

GRAPH 2.2:
ALINUS SCORE: LMDF'S PORTFOLIO AND STANDARD DEVIATION



Source: Cerise and LMDF

The data collected via the ALINUS allows an analysis of how the institution rates in terms of the SPTF, Universal Standards for Social Performance Management, standards which have been designed to ensure that financial services are "safe and beneficial to low-income and excluded customers." These standards hinge round six core dimensions which are shown in Illustration 2.1.

Weaker performance in the interconnected dimensions of: Defining and monitoring social goals and Ensuring board, management and employee commitment to social goals.

This analysis aggregates scores from the MFIs in the portfolio to show where the portfolio's strengths and weaknesses lay.

Analysis of the dimensions
The weaker scores were in:

- **Dimension 1:** Defining and Monitoring Social Goals
- **Dimension 2:** Ensuring board, management and employee commitment to social goals

Both these dimensions are fairly interdependent, with a clear definition and monitoring of policy likely to lead to strong commitment to the goal within the institution.

Other studies have also shown that MFIs commonly show weakness in respect to both these goals. This may not reflect badly on an institution's social credentials but suggests that they have not been well formalised. This is expected when dealing with younger and smaller institutions. LMDF helps to support more formalisation over its funding relationship through social covenants and technical assistance provided by ADA.

In contrast, the following dimensions were areas of particular strength:

- **Dimension 4:** Treat clients responsibly
- **Dimension 6:** Balance financial and social performance

Dimension 6 primarily looks at whether decision making in key financial areas also integrates social strategy. This is a complex dimension, notably with regards to responsible pricing; it has been noted that this complexity can sometimes result in overestimates in performance in this dimension, notably when analysis is conducted internally within an MFI. Nonetheless, the ALINUS analysis was conducted on an objective basis by ADA's analysts and we have no reason to doubt the score.

The other strength lies in Dimension 4, Treating Clients Responsibly. This dimension includes many elements of the Smart Campaign and therefore the MFIs with which LMDF works which are signatories of the Smart Campaign show particular strength in this area, with an average score of 82 (those which are not signatories have an average score of 76).

Treating clients responsibly and balancing social and financial performance were areas of particular strength and this was reinforced by the Smart Campaign and by local client protection initiatives.

ADA's report on Social Performance Management in Microfinance also notes that the underlying measures also often correlate with legal requirements in certain geographies, again leading to high performance in this Dimension. Interestingly there is no significant correlation between client retention rates and score in this dimension (-0.17); instead, clients retention seems to be more a factor of regions, with Central Asia showing structurally lower client retention.

- **Dimension 3:** Design products that meet clients' needs

Dimension 3 shows strong performance relative to the benchmark. Designing products and services that meet clients' needs and preferences is a dimension which, according to ADA's study, is "relatively demanding and requires MFIs to have implemented a certain number of regular procedures and processes to collect and analyse information about their clients' needs and preferences." This is a strong focus during due diligence missions to institutions, and this may result in the disparity between the benchmark and LMDF's portfolio.

- **Dimension 5:** Treating Employees Responsibly

This is also an area of moderate strength. The Fund also carefully monitors this during its investment process and looks at various metrics to ensure that employees are treated responsibly, including staff turnover, proportion of female staff, and the workload of loan officers. Interestingly there is no significant correlation between staff retention rates and score in this dimension (-0.12); instead, staff retention also seems to be more of factor of regions, with Latin America showing structurally lower staff retention. The Fund also looked at the standard deviation of scores for each metric. For the two dimensions with lower scores, the standard deviation was wider. This suggests that there was considerably more variance in performance for these dimensions, than for the relatively stronger dimensions.

Areas of relative weakness show greater variance in scores. Variance is lower in the aggregate average score than across each dimension suggesting that MFIs with weakness in one area are able to compensate elsewhere.

Overall, however, the standard deviation was lower on the aggregate score than for each individual dimension. This suggests that it was not the same institutions showing weakness across all dimensions, but instead that institutions which were weaker on one dimension, had other strengths elsewhere.

ADA's *Study on Social Performance Management in Microfinance* has been referred to several times in this article and provides very useful complementary analysis.

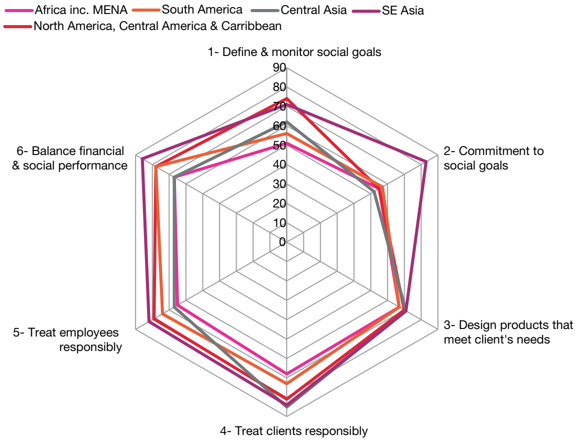
ILLUSTRATION 2.1:
UNIVERSAL STANDARDS FOR RESPONSIBLE INCLUSIVE FINANCE

Source: SPTF

Further social performance assessment

Geographical Breakdown of Scores

GRAPH 2.3:
LMDF PORTFOLIO'S SPI4 SCORES BY REGION



Source: Cerise and LMDF

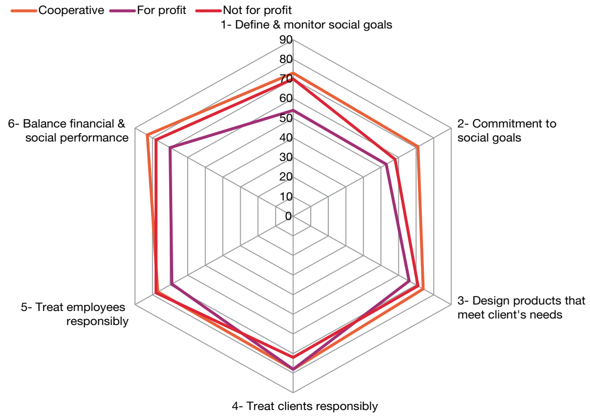
Analysis of the portfolio by geography shows considerable discrepancies depending on the region. Previous studies have shown that Sub-Saharan Africa has considerably weaker scores than the global average, even when data is corrected for various other factors that come into play, such as organisational type (there is a higher proportion of cooperatives in Sub-Saharan Africa and these tend to have lower scores) and size of organisation. Unfortunately, our data set is insufficient to correct for these factors, however, the difference between scores in Africa and among our other geographies is notable.

Africa's performance in the ALINUS lags behind other regions, indicating low degrees of formalisation.

This weaker performance in Sub-Saharan Africa does not indicate that the MFIs are not playing an important role in promoting financial inclusion in the region. It is, however, indicative of a lower degree of formalisation, which merits further support, potentially via technical assistance.

Legal Form

GRAPH 2.4:
LMDF PORTFOLIO'S SPI4 SCORES BY MFI LEGAL FORM



Source: Cerise and LMDF

Typically, cooperatives have been shown to have rather worse performance in SPI4 studies than other forms of institutions. This appears to be down to degrees of formalisation and professionalisation.

Cooperatives in LMDF's portfolio showing surprisingly strong performance in ALINUS scores.

In LMDF's portfolio, a rather different trend is seen, with cooperatives demonstrating by far the best performance in their SPI4 scores. Although there are a lot of cooperatives which apply for funding, LMDF is highly selective with the cooperatives which enter into the portfolio, and so the higher score here is likely to represent the results of this selection process. The SPI4 benchmark data indicates that not for profit organisations tend to have rather better performance than for profit organisations, which is also reflected here.

Size of the Institution

GRAPH 2.5:
LMDF PORTFOLIO'S SPI4 SCORES BY MFI SIZE

Source: Cerise and LMDF

LMDF primarily works with so-called emerging microfinance institutions. These can be smaller Tier 2s – institutions which have already reached a certain size or maturity or larger Tier 3s – institutions which have not shown substantial portfolio expansion, but in which LMDF views there as being considerable potential. In the previous social performance report, Tier 3 institutions unexpectedly showed higher SPI4 scores than Tier 2 institutions. Other studies have demonstrated the opposite trend; having a larger size tends to mean that there is a higher degree of formalisation within the institution, and this formalisation supports stronger social practices. As our results from 2017 demonstrate, it is possible to be a smaller organisation and still have strong social credentials formalised; however, this is not the general rule.

In 2019, Tier 2 MFIs showed better scores than Tier 3 MFIs.

In 2019, our results conformed with other findings, and Tier 2 MFIs showed considerably better overall performance than Tier 3 MFIs. This correlates with our findings on missions, where tier 3 MFIs may have a strong social focus, but this has not necessarily been crystalised in their policies and procedures.

Financial performance and social performance
There are various measures used to gauge the financial performance of an institution. You can look at profitability, or at efficiency, or, in the case of financial institutions, the quality of the portfolio. This latter metric is commonly used in microfinance, with the portfolio at risk at 30 days being one of the key indicators of loan quality. The other key metric that is examined here is operational self-sufficiency: this looks at the firm's operating revenue and whether it is possible to operate sustainably.

No significant links between financial and social performance found in this sample, but sample was too small to correct for other factors.

Previous studies have indicated that there is a correlation between financial and social performance. LMDF similarly decided to consider this within its own portfolio by comparing the scores from the ALINUS to the financial performance of the institution.

LMDF ran a regression of the PAR 30 (averaged over 4 quarters) against the average SPI4 score of the institution. The result was insignificant (correlation coefficient of -0.06). LMDF also ran a regression of operational self-sufficiency against the average SPI4 score of the institution; this was, again, insignificant (0.07).

Given that there are studies showing that social performance does impact on social performance, these findings were surprising. The reason for the lack of correlation may be down to the relatively small sample size. It may also be down to other factors which play more of a role in dictating either the loan delinquency, operational efficiency or social performance, such as geography, legal form, age of an institution, or size of an institution.

ADA's Study on Social Performance Management in Microfinance has been referred to several times in this article and provides very useful complementary analysis.

CASE STUDY - WHAT ARE EMERGING MFIS?

It has been estimated that there are over 10,000 microfinance institutions across the globe.[1] These are very different in nature, ranging from listed MFIs such as Bharat Financial Inclusion, recently merged with IndusInd Bank, in India and Compartamos Banco, originally in Mexico, and now spreading through Latin America, through to small cooperatives serving only a couple of hundred people, in a remote Indonesian island or in the heart of the African continent.

MFIs are usually defined by their Tier category. Tier 1 are mature MFIs with typically over USD 50m assets, established for some time and generating a positive return on assets. Tier 2 are emerging MFIs with between USD 5m & USD 50m of assets with positive trends in return on assets. These MFIs may not yet have ratings, but are likely to have at least 3 years of audited financial statements. Tier 3 are developing MFIs with typically less than USD 5m in assets. These are often at an early stage, and may not yet show signs of profitability, but they may operate in a very interesting niche. They often have a limited degree of formalisation.

LMDF has chosen to focus on emerging microfinance institutions, which have a track record and operating experience, but which often have received limited financing from abroad and which have a significant growth potential ahead. These are defined as the less established Tier 2 institutions and the more advanced Tier 3 institutions. It has chosen to focus on this niche because:

1. **They can reach those most in need**. In more developed markets, larger and more experienced MFIs tend to focus on urban areas, whereas much work is needed in rural areas to financially include the poorest and those most in need. Emerging MFIs are often located in regions which are less developed in term of financial inclusion. Therefore, by financing these MFIs, LMDF can reach those the most in need.

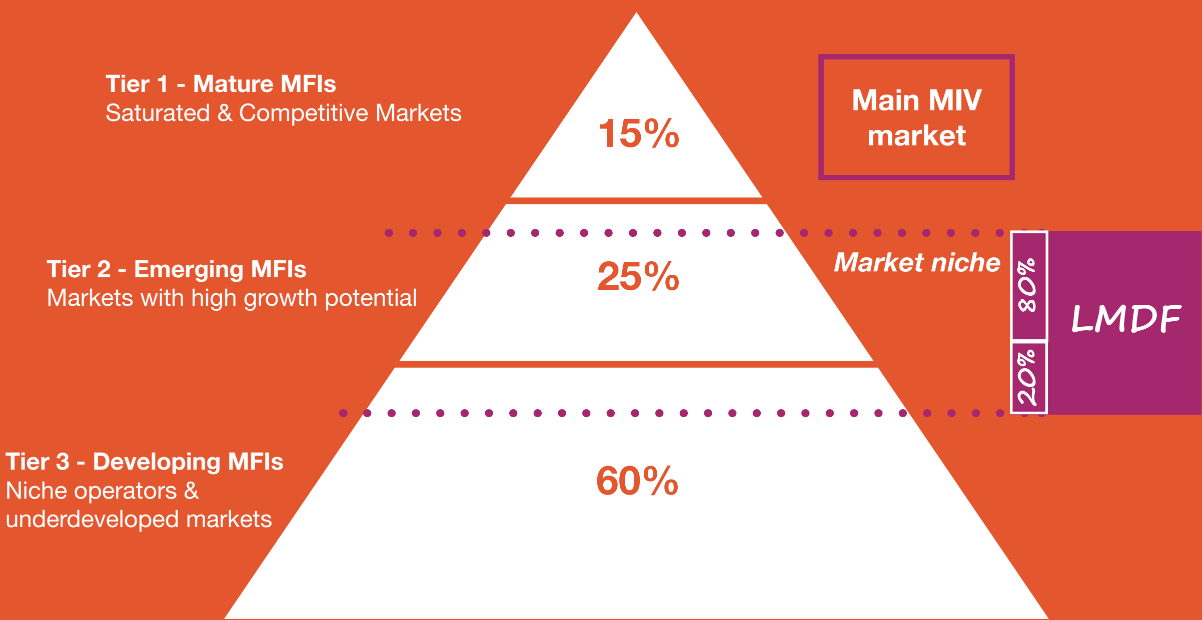
2. **They are more likely to be underfinanced**. The majority of Microfinance Investment Vehicles (MIVs) focus on the very large players, while some of the smaller players may struggle to obtain any financing.

3. **These institutions do have a track record**. Despite being smaller, LMDF works with institutions which do have an operating history so that we can ensure that their methodology works.

As the market continues to evolve, and more players look to invest in Tier 2 institutions, LMDF expects to increase its portfolio in well-established Tier 3 institutions, ensuring that financing continues to reach institutions that are comparatively underfinanced.

[1] Microfinance Gateway

ILLUSTRATION 2.2: MFI MARKET STRUCTURE BY TIER



This pyramid represents the microfinance market, with MFIs segregated according to tiers.
Tier 3 MFIs are the most numerous, but receive limited financing.
Definition: e-MFP. **Data source**: Mixmarket.

Green microfinance

Investing for Development, the umbrella fund for LMDF, launched the Forestry and Climate Change Fund two years ago. Although the Fund has always tried to be green in its approaches, launching a fund with a specific focus on climate change sharpened our approach.

Only 40% of LMDF's portfolio MFIs report on Green Microfinance and scores tend to lag behind the other SPI4 dimensions.

Beyond taking measures internally, the Fund also fosters green opportunities within its partner organisations. Yet this is still very much a work in progress. Currently, only 40% of the MFIs which report to LMDF consider the Green Microfinance section of the ALINUS and, whereas average performance in the ALINUS is 68% across the other measures, it only reaches 31% for Green Microfinance (with no institution scoring higher than 60%). The Green dimension of the SPI4 has four key elements:

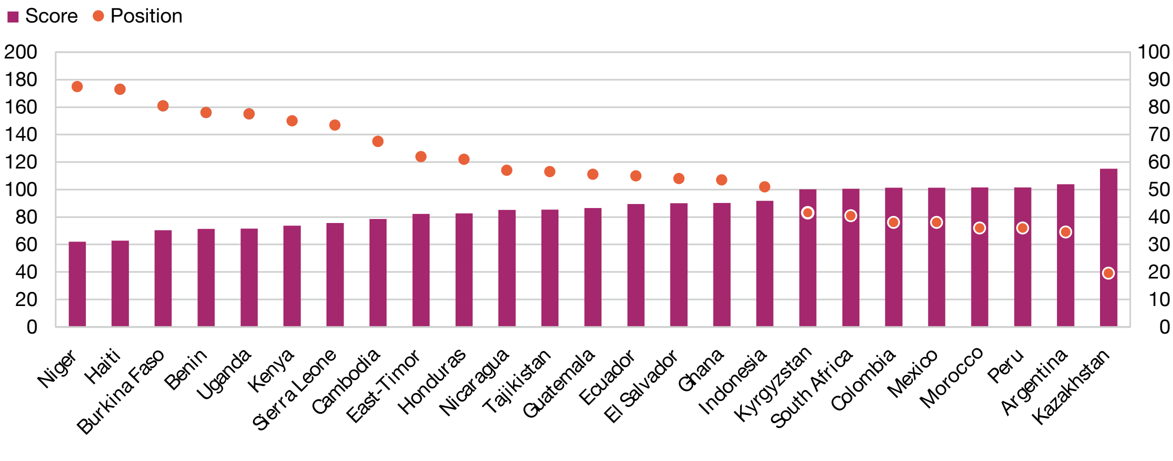
- **7A** The provider defines, manages and monitors its environmental strategy
- **7B** The provider manages its internal environmental risks
- **7C** The provider manages its external environmental risks
- **7D** The provider fosters green opportunities

The institutions which have completed the questionnaire on green activities tend to show strength in point B and monitor their own internal risks. The other dimensions are principally areas of weakness, notably the definition, management and monitoring of an environmental strategy.

Interestingly, while speaking with MFIs, it is clear that environmental risks are increasingly becoming a concern. Some MFIs have experienced drought, others flooding and other natural disasters. In this context, MFIs show great enthusiasm for learning more about the best ways to manage these emerging environmental risks.

Table 2.2 shows the countries in our portfolio according to the climate adaptation ranking (181 countries listed) – this considers both the threat that countries face from climate change and their readiness. The ranking (see below) shows a high correlation with GDP and Human Development. As LMDF invests in less developed countries mostly, it is not surprising to find that many of the countries in our portfolio are highly vulnerable to environmental threats. Eight of the countries in which we operate are among the 25% most vulnerable, while 17 are in the 50% most vulnerable.

GRAPH 2.6:
VULNERABILITY TO CLIMATE CHANGE BY COUNTRY IN LMDF'S PORTFOLIO



Note: Lower scores and higher positions indicate greater vulnerability.
Source: Notre Dame Global Adaptation Initiative. 2019 Data

What can MFIs do about climate change?
When we think about climate change, we tend to think of actions to mitigate environmental damage, consuming less fuel, flying less, being more aware of the impact of our diet… Certainly MFIs have a role to play when it comes to mitigation.

Many MFIs have developed a range of green products, to ensure responsible consumption practices by their micro-entrepreneurs. These range from efficient biogas cookers, to solar panels for the household's electricity consumption.

Many MFIs are exploring green products, from solar panels to efficient cookers.

Yet, the countries in which LMDF works are not the high consumers of natural resources.

As the Microfinance Barometer[1] reported, the effects of climate change on such areas is four-fold:

1. Communities often earn their livelihoods from activities highly affected by climate change (e.g. agriculture)
2. The regions they are in are often highly affected by climate events e.g. flooding, sea rise, desertification
3. Vulnerability is increased by the low economic and institutional capacities of individuals and states
4. Impacts are multiplied by migration

The question that follows is how MFIs can help communities to adapt in the face of changing circumstances and to become more resilient. This is also important for an MFI because of the increasing risks they face as a result of these changes.

MFIs can also help support resilience in many varied ways.

There are some global solutions which MFIs can adopt. Providing savings facilities can help families to have a financial cushion in case of an environmental disaster. This can also be supported by microinsurance. In contrast, some practices adopted by MFIs are context-specific. Some MFIs may help clients to buy particular types of seeds which are drought or flood resistant, while others may offer training to their clients so that they can better manage the increasing environmental risks. Additionally, MFIs can also warn their clients when extreme weather events are threatening them. Finally, MFIs can also support their clients in improving their houses or provide equipment loans which would enable them to overcome the costs of natural disasters.

[1] Convergences' Microfinance Barometer (2019)

Comuba's clients are highly vulnerable to the effects of climate change // Benin

CASE STUDY – THE IMPACT OF CLIMATE CHANGE IN BENIN

During the African Week of Microfinance (SAM), the LMDF team had the chance to speak to many of the African portfolio MFIs. All viewed climate change as an increasingly pressing question, but few had taken their concerns about climate change as far as Comuba. While other MFIs were just attending the Microfinance Week, the Comuba team were staying in Burkina Faso for a full 3 weeks, to receive training on agricultural finance and on risk management. When we spoke to them, we soon understood their reasoning.

Comuba is based in Benin, a country of considerable diversity, with lakes to the South and rocky hills and plateaus to the North. The country is under considerable threat from climate change and is ranked the 15th most vulnerable country to climate change in the world.[1] This year the effects have already been felt; the rainy season was much longer and heavier than anticipated, leading to considerable flooding. Rivers burst their banks leaving whole villages flooded and many places inaccessible. As the water levels rose, Comuba too began seeing the effects. Its PAR 30 levels were 3 percentage points higher than those of the previous year. Small businesses struggled to sell their wears as the heavy rains persisted.

As climate change becomes a more pressing problem, Comuba has been developing a strategy to deal with the changes. The first step involves climate change mitigation. In Benin, over 70% of families burn wood to cook their food and make their meals.[2] This has a detrimental effect on forest cover in the country, with the country losing 1% of its tree cover each year.[3] Burning wood also has a damaging effect on health, with evidence showing such cooking methods are linked to pneumonia, strokes and lung cancer, among other diseases. Comuba is now promoting clean cooking, providing its micro-entrepreneurs with efficient gas ovens; over 5,000 families have received a stove since the scheme started in June 2019. The loans are paid back within 3-5 months and cost less than a dollar a day. The time that families save in preparing fires can also be put towards more profitable activities.

The second step involves adaptation. This was the reason why Comuba found themselves at the risk and agricultural finance workshops during the SAM. Clearly climate change is impacting on the risks facing the institution, but how can an MFI and its clients adapt? One of the first areas that Comuba is investigating is insurance – if appropriate policies can be found, these can help to insulate the institution and its clients against the risk of environmental shocks.

The institution is also using its risk training from ADA to create an inventory of the risks it is facing, including climate risks, and work out the best mitigants. Finally, Comuba is working with a fintech firm, which is helping it to analyse and understand the climate risks within the portfolio. Having understood the risks, Comuba can then work out the best steps to take, from providing flood resistant crops, to requiring insurance for clients operating in certain areas.

The path to mitigation and adaptation is long, but by taking the first steps, Comuba will be better prepared when future climate events hit Benin again.

[1] Ministry of Foreign Affairs of the Netherlands
[2] Clean Cooking Alliance
[3] Rainforests Mongabay

Our Chairman and loan officers during field visits in early 2020 // Kenya

Chapter 3: The Impact of LMDF

LMDF's contribution to the SDGs

We are now in 2020, just 10 years before the SDGs are meant to be achieved, and there is still a lot of work to do. There are many projects contributing to SDG targets. Some projects may be very focused, with an impact on just one sub-element of just one goal. Others may take a very broad approach and focus on several goals at once.

An interesting element of the microfinance projects with which we work is that they also may take a broad approach or a narrow approach. Some of the projects choose to have a focus beyond poverty alleviation and inequality reduction, and may focus on women, health or even the environment; some are much more focused. Beyond these direct impact goals, there may also be indirect impacts in a broad range of areas, which are conducive to long-term change.

Illustration 3.1 underlines the goals targeted by LMDF and its partner MFIs. From this analysis, it is clear that LMDF has a substantial contribution to many of the goals focusing on People and Prosperity (traditionally defined as goals 1, 2, 3, 4, 5, 7, 8, 9, 10, 11 and 16), but less of an impact on the Planet goals (6, 12, 13, 14 and 15). This also tallies with the work conducted on the SPI4, which showed the limited efforts MFIs have made to date when it comes to green initiatives.

The Fund also shows a balance between targets (sub-elements ending in a number) and means of implementation (sub-elements ending in a letter). This balance is interesting, as it demonstrates that microfinance cannot only have a direct impact, but that it can also serve to promote mechanisms which drive long-lasting improvements.

The analysis shows that LMDF's significance is particularly strong in the following goals: 1, 4, 5, 8, 10 and 17. LMDF has a weaker contribution to many of the other goals, mainly through small components of projects run by individual MFIs. These prove very promising and have a significant cumulative impact. However, the data we receive here in Luxembourg is limited, and thus further in-depth analysis on these goals is beyond the scope of this report.

ILLUSTRATION 3.1: GOALS TARGETED BY LMDF AND PARTNER MFIS

	Specific target	Contribution	Some indiv. projects in this area
1. No poverty	●	●	
2. Zero hunger		●	
3. Good health and well being			●
4. Quality education	●	●	
5. Gender equality	●	●	
6. Clean water and sanitation			●
7. Affordable and clean energy			●
8. Decent work and economic growth	●	●	
9. Industry, innovation and infrastructure		●	
10. Reduced inequalities	●	●	
11. Sustainable cities and communities		●	
12. Responsible consumption and production			
13. Climate action			●
14. Life below water			
15. Life on land			●
16. Peace, justice and strong institutions		●	
17. Partnerships for the goals	●	●	

Source: LMDF analysis

LMDF's contribution to its target SDGs

(Data indicated here is to June 2020)

Goal | **Target, Indicator & Results**

1 NO POVERTY

1.4 Equal rights to ownership, basic services, technology and economic resources
By 2030, ensure that all men and women, in particular the poor and the vulnerable, have equal rights to economic resources, as well as access to basic services, ownership and control over land and other forms of property, inheritance, natural resources, appropriate new technology and financial services, including microfinance.

Results
- Micro-entrepreneurs (MEs) currently financed: 63,259
- MEs ever financed: 296,598
- Av. Loan size to GDP: 0.48

1.a Mobilisation of resources to end poverty
Ensure significant mobilisation of resources from a variety of sources, including through enhanced development cooperation, in order to provide adequate and predictable means for developing countries, in particular least developed countries, to implement programmes and policies to end poverty in all its dimension.

Results
- Current portfolio size: EUR 29.8m
- Loans disbursed since inception: EUR 60.9m
- Proportion of micro-entrepreneurs in low or middle income countries: 72%

4 QUALITY EDUCATION

4.3 Equal access to affordable technical, vocational and higher education
By 2030, ensure equal access for all women and men to affordable and quality technical, vocational and tertiary education, including university.

Results
- Number of low income university students financed: 1,148

4.4 Increase the number of people with relevant skills for financial success
By 2030, substantially increase the number of youth and adults who have relevant skills, including technical and vocational skills, for employment, decent jobs and entrepreneurship.

Results
- Proportion of MFIs offering non financial services: 58%
- No. of micro-entrepreneurs receiving training from partners MFIs: 1,042,769


Team meeting of the MFI Óptima in times of COVID-19 // El Salvador

5 GENDER EQUALITY

5.1 End discrimination against women and girls
End all forms of discrimination against all women and girls everywhere

Results
- Proportion of financing to countries with Very High or High levels of gender inequality: 11%

5.5 Ensure full participation in leadership and decision-making
Ensure women's full and effective participation and equal opportunities for leadership at all levels of decision-making in political, economic and public life.

Results
- Proportion of women financed: 72%
- Proportion of women employed by MFIs: 49%
- Proportion of women in governance of MFIs: 41%

8 DECENT WORK AND ECONOMIC GROWTH

8.3 Promote policies to support job creation and growing enterprises
Promote development-oriented policies that support productive activities, decent job creation, entrepreneurship, creativity and innovation, and encourage the formalisation and growth of micro-, small- and medium-sized enterprises, including through access to financial services.

Results
- Percentage of loans supporting revenue generating activities: 81%

8.5 Full employment and decent work with equal pay
By 2030, achieve full and productive employment and decent work for all women and men, including for young people and persons with disabilities, and equal pay for work of equal value.

Results
- No. of jobs created: No data currently available

10 REDUCED INEQUALITIES

8.6 Promote youth employment, education and training
By 2020, substantially reduce the proportion of youth not in employment, education or training.

Results
- Youth reached: 26% (of the 5 institutions which report on this metric)

8.10 Universal access to banking, insurance and financial services
Strengthen the capacity of domestic financial institutions to encourage and expand access to banking, insurance and financial services for all.

Results
- Av. portfolio growth rate of underlying institutions: 19%

10.2 Promote universal social, economic and political inclusion
By 2030, empower and promote the social, economic and political inclusion of all, irrespective of age, sex, disability, race, ethnicity, origin, religion or economic or other status.

Results
- Proportion of MFIs specifically targeting rural populations: 32%
- Proportion of loans going to rural micro-entrepreneurs: 60%
- Proportion of micro-entrepreneurs seeking loans for agriculture: 23%

10.5 Improved regulation of global financial markets and institutions
Improve the regulation and monitoring of global financial markets and institutions and strengthen the implementation of such regulations.

Results
- Financial rating covenant in MFI contract: 50%

10.b Encourage development assistance and investment in least developed countries
Encourage official development assistance and financial flows, including foreign direct investment, to States where the need is greatest, in particular least developed countries, African countries, small island developing States and landlocked developing countries, in accordance with their national plans and programmes.

Results
- Proportion of investments in ODA countries: 96%
- Proportion of investments in least developed countries: 25%
- Proportion of investments in Africa: 27%
- Proportion of investments in small island states: 4%
- Proportion of investments in landlocked developing countries: 13%

Clients of Crediflorida preparing coffee beans for drying // Peru

17 PARTNERSHIPS FOR THE GOALS

17.3 Mobilise financial resources for developing countries
Mobilise additional financial resources for developing countries from multiple sources.

Results
- Money contributed by different investor types:
  - Concessional investors (government and NGOs): EUR 6.4m
  - Institutional investors: EUR 20.8m
  - Individuals and Foundations: EUR 14.m
- LMDF among first 3 lenders: 16%
- LMDF among first 3 international lenders: 45%

17.7 Promote sustainable technologies to developoing countries
Encourage and promote effective public, public-private and civil society partnerships, building on the experience and resourcing strategies of partnerships.

Results
- Proportion of MFIs offered TA via partnership with ADA: 56%

LMDF and poverty reduction

In the vision and mission statements of partner MFIs, 39% explicitly state that poverty reduction is a core goal. Nonetheless measuring the contribution to poverty alleviation is a challenge.

The Fund has enabled over 296,000 micro-entrepreneurs to access financial services.

Certain studies on microfinance impact assessment demonstrate that microfinance contributes to increasing individuals' income and reducing their vulnerability.[1] At the moment, the Fund focuses on ensuring its outreach, i.e. whether the Fund is able to reach those who are seen to receive a beneficial impact from microfinance.

LMDF estimates that it has helped 296,598[2] people to access financial services and this is also illustrated by the map on page 48.

Over three quarters of the micro-entrepreneurs financed live in countries in the bottom half of the Human Development Index. This number indicates that LMDF is targeting its financing towards countries with a particularly high level of poverty.

Over three quarters of micro-entrepreneurs are located in countries in the bottom half of the Human Development Index.

Yet the Fund has also chosen to invest in some institutions based in High and Very High-income countries. In the case of the US, this is an institution which is domiciled in America, but which invests in MFIs in Latin America. In the other cases, LMDF has found that there are pockets of exclusion even among more affluent populations. Graph 3.1 shows average loan size relative to GDP against the HDI ranking of a country. There is a negative correlation suggesting that the richer the country, the greater the tendency for the Fund to work with the poorest of the society.

In general, the loan size ratio remains below 1, and in many cases it remains below 0.5. This indicates that the loans being made are of relatively small size and therefore that the recipients are among the poorest. However, several outliers can be observed. They stem from MFIs engaging in financing a higher number of SMEs.

The average loan to GDP ratio is 0.48, indicating loans are reaching disadvantaged citizens.

From this analysis, it is clear that LMDF has a poverty focus in its outreach and is able to direct resources both towards less developed countries and towards poorer communities in more affluent societies. Beyond this, more studies on the impact of loans after they have reached the target populations are necessary, to see how outreach translates into outcomes and impact.

[1] WRI

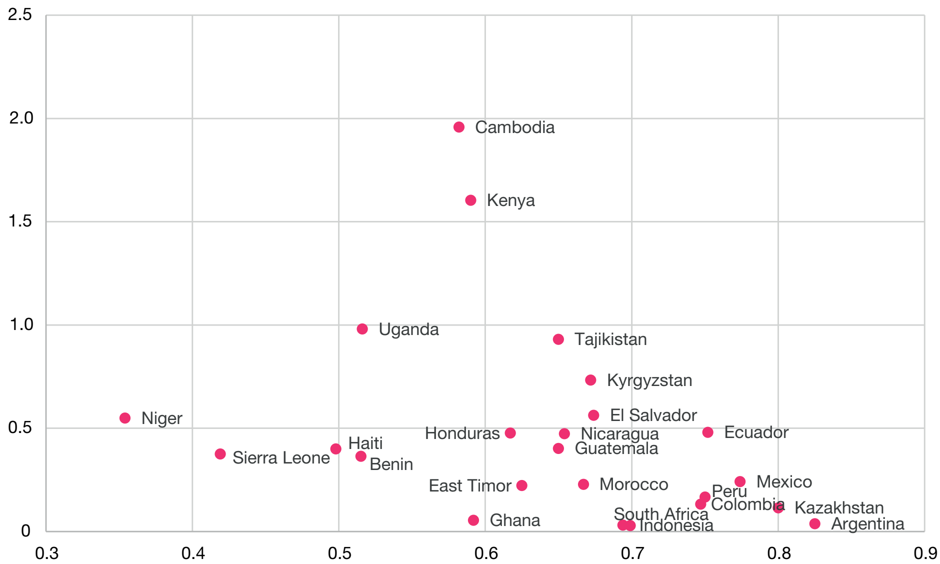
[2] As of 30th September 2020. This figure has been compiled by dividing the total loans disbursed to each MFI by the average loan size and calculating the amount of times this money would have been recycled based on the average duration of loans to micro-entrepreneurs.

TABLE 3.1:
NUMBER OF MICRO-ENTREPRENEURS SUPPORTED BY HDI STATUS AND AVERAGE LOAN SIZE/GDP (TO JUNE 2020)

HDI Status	Number of micro-entrepreneurs	Percentage of micro-entrepreneurs	Average Loan Size/ GDP Ratio
Very high[1]	11,897	4%	0.04
High	70,817	24%	0.23
Medium	168,138	57%	0.59
Low	43,823	15%	0.46

[1] This includes loans to HEFF, a US based investment vehicle, which disburses its loans to countries in Latin America with lower HDI status. This also includes loans to Uruguay which were disbursed when the country was at High HDI status, not Very High HDI status. **Source**: LMDF analysis

GRAPH 3.1:
HDI SCORE (X AXIS) RELATIVE TO LOAN SIZE/ GDP (Y AXIS) IN PARTNER MFIS



Note: This graph excludes Burkina Faso – which is an outlier with a loan to GDP ratio of 7.5x. This is due to the fact that the MFI with which we work with in Burkina Faso primarily finances SME loans which are rather larger than the average loans disbursed to micro-entrepreneurs and also because of the extremely low GDP level in the country (annual per capita GDP is EUR 275.40).
Source: LMDF analysis. HDI, June 2019.

LMDF's impact map

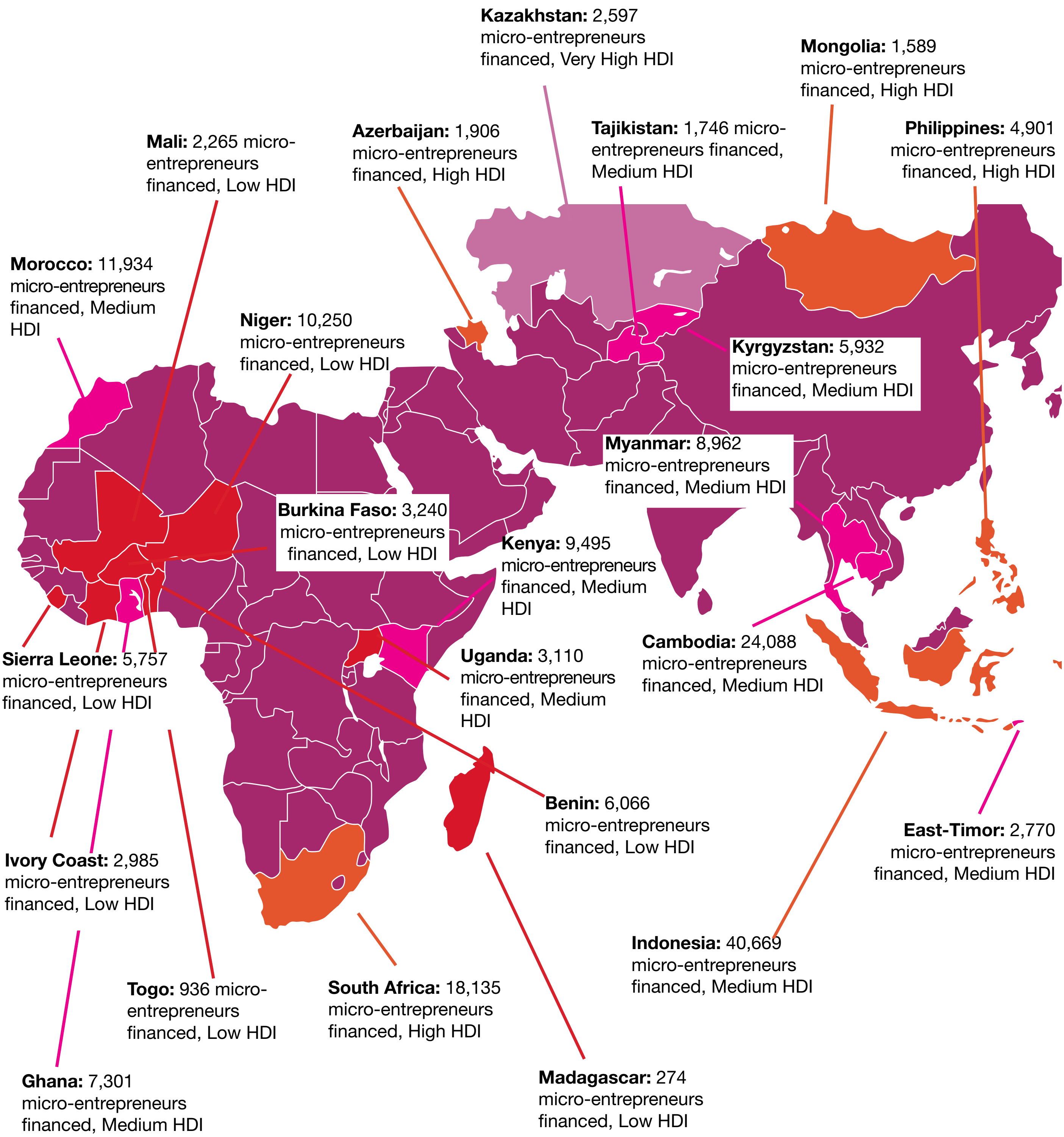
The map below illustrates the approximate number of loans provided by LMDF to micro-entrepreneurs across the globe. Over time, 296,598 loans have reached micro-entrepreneurs.

Based on countries' HDI score, a color code has been established for the countries where LMDF has worked.

Colour Codes:

Low HDI | Medium HDI | High HDI | Very high HDI

Source: LMDF analysis and HDI until September 2020



Note: LMDF disburses funding to HEFF, an institution based in the USA. However this funding is subsequently lent to students based across Latin America.

LMDF and education

Education can be viewed as an investment. Every extra year in schooling boosts an individual's earning power by up to 10%. Researchers estimate that if every child learned to read, around 170 million[1] fewer people would live in poverty. Education also has a dramatic impact on health issues, reducing infant and maternal mortality and contributing to disease control, notably for AIDS and malaria.

Diverse education products are offered by one third of our partner MFIs.

By viewing education as an investment to a healthier and more prosperous future, it is easier to see what microfinance's role may be. LMDF has always looked to support MFIs which do focus on education and a third of the institutions with which it works have specific products in this area. Products which contribute to education include:

ACME, Haiti: Rantre Lekòl – Supporting parents with preparation for the new term
ACME is aware that many parents may dip into their business loans when the new term starts, to ensure their children have money ready to pay school fees, to obtain books and other equipment needed for the term. This loan helps parents to ensure that business does not come to a standstill at this time of year.

ACTB Savings and Loans, Sierra Leone: Micro School Loans – Supply side financing
The Civil War in Sierra Leone took a large toll on the education system in the country, leaving over 1,000 primary schools destroyed. Today, the country still suffers from this heritage and schools remain woefully underequipped with shortages of textbooks and basic facilities hampering learning.[2] This loan helps schools to develop their infrastructure and provide a quality learning and teaching environment for pupils.

Sinapi Aba, Ghana: Smart Kids Account – Supporting kids in times of financial difficulty
Children often suffer when their parents go through a period of financial hardship; during such periods, children remain at high risk of being taken out of school. This custodial account encourages parents and guardians to save for their children and acts as a cushion in times of financial mishaps, helping to ensure children do not get removed from school. The high interest rate on this savings account also means that it may be able to support staying in education for a longer period.

Over half of the partner MFIs offer training allowing more than 1 million micro-entrepreneurs to be reached.

Bimas, Kenya: Solar Loan
Solar loans have a range of purposes, but BIMAS noted that they have a particular significance for children in rural communities. These children are often disadvantaged at schools because they are unable to complete their homework as they have no access to lights. Introducing solar panels increases the length of time when they can study and helps to prevent rural and poor children from being further marginalised.

HEFF, Latin America: University financing – Supporting career opportunities
HEFF works across Latin America to mobilise student loans for low income populations. It works with a variety of MFIs and aims to support young men and women, not only with repaying loans, but also with becoming professionals who can support their local economies and foster, further opportunities.

[1] UNESCO Global Education Monitoring Report
[2] The Borgen Project

To date, by supporting this scheme, LMDF has enabled 1,148 low-income students to access higher education. // LMDF

Case-study: Higher education

While we can qualitatively assess how LMDF has supported a broad range of education projects, it is more challenging to assess it quantitatively. However, one metric used for this purpose is the number of students supported by LMDF in accessing higher education.

Supporting Higher Education has particular benefits. The World Bank recently wrote that "Higher Education is key to boosting growth and reducing poverty and inequality."[1] Not only does Higher Education support individuals with finding new career opportunities, but ensuring that such professionals enter into the local labour force helps to reinforce fragile economies.

Yet there are particular complications when it comes to higher education financing. Whereas typical microfinance loans have a duration considerably less than a year, higher education loans may be required for a period of as long as 5 years. Typically, micro-entrepreneurs will have an amortising loan and will be able to start paying back immediately, but students may be out of the work force for several years, and unable to pay back a loan for the duration of their studies. They often do not have any collateral to provide either.

LMDF supports one project, HEFF, which has created a loan product designed for low income students. It supports students financially so that they can not only afford education expenses, i.e. registration, fees, etc., but also daily expenses, i.e. food, transportation, health insurance. During their studies, students are also offered support from academic and professional counselors, to improve their career prospects when they finish.

As at 30^{th} June 2020, by supporting this scheme, LMDF has enabled 1,148 low-income students to access higher education.

[1] The World Bank

Life-Long Learning

The learning process certainly does not stop when days in formal education are over. Many of the micro-entrepreneurs that LMDF finances may not have completed basic schooling and may not be literate. This presents particular challenges when running a small business, with all the administration and financial skills that are required.

For this reason, many MFIs provide further support to their micro-entrepreneurs by offering training, as well as loans. LMDF found that over 58% of the MFIs in LMDF's portfolio offer some form of training, be it in literacy, financial skills, healthcare or empowerment. From this information, LMDF also projected how many micro-entrepreneurs with whom partner institutions are working are likely to have received training. From the limited data provided, it appears that when training is provided by MFIs, it reaches, on average, two thirds of clients; for some institutions training is obligatory, while in others it reaches relatively limited numbers. Using these projections, LMDF calculated that its partner institutions currently support over 1 million micro-entrepreneurs in accessing skills training.

The majority of LMDF's portfolio MFIs offer some form of training, be it in literacy, financial skills, healthcare or empowerment.

There are many anecdotes which also underpin these statistics. In a recent interview we conducted with BIMAS in Kenya, we heard of one client who had dropped out of school at primary level. Her loan officer was therefore very surprised to hear that she had now gone back to school and asked what had happened. She explained that her business was now growing every day, but as it grew, she needed more skills to be able to manage the new challenges.

CASE STUDY: COMUBA – HOW A SMALL INSTITUTION MANAGES TO EDUCATE ALL ITS MICRO-ENTREPRENEURS

Comuba is a cooperative based in Benin. We have already heard about the challenges Comuba faces from climate change, but Comuba is notable in many other ways. As a cooperative, Comuba certainly does not have unlimited funds, yet it still manages to deliver training to every one of its 61,000+ female clients. This is particularly important in Benin where 69% of women are illiterate.[1] Although primary school completion rates have now rocketed, and 74% of women complete their primary education, in 2000 this number was just 26%, meaning that many of its micro-entrepreneurs have received limited schooling.[1] How does Comuba manage to achieve such a feat?

Comuba adopts a Group loan methodology. Each savings group elects a Leader, a President and a Secretary. These are normally well-respected women in the community, that may have a higher level of education than other women in the group and a basic degree of literacy. On an annual basis, Comuba brings the group leaders together and provides them with many useful lessons. These group leaders then go back to their groups and transmit what they have learned. This has the added benefit that the group leaders know their group members very well and are able to transmit the most useful knowledge in a way that supports everyone's learning.

The topics which are chosen for training are specifically focused on the needs of women who have not attended school and the challenges they may face. This means that financial education is an important component of the learning and Comuba provides modules on savings, budgets and negotiations. Other challenges may be in the home life, and Comuba also provides information on family planning and family hygiene. Although no studies on the impact of such lessons have been made, anecdotally the Comuba team have noted an improvement in family well-being.

[1] The World Bank

LMDF and gender equity

"A woman multiplies the impact of an investment made in her future by extending benefits to the world around her, creating a better life for her family and building a strong community." 50. USAID.Gov

Microfinance has typically been associated with women. This is partly because of the origins of microfinance. Muhammad Yunus, often known as the Father of Microfinance, first started out by lending USD 27 of his own money to women in a small Bangladeshi village with no other sources of financing. This model spread, and predominantly focused on women, given their limited access to financing. Still today, the IFC estimates that 70% of women-owned SMEs in developing countries are unserved or underserved[1] and 9% fewer women have bank accounts than men, a figure which remained unchanged over the years[2].

72% of the micro-entrepreneurs that LMDF supports are female and this number has consistently remained above the benchmark.

The other reason for the association of microfinance with women is because of the philosophy encapsulated by the quotation from USAID. It is believed that by supporting a woman, you will support her whole family and it is often noted that women will invest more back into their families and communities and prioritise food, healthcare and education expenditure. This is particularly important in the context of research conducted by FINCA, a global microfinance organisation, with whom LMDF works in Haiti, which found that 72% of their female clients become primary breadwinners for their families after receiving access to financial services.[3]

Given these dynamics, and the relative lack of opportunities for women, LMDF has always had a particular focus on female financial empowerment within its Fund. Over time, the relative proportion of women reached has stayed relatively stable and female entrepreneurs have nearly always been more than two thirds of those receiving financing. LMDF has also always financed a higher or equal proportion of women to the Microfinance Benchmark (Symbiotics MIV survey).

70% of women-owned SMEs in developing countries are unserved or underserved.

The countries in which LMDF works are not necessarily the geographies which suffer most from gender inequalities as shown by Table 3.3.
At the moment, among LMDF's current recipient countries, for which data is available, 2 have very low levels of gender inequality, 10 have low levels, 6 have medium levels, 3 have high levels and 1 has a very high level. Within these countries, investments are concentrated among those with Low and Very Low levels of Gender Inequality, which constitute 67% portfolio, suggesting the Fund could do more to concentrate its efforts towards areas where discrimination against women is highest.

LMDF has also analysed whether gender inequality has any correlation with the number of women financed by an MFI, but found that there is no significant correlation. MFIs operating in countries with high or low levels of gender inequality show equal tendencies in their choice of financing loans for women.

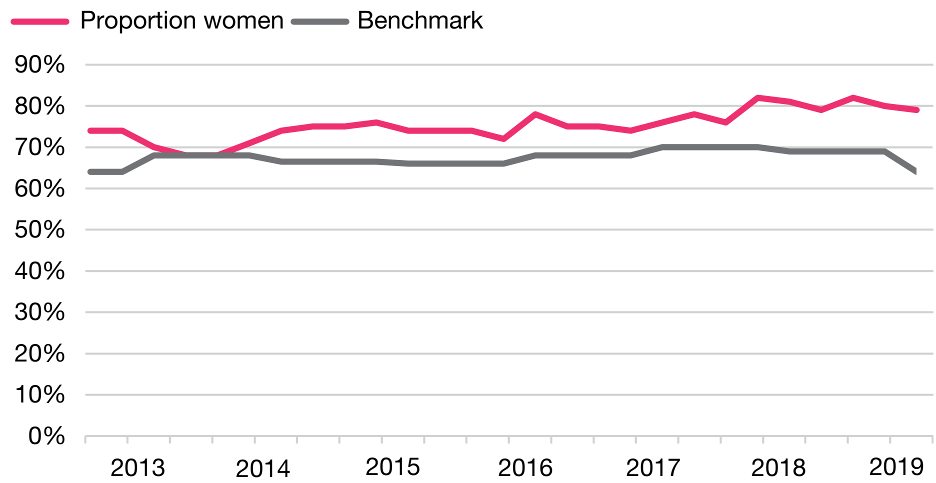
[1] IFC
[2] The World Bank
[3] FINCA

TABLE 3.2:
PROPORTION OF PORTFOLIO HELD IN COUNTRIES WITH DIFFERENT LEVELS OF GENDER EQUALITY

Gender Inequality Level	Proportion of portfolio
Very Low	7%
Low	60%
Medium	20%
High	10%
Very High	1%
No Data	3%

Source: Gender equality index

GRAPH 3.2:
PROPORTION OF WOMEN FINANCED BY LMDF VERSUS SYMBIOTICS MIV BENCHMARK



Source: LMDF, Symbiotics annual MIV survey

Having more of a powerful role within the household or within the community is often contingent on the production of profitable work // Uganda

Women within MFIs

We have seen that LMDF supports a high proportion of women with its financing. There are many anecdotes to show that women do feel that they have more effective participation as a result of their loans. Often having more of a powerful role within the household, or within the community, is contingent on the production of profitable work. Yet, beyond anecdotes, it is difficult to measure whether the micro-entrepreneurs do indeed have a greater role in decision making following the receipt of a loan, due to the lack of quantitative data.

49% of MFI staff and 41% of MFI directors are female and these staffing levels show considerable correlation with the levels of gender equality in each country.

On the other hand, LMDF does receive considerable data from microfinance institutions themselves about their staffing. This provides a very interesting perspective on the extent to which organisations themselves do promote equal opportunities and effective participation.

Overall, out of all the institutions which LMDF finances, 49% of staff are female. This level decreases marginally when it comes to management and only 41% of directors are female. This is encouraging as it suggests that gender parity is a priority, even within the structures of the organisation. LMDF then examined the correlation between the proportion of women financed, and the proportion of female staff. It found that there was no correlation (coefficient -0.01) between the proportion of women financed and the proportion of women employed by the institution. For directors, the correlation was -0.17 suggesting an extremely weak negative correlation between the proportion of women financed by an MFI, and the proportion of women on the Board, a rather unexpected outcome, which may just be down to small sample sizes.

The proportion of female staff and directors was also examined against the gender equality index for each country. The results from this were as expected, with countries with higher levels of gender inequality employing fewer female staff (correlation coefficient -0.27) and fewer female board members (correlation coefficient -0.33). Although these results may be expected, it does demonstrate again that more efforts could be made to support equal opportunities, even within MFIs, in areas where gender inequality is more of an issue.

CASE STUDY – PROMUJER ARGENTINA, SUPPORTING FEMALE WELL-BEING

Given the problems faced by marginalised women in Latin America, in terms of health, discrimination and gender-based violence, and the potential it sees in women investing their funds into local communities, ProMujer has chosen to run operations across the geography. Currently, LMDF finances the Argentinian branch of the institution.

To combat discrimination and support women's well-being, ProMujer goes much further than just offering financial services. It considers itself a female development organisation and offers training, healthcare and services promoting the all-round well-being of their clients.

As ProMujer Argentina's client Carina Santillan explains: "I have stayed with ProMujer because they have given me the chance to get ahead, to progress. And it's not just that I have been able to overcome and change, but everything that has happened to me has had repercussions for my family. The loans enable me to continue investing in and growing my business, and the health services and trainings are a great benefit for us and our families. But mostly, I stay because I feel that I have found my own space where everything is possible and where I can do what I need to do to get ahead. ProMujer has taught me that it is never too late to start, to never lose hope and to be responsible."

CASE STUDY - BIMAS KENYA, DIGNITY FOR RURAL WOMEN

In Kenya, men are increasingly heading to the cities in search of work, leaving women and families in the countryside. Women are suddenly elevated into a new position as head of the household. Yet they are not accustomed to having this role, and often have few resources to manage it. Women frequently have to phone their husbands in the city if they need to access any finance, even for the most basic and urgent needs, such as healthcare.

BIMAS looks at how such women can be given dignity. It considers what can be done to ensure that these rural Kenyan women do not have to depend on a man for everything and so that they begin to have more bargaining power within the household.

To do this, BIMAS has carefully considered what women need and has built up their portfolio accordingly. It has found needs to be very diverse, and priorities often include sanitation, education and healthcare. Solar loans provide benefits when it comes to education, allowing children to extend the period in which they can study. BIMAS also helps its clients and their entire household to sign up to the National Hospital Insurance Fund, the government run healthcare scheme, by paying the upfront costs and then receiving repayments throughout the year. Being signed up means that women are no longer reliant on husbands before receiving healthcare. BIMAS has products to support its clients with basic sanitation concerns, from water, to toilets too.

Yet this is not the only way in which women are empowered and get their dignity back. One of the most crucial aspects to empowerment has proved to be BIMAS's group methodology. Staff have found that women get a lot from meeting with other women in a similar situation, sharing their struggles and learning from other women's solutions. After all a problem shared is a problem halved, and BIMAS clients all seem to look forward to their regular group activities.

Providing decent opportunities

Across the world, 5% of people, who are seeking work, are unemployed.[1] This headline figure masks a multitude of other concerns: there are many people who have simply given up seeking work, and are therefore not included in official rates; others may be severely underemployed. Yet what is certainly notable is that some groups are disproportionately affected by this phenomenon, especially the young.

84% of loans are supporting revenue generating activities, with the majority (53%) financing services and trade; the rest finance agriculture (22%) and craft (9%).

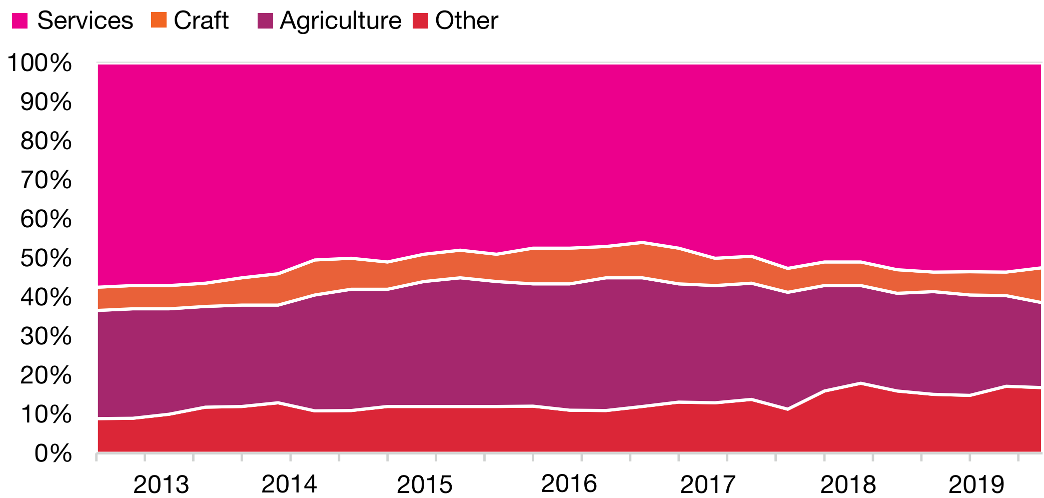
This inadequacy of opportunities has serious consequences. Beyond the financial disadvantages for the individuals concerned, and the multiplier effects of their lost revenue nationally, we also find correlations between unemployment and many of the pressing issues of our time, such as global insecurity and migration.

Microfinance has been relied upon to provide alternative employment solutions. Yet this reliance on microfinance has risks. Funds need to ensure that microfinance is going to the provision of productive and responsible opportunities.

To ascertain whether loans are going towards revenue generating activities, our analysts spend substantial time in the field, examining the business of micro-entrepreneurs and the practices of microfinance institutions. They want to see how local loan officers understand underlying businesses and their capacity to receive funding. If this is satisfactory, they will go on to examine the other practices conducted by the institution.

The concern is always that funding is being used to support projects which might ultimately weaken the financial situation of a micro-entrepreneur rather than support them. A particular worry are loans being used to fuel certain forms of consumption activities. If a loan, which is meant to support, for instance, the working capital needs of a small enterprise, is instead used to purchase a television, there is a concern that a micro-entrepreneur may struggle to pay their loan back.

GRAPH 3.3:
LMDF'S UNDERLYING PORTFOLIO: MICROFINANCE LOANS CLASSIFIED BY ACTIVITY TYPE



Source: LMDF anaysis

Example of craft activities // Ecuador

Providing loans to support consumption does not always have negative consequences. Although loans to support education or housing improvements may not immediately lead to an increase in income, they can make substantial changes to the fortunes of poor communities, allowing people to follow a different career trajectory, have electricity in their houses – extend a working day, have better sanitation and facilities with an impact on health etc.

However, these loans do come with certain risks and have to be monitored carefully. Understanding the “Other” loan category is an important focus of an analyst’s work.

83% of loans in LMDF‘s portfolio support revenue generating activities. For reporting practices and to understand the dynamics of the portfolio, LMDF divides these other loan types up into three categories:

- **Agricultural Loans – 22%**
  Loans focused on supporting agricultural activities, primarily in rural areas. These loans often have special repayment schedules, enabling them to fit in with crop cycles.

- **Craft loans – 9%**
  The underlying crafts may vary with micro-entrepreneurs working in areas from carpentry to clothing manufacture. Dynamics with the buyers of crafts need to be considered carefully in such cases.

- **Services and trade - 53%**
  These form the majority of the portfolio and consist of the multitude of small businesses you can see walking down the street in any of the countries in which we walk, from corner shops, to grocery stores and bakeries. The microfinance industry has developed around such businesses and therefore loans of this type are a point of strength.

[1] The World Bank

Providing a boda boda loan helps young people to buy their own motorcycle to use as a motor taxi // Uganda

CASE STUDY: TUGENDE, UGANDA

In every country where LMDF works, youth disproportionately lack opportunities. This is a problem which is accentuated by the fast growth rates in the young population, which is also a common feature of many of the geographies in which we work. In certain places, youth unemployment exceeds the average unemployment rate by over 30%.

Yet many institutions are reluctant to take what they perceive to be a higher risk. Young people are viewed to be harder to trace and less likely to have a fixed home. MFIs also often feel that youth need more training and experience.

With these problems in mind, LMDF has noticed that relatively few of its projects have a youth focus. Within its portfolio, just 5 of the MFIs report on the proportion of young people reached. Within these projects, an average of just over a quarter of the financing goes to support young micro-entrepreneurs.

Tugende stands in marked contrast to this. In its portfolio, 54% of its clients are young adults (under 25). This is particularly important in the context of Uganda, where 70% of the population are under 25 and where youth unemployment remains remarkably high.

One sector of the population which really struggles are young men who have not completed their schooling. There are few employment opportunities open to them and driving boda bodas (motor taxis) is one of their best sources of income. However, the majority of these boda boda drivers cannot afford to buy a motorbike. Instead they have to rent, this leaves them in an economically perilous position, with a landlord who can take away their livelihood at any time. The costs of fuel and rent barely leave such young men with any savings or any funds which enable them to think beyond a day at a time.

Providing a boda boda loan helps young people to buy their own motorcycle instead. This leaves them less dependent on their landlord and gives them the chance to begin to put aside money for other uses. Having provided drivers with loans, Tugende calculates that the first 18 months of business will be slightly more expensive for micro-entrepreneurs (expenses up to USD 16 per month), but after the loan finishes and the driver owns his own bike, they may find their income being up to USD 100 higher per month. Given this, Tugende has noticed its micro-entrepreneurs beginning to invest in housing, education and livestock.

Of course, such a model is not without its complications, but Tugende takes various measures to support its drivers. Everyone is required to have a driving license and insurance is mandatory, helping to resolve issues in case of an accident.

Reducing inequalities with microfinance

Of the world's 36 poorest countries (Low HDI Rank), all bar five are in Africa. While the number of poor across the globe has declined steadily over the past few decades, in Sub-Saharan Africa, the numbers have continued to rise. By 2030, it has been estimated that 9 out of 10 of those living in extreme poverty will be on the continent.[1]

To break the cycle of poverty, more investment is needed into the continent and more opportunities need to be provided to marginalised populations living there. It is estimated that 122 million[2] new jobs will be needed in the continent by 2022 to cater for the growing population. Given that small businesses and entrepreneurship are the mainstay of many African countries, measures to support them are fundamental.

while other MIVs in general invest 8% of their assets in Sub-Saharan Africa, LMDF has 24% of its assets there.

For this reason, LMDF has always placed a considerable focus on investment in Africa. Since its launch, it has worked with 13 countries in the continent and supported over 80,000 micro-entrepreneurs there. This differentiates LMDF for other funds: whereas the 2019 Symbiotics survey found that 8% of MIV portfolios were in general invested in Sub-Saharan Africa, LMDF has 24% of its portfolio in Sub-Saharan Africa.

Having such a focus is not always easy, we have already noted that the SPI4 score among LMDF's partners in Africa lags those elsewhere. Many of the microfinance institutions in Africa are at an early stage or have remained relatively informal; regulation of the industry also shows considerable discrepancies from country to country but is very basic in some areas.

Yet we have also noticed that some of the most innovative business models for MFIs also originate from Africa. The Fund recently invested in M-Kopa, a Kenyan solar panel leasing company, which relies on mobile repayments, and which is helping to bring light to off the grid households. As mobile penetration rises, and concepts get tested, LMDF expects to see more innovative models arising from a continent in much need of investment.

[1] World Bank Blogs

[2] African Exponent

EIB impact study

One of the key aims of microfinance is to bring opportunities to communities who would not otherwise have had access to financing. By doing so, the aim is to give them the chance to improve their livelihoods and have the same life chances as others living in their country.

One of the best ways to illustrate the success of such initiatives is to look at impact studies, such as the one conducted by the EIB, an investor in the Fund since 2016, on PAMF Ivory Coast.

The deep dive impact study provided the Fund with a very useful insight into the impact microfinance has, but also provided valuable lessons on the support and focus which LMDF should have in the future.

The Fund can be pleased with the impact this partnership has had on financial inclusion and the levels of satisfaction among clients. However, it also needs to think about the best ways to support clients in scaling up and accumulating assets.

Impact Study

Company overview

Première Agence de Microfinance (PAMF-CI) provides financial services to more than 17,000 micro-entrepreneurs and small-scale farmers in northern and central Ivory Coast who are excluded from commercial banking services. PAMF Côte d'Ivoire (PAMF-CI) was created in 2008 and has received funding under LMDF.

The Study

The uneven penetration of financial services across the Ivory Coast has left large segments of the population unserved or underserved. The Consultative Group to Assist the Poor (CGAP) estimates that 44% of adults in the country have never used formal or informal financial services, with these numbers being substantially higher among rural populations, women and vulnerable groups.

Traditionally, microfinance institutions in the Ivory Coast have focused on urban areas. PAMF-CI, however, has built up significant market share in more remote areas in the rural north of the country, with a focus on cereal farmers. PAMF-CI was interested in understanding whether and how existing clients had benefitted from borrowing, in order to help the company continue optimising its services, particularly in order to reach and support underserved market segments.
To address these questions, two Research Fellows under the EIB-GDN Programme investigated the impact of PAMF-CI lending by:

- Collecting and analysing primary data through a phone survey of 303 solidarity group borrowers of PAMF-CI in the regions of Bouaké and Boundiali.
- Using statistical techniques to compare the outcomes of PAMF-CI borrowers who had accessed a number of repeat loans ("senior" clients) with those clients who had recently started borrowing from PAMF-CI ("new" clients).
- Triangulating findings through key informant interviews with PAMF-CI, managers, credit agents, risk managers and solidarity group coordinators.

The research was conducted over a six-month period from January to July 2018.

Findings

- **PAMF-CI is contributing to financial inclusion in some of the poorest areas of the Ivory Coast.** More than 94% of their clients had been financially excluded prior to gaining access to PAMF solidarity-group loan.
- **Clients are highly satisfied with PAMF-CI products and services.**
- **PAMF-CI loans are mainly invested in business activities**, and the study found robust evidence that successive borrowing had positive impacts on the economic and financial performance of micro-enterprises. Customers also perceive positive impacts on their economic well-being.

There is need to do more to catalyse even greater impact for clients // LMDF

- However, **no evidence could be found of an impact on longer-term fixed asset accumulation.**
- **PAMF-CI is successfully addressing financial exclusion among women**, who make up over half of the client sample. However, the impact of PAMF-CI lending on business outcomes is less pronounced for women entrepreneurs.

Going Forward

The study provided PAMF-CI with insights into their clients, and LMDF with insights into the impact of the supported intermediaries on the ground. Both were encouraged to see evidence of positive impact and that they are successfully targeting the underserved groups that they aim to support.

LMDF and PAMF-CI management acknowledged the need to do more to catalyse even greater impact for clients. **LMDF and PAMF are looking at ways to further empower women and boost their capacity to benefit from borrowing. Increasing the loan sizes available to successful repeat client groups could be another option to increase impact while keeping risk low.** Larger loans could make larger investments in productive assets possible, allowing the clients to scale up from pure investments in working capital. In addition, some of the clients may be ready to move on to loans aimed at Small and Medium Enterprises (SMEs). PAMF-CI recently launched this product line. SME loans provide slightly larger amounts and allow eligible clients to move away from the group lending modality.

Note: We would like to thank Gloria Uwingabiye and Guylaine Nouwoue for carrying out this research, under a partnership with the Global Development Network. More information about the EIB-GDN programme can be found here: https://www.eib.org/en/publications-research/economics/impact/eib-gdn/index.htm

The importance of partnerships

LMDF is reliant on long-term support from its many partners, and LMDF's partner MFIs also need long-term support from financial institutions.

Partnerships both in Luxembourg and with MFIs are fundamental to LMDF's model.

Partnership with ADA
At the heart of LMDF's partnership network, is the partnership with ADA. Over the past 10 years the organisations have worked together to:

- **Disburse over 170 loans to MFIs**
- **Work in over 37 countries with considerable need for improved financial systems**
- **Directly reach over 296,000 micro-entrepreneurs**

The partnership also allows MFIs to receive support which goes beyond the financing which LMDF provides. **This year alone, 56% of LMDF's partner MFIs have received technical assistance and training.** This training is chosen according to the needs of the institution.

Luxembourg Partners
The Billions to Trillions campaign explains: "***there is no single entity with either the cash or the capacity to invest or deploy the requisite capital to achieve one, let alone all, of the Global Goals.***"[1]

Only through bringing so many parties together has LMDF been able to contribute to the achievements previously listed.

LMDF has been able to mobilise funding from multiple sources, noting that these multiple sources may have different requirements and ambitions for their funding. For this reason, it has developed a share structure which reflects the different needs of investors (see Table 3.3).

Through its partnership with ADA, LMDF has disbursed over 170 loans in 37 countries reaching over 296,000 micro-entrepreneurs.

Graph 3.4 demonstrates the success of the model. From the government providing nearly a third of funding at launch, government and philanthropic financing (in the form of Class A and A_{bis} shares) now stands at just over 10% of funds.

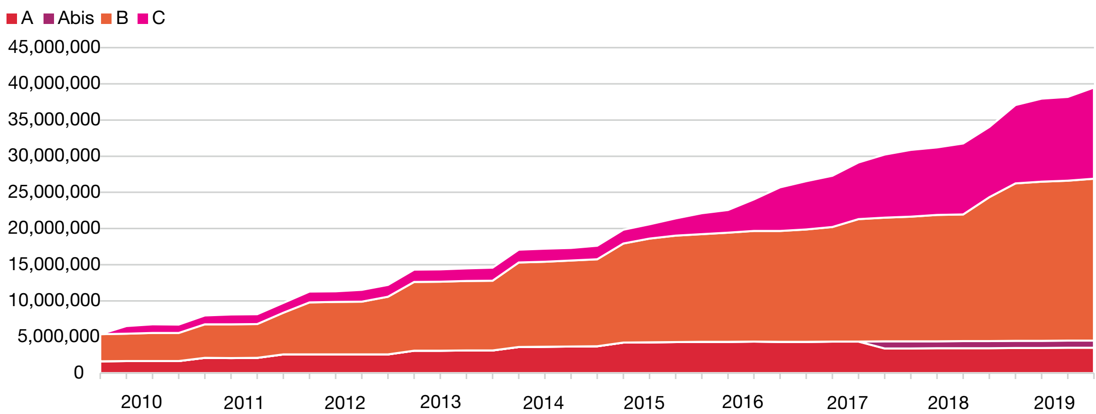
Meanwhile funds from the private sector and retail investors have grown considerably.

Overall this structure has allowed the following sums to be provided by various groups, to be invested in developing countries:

- Public and philanthropic investors – EUR 6.4m
- Institutional investors – EUR 20.8m
- Individual investors and foundations – EUR 14.7m

[1] From Billions to Trillions

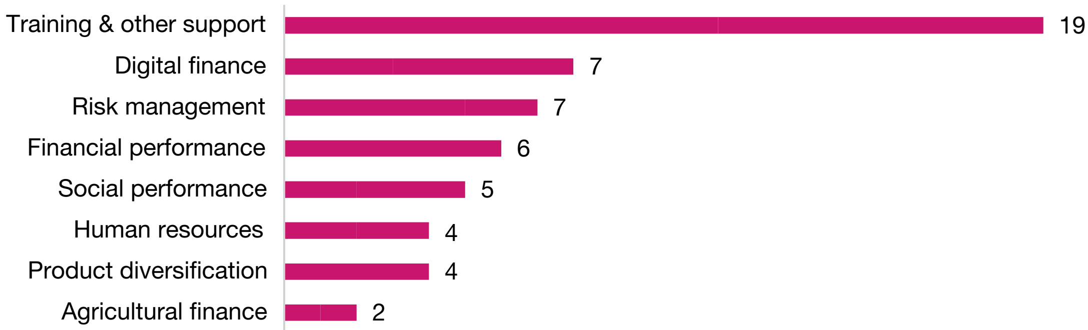
GRAPH 3.4
EVOLUTION OF SHARE TYPES IN RELATION TO NAV SINCE INCEPTION OF THE FUND



Source: LMDF analysis

Staff at an office of the MFI SIPEM // Madagascar

GRAPH 3.5
NUMBER OF LMDF INSTITUTIONS RECEIVING TECHNICAL ASSISTANCE, BY TYPE AND THEME, FROM ADA



Source: ADA asbl, data 2019-2020.

TABLE 3.3:
LMDF'S SHARE STRUCTURE

Shareclass	Description
A and A_{bis}	Primarily for public and philanthropic investors. Prioritises social impact by providing first loss capital – enabling those who would not otherwise be able to withstand the risk of frontier markets to enter the Fund.
B	Designed for institutional investors who aim to blend social and financial performance and are prepared to bear full microfinance risk.
C	Designed for individual investors and foundations. These groups would not typically be able to invest in the regions where LMDF operates but can do so as a result of the risk mitigation offered by Class A and A_{bis} shareholders.

Source: LMDF analysis

The Impact of Partnerships
When LMDF invests, it is always trying to see whether it is investing in such a way as to maximise impact. We have seen how LMDF measures the quality of the institution and its outreach, however, another dimension of the impact is whether the MFI would otherwise have access to financing.

LMDF analyses whether its investment can be a cornerstone, encouraging further investors to follow.

It analyses whether its investment can be a cornerstone, encouraging further investors to follow. For this reason, it considers whether it is among the first investors in each MFI, see Table 3.4.

Notably within Africa, LMDF is one of the first international investors – and in several cases, it is also among the first three lenders with which an MFI has worked. Taking this role is very significant. The first few loans often act as a catalyst for other lenders, both local and international, to provide further financing and spur on a new growth stage.

To monitor whether this strategy is successful, the Fund monitors the pace of growth of the portfolio and the growth in the number of clients. It is notable that growth rates are quite volatile. In general, there has been a slowing growth trend as markets have become increasingly competitive. Nonetheless, LMDF is still pleased to note the 9% increase in clients accessed last year and the 10% growth in portfolio disbursed.

TABLE 3.4:
PROPORTION OF MFIS FOR WHICH LMDF IS AMONG THE FIRST LENDERS OR INTERNATIONAL LENDERS

Region	LMDF among first 3 lenders	LMDF among first 3 intern. lenders
Africa	40%	73%
South-East Asia	0%	50%
South America	0%	46%
Central Asia	38%	38%
Central America and Mexico	0%	20%
Overall	**16%**	**45%**

Source: LMDF analysis March 2020

TABLE 3.5:
AVERAGE ANNUAL GROWTH OF LMDF'S PORTFOLIO MFIS

Year	Portfolio Growth	Growth in client numbers
2011/12	44%	29%
2012/13	24%	36%
2013/14	5%	6%
2014/15	47%	15%
2015/16	13%	10%
2016/17	16%	11%
2017/18	2%	11%
2018/19	13%	9%
2019/20	10%	9%
Avg. since incept.	**19%**	**15%**

Source: LMDF analysis March 2020

Norandino has supported over 26,880 clients in rural Peru // Peru

Chapter 4: The Impact of COVID

How has COVID affected LMDF's clients?

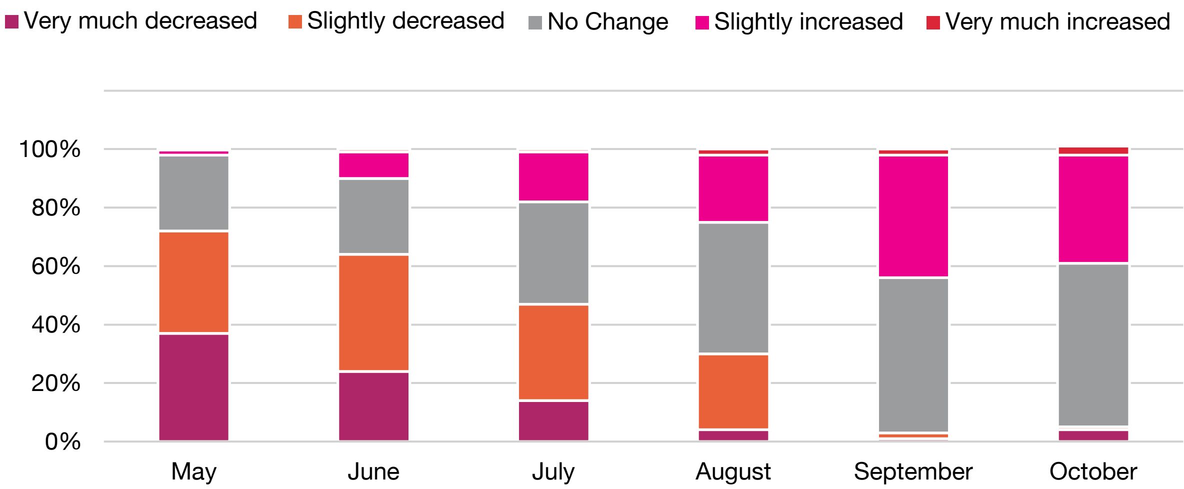
At the start of the pandemic, the world went into information overdrive. Everywhere you looked, information was being published about the effects of COVID. This information showed considerable variance, predicting everything from a storm in a teacup to the end of the world as we knew it. Information for the markets in which we operated was similarly confusing. In this context, the best step is to take time to listen to clients and understand what is really happening to them.

To complete such research, we have been heavily reliant on data provided by 60 Decibels, which has collated interviews from over 23,000 people, the majority of whom live in poverty, in the regions where we operate.

The first thing to note is the level of anxiety which COVID has prompted, with over 79% of those interviewed being very concerned and 18% being slightly concerned, with similar levels being registered even in remote rural areas. These numbers have now subsided considerably and confidence seems to be returning with 66% of those interviewed no longer being concerned about COVID at a later stage. COVID related concerns are varied, but we note that, as the crisis becomes less pronounced in a region, concerns move from the immediate question of health, to the question of income.

It is little surprise that this becomes an area of focus. For months on end, incomes were dropping, and although this trend is now reversing, 72% of interviewees viewed their financial situation as worse than it was before the pandemic, with only 7% reporting financial improvements. However, tides now seem to be starting to turn: 40% of interviewees report income improvements in the most recent month. Meanwhile over a third of households have seen increases in expenses –

GRAPH 4.1:
CHANGE IN HOUSEHOLD INCOME, MONTH ON MONTH



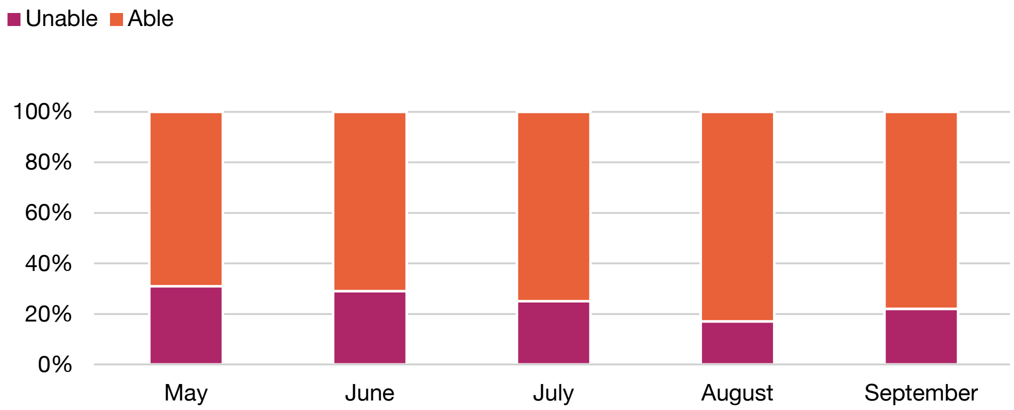
Source: 60 Decibels. 2020 data.

with notable price rises in commodities and food, particularly in West Africa.

Given this situation, we may expect increasing pressure on microfinance institutions. Clients are likely to struggle to repay when incomes are falling, and expenses are rising. What has been surprising is that clients do appear to prioritise repayments, and this is increasingly the case as the pressures and concerns become less acute. Nonetheless, this data aggregates payments for energy, financial services and agriculture, and energy repayments appear to be particularly high priority, perhaps given the context of lockdowns, with people forced to spend longer at home. Such high repayment rates do raise some ethical quandaries, and although 56% of those interviewed do not view repayments as a problem, 33% view them to be somewhat of a burden and 11% view them to be a heavy burden. With this in mind, the Fund works with institutions which prioritise good social practices and are mindful of these concerns.

Given falling incomes, and potentially rising expenses, it is also important to think what coping mechanisms are being used. Clearly having recourse to savings has been the preferred option, with the majority of those interviewed needing to dip into savings over the course of the pandemic. Borrowing money has also been required for around a third of those interviewed. Those borrowing money, however, have generally preferred to do so from family and friends. Even money lenders have been used rather than MFIs, which prompts the question of how MFIs can best tailor their offering and support clients in this new context.

GRAPH 4.2:
PROPORTION OF HOUSEHOLDS ABLE TO MAKE SCHEDULED REPAYMENTS

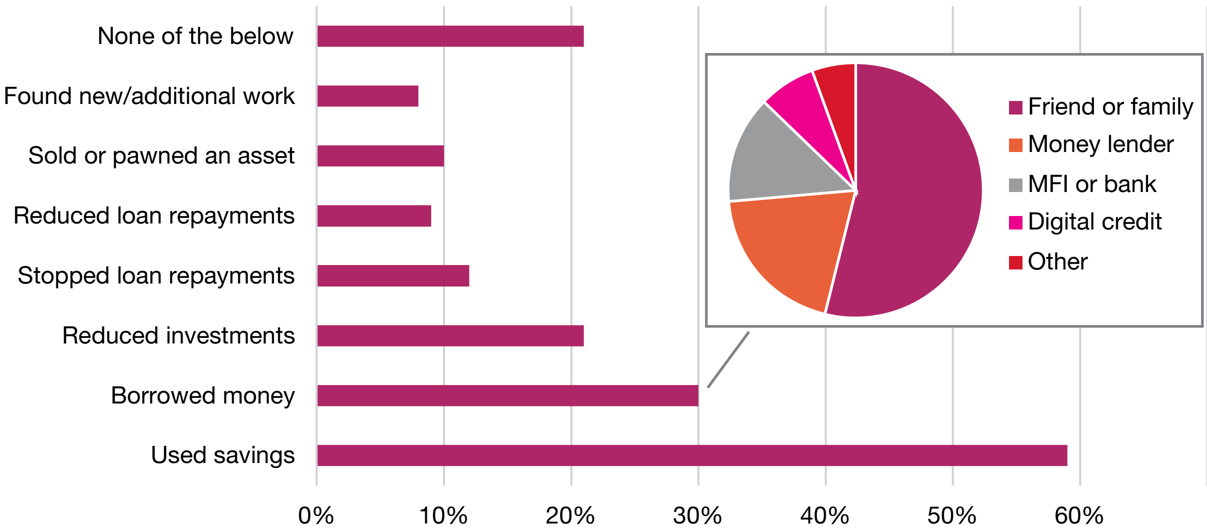


Source: 60 Decibels. 2020 data.

What has been surprising is that clients do appear to prioritise repayments // LMDF

GRAPH 4.3:
FINANCIAL COPING MECHANISMS

As a way to cope with the COVID 19 situation, have you or anyone in your household had to do any of the following that you wouldn't normally do, since the pandemic began?



Source: 60 Decibels. 2020 data.

Just as in Óptima, all our partner MFIs have adopted COVID protection measures // El Salvador

CASE STUDY: ÓPTIMA SERVICIOS FINANCIEROS – LISTENING TO CLIENTS' NEEDS

Just as LMDF viewed communications and listening to be a priority, so did Óptima, a partner of LMDF's based in El Salvador, which the Fund has worked since 2013. Ensuring safety of clients and workers was, of course, the first step, but once sanitation measures were launched. Óptima began conducting weekly calls with all its clients. It also decided to launch online surveys in order to analyse its clients' needs better and to deliver appropriate solutions.

Óptima's clients predominantly work in services and trade. El Salvador faced a very harsh lockdown which lasted many months. As a consequence, over 80% of their clients reported reductions in income of over 50%, with only 4% managing to maintain their pre-COVID income. Despite these harsh findings, clients were optimistic about how long it would take to recover their incomes, with over 80% expecting their incomes to recover within 3 months. This was good news as the government of El Salvador had been recommending 3-month extensions for businesses which were struggling.

Another interesting finding was that approximately 89% of clients have only one income stream and that 11% are looking for another stream or to shift their current business activities. Clients appear to be waiting before taking on new ventures, rather than increasing their risks at this challenging time.

Óptima has used this data to develop appropriate solutions for its clients in this difficult time. One notable development is the pushing of the mobile app, partly for financial logistics, but which also includes videos on how to handle the crisis.

How have MFIs responded to COVID?

ADA, Inpulse and the Grameen Crédit Agricole Foundation have joined forces to hear from their MFI partners and to better understand the impact of the COVID-19 crisis from the perspective of financial service providers. Given the partnership between ADA and LMDF, ADA has kindly shared the data for LMDF's MFIs. The survey in this report dates from 18-27 May 2020 and gathered the views of 18 LMDF's MFIs from around the world.

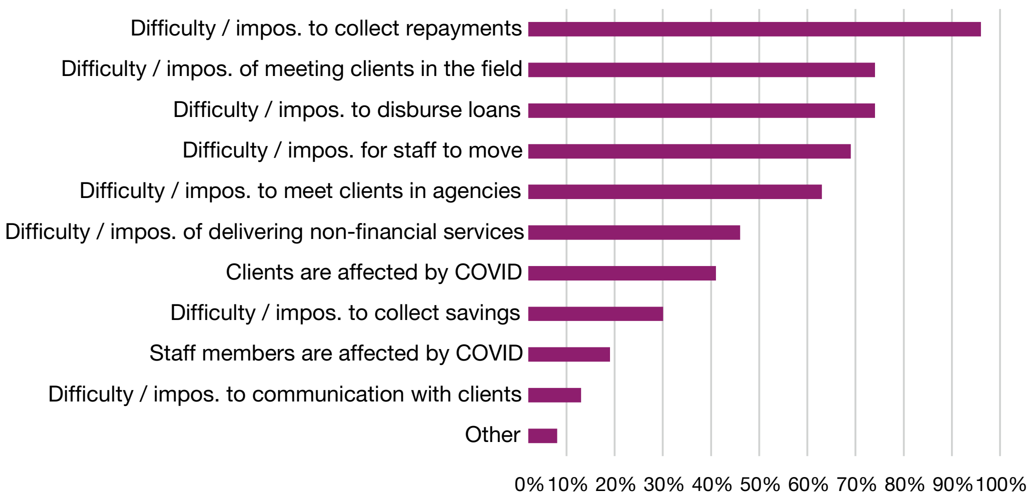
MFIs smoothly managed to adapt their business model to the crisis thanks to the increasing use of new technologies to communicate with their clients.

The results of this first round show that while the crisis is affecting different regions of the world in different ways, certain difficulties are being encountered by the majority of MFIs, such as the inability to manage their lending activity as usual, leading to an increase in portfolio at risk and a reduction in outstanding portfolio. However, despite the challenges they face, MFIs are adapting, not only at the operational level, but also by thinking about the evolution of their products and services in the future.

First of all, MFIs have acknowledged that business is not continuing as usual. The COVID-19 crisis has required MFIs to adapt their activities and this has reshaped the microfinance sector. The daily operational activities of the MFIs have strongly been impacted by the crisis: 72% of the MFIs cannot go into the field and 61% cannot meet clients in agencies either. These numbers illustrate that most MFIs have been required to adapt their business models, which are typically based on close contact, and often also on group lending.

Moreover, 94% of the MFIs answered that they have difficulties collecting loan repayments and 72% commented on challenges disbursing loans. However, communications were less of an issue, with only 11% responding that they struggle in communicating with their clients, even remotely. Indeed, MFIs managed to adapt their business model to the crisis thanks to the increasing use of new

GRAPH 4.4:
IMPACT OF COVID ON MFIS' ACTIVITIES



Source: ADA, Inpulse and the Grameen Crédit Agricole Foundation. Survey May 2020.

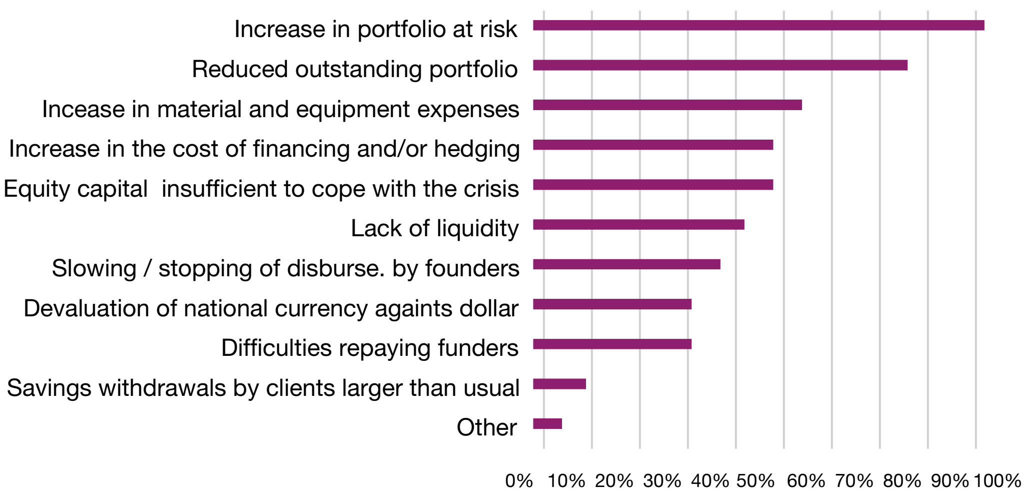
technologies to communicate with their clients.

72% of the MFIs interviewed responded that they communicate more than they used to before the COVID-19 crisis. 56% also answered that there is a greater use of existing digital services with their clients, but only 33% of the participating MFIs relied on new digital solutions to manage products and services with customers. While communication appears easier to organise online, it may take somewhat longer to organise all financial activities online. It is interesting to see that more MFIs have given priority to communication over repayments, but this does demonstrate the focus which institutions have had on truly understanding their clients' needs.

In parallel, the crisis has also impacted MFIs' financial activities. While 94% of the MFIs answered that they encountered an increase in their portfolio at risk, 50% still believe that they have possibly sufficient equity capital to cope with the crisis. 44% of the interviewed MFIs respond that they have a lack of liquidity, but only 33% have difficulties in repaying their funders and only 11% reported that saving withdrawals by their clients are bigger than usual. In term of portfolio quality, only 6% of the MFIs reported that their PAR30 (in %), compared to 31.12.2019, decreased and 72% of the MFIs reported an increase (more or less than doubled). Finally, 73% of the MFIs also responded that they need additional funding in order to respond to the COVID-19 crisis.

With the COVID-19 health crisis, MFIs had to be innovative in responding to this unprecedented situation. In order to overcome their financial difficulties, 72% of MFIs have established a "Business Continuity Plan", 89% have updated their liquidity plan and 83% have even set up a management committee to monitor the crisis. Moreover, 72% also answered that they solicit financial support from their funders/partners. MIVs certainly have an important role to play to support MFIs in delivering adequate solutions for the sector and their clients.

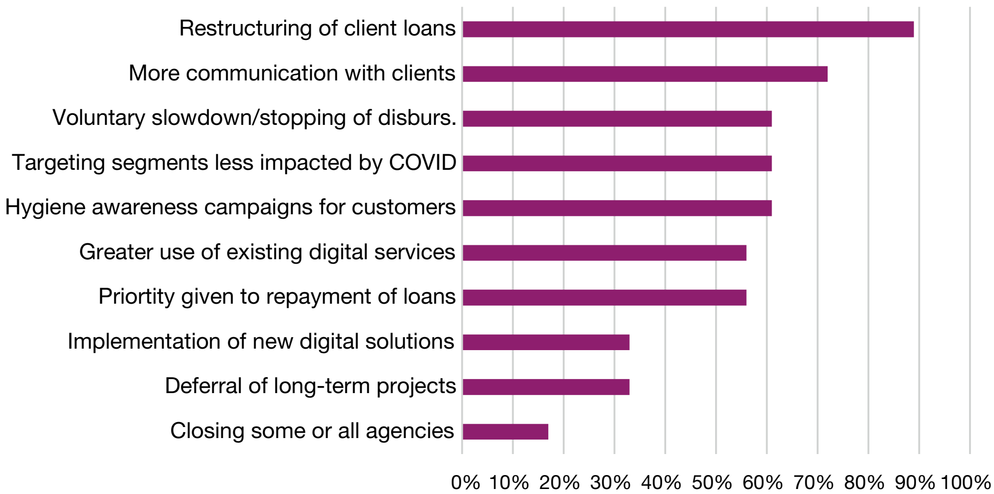
GRAPH 4.5:
MFIS' FINANCIAL SITUATION



Source: ADA, Inpulse and the Grameen Crédit Agricole Foundation. Survey May 2020.

Business models are being adapted in the face of COVID // LMDF

GRAPH 4.6:
MFIS' RESPONSE TO COVID



Source: ADA, Inpulse and the Grameen Crédit Agricole Foundation. Survey May 2020.

The COVID pledge

Key principles to protect microfinance institutions and their clients in the COVID-19 crisis

As the COVID-19 health crisis is in full swing, a group of Microfinance Investment Vehicles (MIVs), including LMDF, and microfinance stakeholders, including ADA, convened in April 2020, on the initiative of the Grameen Crédit Agricole Foundation, to exchange views and draw a common pledge to guide their response to the crisis in a responsible and concerted manner.

By signing a pledge, signatories committed to complying with some key principles to support MFIs during this challenging time. The pooling of available information, analyses and expectations, followed by the concerted implementation of shared decisions proved to be vital to support the industry. Through alignment with key principles, the signatories aimed to overcome the effects of the exceptional health and economic crisis, which has the potential to have such a profound effect on so many MFIs, leaving fragile populations in desperate situations.

Full details of the Pledge can be found on: https://www.lmdf.lu/en/covid/united-against-covid-19/

COVID and innovation

Challenging times prompt reflection. In every business, you can now find an impromptu think-tank. People are questioning their methods and whether they are sustainable in this new paradigm. Whatever the stage of the pandemic, it is clear that when the lockdown ends, the world will have changed, and the old methods of work may no longer be so applicable.

The fundamental questions of how to maintain the relationships, which are so core to microfinance, in a time of social distancing and lockdown, are key.

Even in the midst of the crisis, there are important questions to be asked: How can business be sustained during a lockdown period? Topics such as business continuity and staff safety are common to all businesses. However, microfinance models have an additional complication: human contact and personal relationships have been at the heart of microfinance models. Often trust is built via one on one relationships between loan officers and clients, or through group solidarity. There may have been some evolution, as tech and touch models gain ground, but the fundamental questions of how to maintain the relationships which are so core to microfinance, in a time of social distancing and lockdown, are key.

At the same time, models being used by micro-entrepreneurs are also evolving. Working from home may become the new normal for many people around the world, but this is somewhat harder if your livelihood depends on trading animals in a bazaar, or on selling your produce in a local market. Meanwhile, having children at home, potentially for prolonged periods, may lead to innovation from families, trying to keep trade going at this difficult time.

Coming out of the crisis, new questions emerge, notably for investors. There are certain standards which we have all adopted, notably onsite due diligence. Meanwhile, the institutions we work with are expected to have visited their clients and their place of business. It is not clear how this might change, but certainly both funds and MFIs need to question their practices to see what will and will not work in this new context.

The way in which social performance is monitored and analysed may develop, but the core focus on supporting the poor and marginalised in this challenging time will not change.

Nonetheless, the new practices which have developed as a result of the COVID crisis are likely to serve MFIs well in the future. And in the future, microfinance will have a very significant role to play, in rebuilding economies that have suffered such turmoil as a result of COVID. As these new models and innovations take place, the way in which social performance is monitored and analysed may develop, but the core focus on supporting the poor and marginalised in this challenging time will not change.

How MFIs use technology within their operations

BURKINA FASO- DIGITAL WALLETS ARE TAKING OFF

Digitilisation was a slow inevitability in Burkina Faso, where 71% of the population has access to digital money and 43% has digital wallets. However, the crisis has speeded up its adoption by MFIs, which are now hurrying to seek the right software to integrate these tools.

CENTRAL ASIA - OLD TECHNOLOGY REPURPOSED FOR NEW MEANS

Central Asian MFIs have previously not proven to be among the most technologically innovative. Lockdowns have required new methods of communication and many MFIs now find themselves completing the entire loan process via WhatsApp.

KENYA - FROM GROUP TO INDIVIDUAL METHODOLOGY VIA TECHNOLOGY

The group loan model is prevalent across much of Africa, but as restrictions on social gatherings were implemented, meetings became impossible to hold. In Kenya, mobile penetration is high and people are used to using M-Pesa, allowing business to continue, with a relatively smooth transition to new models.

CAMBODIA/MYANMAR - CLEAR COMMUNICATIONS ARE KEY

A key message that has come out from the crisis is the importance of clear communications. All to often, guidance was muddled and not reaching those in need too. Microfinance associations have taken a key role in ensuring clear and correct messages are published and MFIs are passing these onto their end clients.

EL SALVADOR - DATA DRIVEN CLIENT RESPONSE

Learning about client needs became more difficult when lockdowns hit. El Salvador has been known for technological innovation and MFIs quickly implemented online surveys to examine client needs. Based on this, new products and materials can be developed, including online training and refining existing apps.

Chapter 5: The Future of Microfinance

Microfinance's evolution...from credit to comprehensive solutions

The modern microfinance industry started with Muhammad Yunus back in 1976. He offered small credits to women in Bangladesh whose income was insufficient to qualify for banking services. The model that he adopted in Bangladesh quickly spread globally and has been the predominant focus of microfinance investment vehicles. When LMDF was founded in 2009, it was just such an approach that was the key focus of its investments.

70% of firms in LMDF's portfolio offer services beyond basic lending.

Since 2009, there has been a considerable development in the industry. It is increasingly apparent to all actors that services beyond credit are needed to permit full financial inclusion and even credit services need to be adapted to catalyse greater impact. For this reason, an increasing number of firms offer financial services beyond basic lending: to date 70% of firms in LMDF's portfolio offer such services. These include insurance, savings and payment services- among others.

Microfinance is one component of the solution for alleviating poverty and improving living standards; these other services, together with education and training, are fundamental in supporting the Fund's aims. These are, by no means, new models, but their importance is becoming increasingly understood within the development community.

Among the most common additional services we see are:

Microinsurance
Microinsurance offers a complimentary service to microcredit. In the case of an adverse event, notably deaths in the family, but also, increasingly, natural disasters, the loan is paid back for the micro-entrepreneur via the insurance facility. This ensures that micro-entrepreneurs are not having to service loans at these most challenging times. Additional life insurance can also help to provide the family with further funds in the case of the loss of their breadwinner.

Savings
Providing micro-entrepreneurs with savings facilities helps with asset accumulation and also provides a degree of financial insulation in case of adverse events. Savings can also be used to accumulate money to fund a particular need, notably children's education.

Payment services
In the remote areas where many of the micro-entrepreneurs live, it can be complex and expensive to make transfers, requiring visits to local towns and incurring considerable charges and expenses. This can make transactions, which are simple here in Luxembourg, such as paying an electricity bill, much more challenging. MFIs which offer transfer and payment services are able to generate additional revenue, by making a small charge for each transaction, while making their micro-entrepreneurs' lives considerably easier.

Yet even the services above are now becoming quite standard. Many microfinance firms have realised that they need to evolve still further to meet their clients needs. They have realised that MFIs need to evolve to better answer clients' needs. In many cases, firms are now also providing services to small and medium size enterprises, as well as micro-entrepreneurs. This evolution may have occurred because clients' businesses have evolved and now require more robust loans; alternatively, they may have chosen to expand into this segment because they have realised it still remains woefully underserved (recent studies found that 51% of Africa's MSMEs lack the finance needed to grow further[1]).

Microfinance firms have realised that they need to evolve still further to meet their clients needs.

Other firms are looking into leasing models. They may have been set up with the express purpose of providing financing to support clients in purchasing one or other type of asset. Alternatively, they may look to upgrade the quality of life of clients by providing certain assets (notably solar panels and environmentally friendly cookers), together with standard loan packages.

Green and digital innovations are also more commonplace and are discussed in the next two articles.

These new models require a different type of analysis to truly understand their social impact. The industry has primarily focused on understanding the outreach, outcomes and impact of microcredits. These new models require a different mindset and a different set of key performance metrics. For a start, the loan size is likely to be different from loans disbursed in microfinance – and looking at loan size relative to GDP may be less relevant. For SME financing, a fundamental metric to understand is job creation, as such firms often lay at the heart of local economies. Meanwhile, leasing models may have a very varied impact, with the impact of receiving a solar panel being very different from the impact of purchasing a vehicle.

Understanding the best way to measure social performance in new models is a project for the LMDF and ADA teams this year and we look forward to reporting on this further in the next social performance report.

[1] African Eye Report

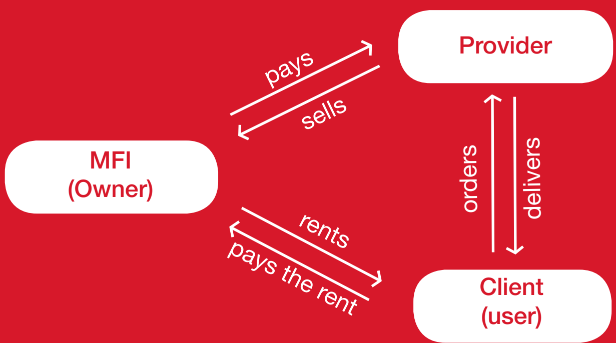
Sofipa in Mexico realised the importance of offering insurance products as well as loans. It works closely with a local insurance company to provide its clients with life insurance and coverage in case disaster strikes.

Sipem in Madagascar has developed from a microfinance institution into a fully-fledged bank and now offers a full range of transfer and payment services, including international transfers. Many of these services are also offered online.

Pilarh has developed a broad range of savings products based on the needs of the clients they serve. They have noted a particular desire for women to use savings to care for children and their education and various products have been developed with this goal in mind.

New models require a different type of analysis to truly understand their social impact // Finamiga, Colombia

LMDF'S LEASING WORKSHOP



With the rise in leasing models, LMDF and ADA were very pleased to receive Patrick Losch, Board member of LMDF and ADA, and an expert in leasing models, for a workshop. He explained leasing models in more depth and what should be a particular focus during due diligence missions.

Leasing models depend on a different model from conventional microfinance, in that there is a third party involved, the supplier of assets. The functioning of the model hinges on the quality of assets provided by the supplier and this needs to receive considerable scrutiny during due diligence. Other areas of particular focus need to be the ability to ethically recover the item in case of the client being unwilling or unable to pay and the extent to which the item maintains value over time.

At present, LMDF is invested in two companies providing loans for motorbikes to be used as motor-taxis. This model is popular with a younger male audience, who are not often reached by microfinance. The Fund also invests in other leasing models, notably those which enable the provision of green energy.

The importance of "tech and touch" models

Back in 2009, as the Fund was launched, smartphone ownership started to take off around Europe. Yet it is not just in Europe that there has been a meteoric rise in phone ownership. The same take-off is now being seen in many of the territories where LMDF works.

This change has considerable implications for financial inclusion. Ownership of mobiles allows for mobile banking and money transfers. Access to smartphones permits internet access and an even greater range of services. Now even these services are increasingly being translated to non-smartphones via USSD services. As more potential consumers are accessible through digital channels, there is an expansion in the services provided to them.

The fintech firms have tended to use their technology to enable fast disbursements at a relatively low operational cost, but there is little human interface and consequent high default rates.

The LMDF team recently went on a field trip to Kenya to investigate this rise. Kenya is one of the most mobile literate economies in Africa. 96 in 100 Kenyans now have a mobile subscription. With this rise in digital access has come a rise in fintech firms. Nairobi is now viewed as the second largest fintech hub in Africa, after Johannesburg, with 20% of African Fintechs being located in the city.

These fintech firms have a wide remit, some focus on transfers and remittances, others on payments, but a lot also focus on offering credit. Nonetheless, meeting with fintech organisations during the visit, the team found that there was a considerable disparity between the way fintech firms in Kenya tended to operate and the way in which more conventional microfinance firms were operating.

The fintech firms have tended to use their technology to enable fast disbursements at a relatively low operational cost, but there is little human interface and consequent high default rates. There is little human interface, with a reliance on algorithms for customer due diligence. These firms may still be requiring large amounts of capital to develop their technology, but the actual cost of loan disbursement remains low. As things stand, this model results in relatively high default rates.

Microfinance firms have a rather more laborious model, requiring a high degree of human interaction, creating relatively high operational costs. This model results in relatively low default rates.

TABLE 5.1:
A COMPARISON OF KEY CHARACTERISTICS IN FINTECH FIRMS AND TRADITIONAL MICROFINANCE MODELS

	Fintech	Traditional MFI
Loan size	Varied - based on client demand	Determined based on client needs
Disbursement speed	Very quick - often less than 5 minutes	Relatively slow - up to 2 days
Customer due dilligence process	Conducted online - limited human contact	High degree of human contact with loan officer
Interest rates	High - Very high	High
Operational costs	Low	High
Default rates	High	Low

Source: LMDF

There is a justified concern that the fintech firms currently entering the market en masse are creating a risk of over-indebtedness and there are also concerns about the ethics of some of the practices they adopt.

The interplay between fintech firms and microfinance firms is clearly going to develop in future and tech and touch models will become more standard.

One notable concern in Kenya is the reporting of clients to the credit bureau after the client has failed to repay relatively small amounts of money, with limited understanding of the reasons behind the lack of repayment. This can seriously hinder this client's chance of receiving financial services again.

Despite these concerns, the interplay between fintech firms and microfinance firms is clearly going to develop in further and tech and touch models will become more standard. Fintech firms may become more discerning in their lending practices, better understanding client needs and bringing their default rates down. Traditional MFIs may employ technology with success to bring down their operating costs, while still maintaining their strong relationships with clients. The client relationship is at the core of microfinance and it will be interesting to see how "tech and touch" models (models using technology but maintaining a high degree of personalisation) evolve.

CASE STUDY: ERIC, BIMAS

When I was young, I used to see my mother with passbooks, which she used for keeping records. I asked her what they were, and she explained that she was a member of Bimas. My mum used to take loans from Bimas, partly to help fund my education and my school fees. She is still a client with Bimas today.

If it hadn't been for Bimas' loans, I doubt I would have had the same educational opportunities. But actually, I personally, have got much more from Bimas too. When I was in high school, I asked for an internship from my mother's loan officer and I had the chance to intern with the Meru office. From there, I started from the lowest ranks in 2011, and now I am Regional Manager.

How MFIs are already using technology within their operations

DATA COLLECTION

MFIs are equipping their loan officers with apps with which to complete their customer due diligence. This reduces the administrative burden and allows data which is collected to be sent for approval very speedily.

LOAN DISBURSEMENT AND REPAYMENT

Mobile money is increasingly being used for loan disbursements and client repayments. This considerably lowers the logistical burden for clients and loan officers, and also helps with security concerns.

PROVIDING ADVICE

As mobile phone ownership increases, MFIs are increasingly providing bespoke advice to their clients via SMS. This may include advice as to when to plant crops or when rains are likely to come.

ADDITIONAL FINANCIAL SERVICES

Additional services are being developed on both smart phones and non-smart phones, such as transfers and facilities to check savings balances.

Supporting micro-entrepreneurs confronted with climate change will increasingly be a priority for MFIs and MIVs // LMDF

Focus on climate change

Even before the COVID pandemic started, the end of 2019 and the beginning of 2020 have not been easy times. MFIs have been affected by numerous climate related issues:

- Irregular rains
  Rain has come much earlier than anticipated across Kenya, challenging the normal harvesting cycle.

- Flooding
  Southern Benin is a wetland filled with lakes, but unprecedented rains brought water levels even higher leading to logistical problems for many small businesses.

- Drought
  South Africa has seen disruption to its normal weather cycles, with several areas not seeing a drop of rain for several years.

- Hurricanes
  Although the hurricane season did not hit our portfolio MFIs as heavily as it has in many previous years, tropical storms still regularly batter Central America, leaving trails of destruction behind them and destroying livelihoods.

The vulnerability to climate change of LMDF's portfolio has already been detailed, as has the potential of MFIs to contribute to both climate mitigation and adaptation efforts. Given that the challenges described above are only likely to become more serious in the coming years, LMDF will increasingly focus on the measures it can take to support MFIs and micro-entrepreneurs with the challenges they face because of climate change.

LMDF is consequently taking the following actions:

- Environmental analysis at the country level
  The Fund is incorporating environmental data into each of its country notes so that it can better understand the risks the country faces as a result of climate change and core environmental challenges the country faces.

- Supporting MFIs in understanding their risks
  Each MFI will be encouraged to provide data for the Green section of the ALINUS. Based on this, LMDF will better understand the environmental risk profile of the MFIs, and ADA may be able to offer appropriate risk management training to help manage increasing environmental hazards.

- Financing initiatives to help farmers with adaptation
  In the context of climate change, farmers are often among the most vulnerable groups. LMDF is looking at MFIs which are adopting innovative methods to help farmers to adapt to changing conditions, including providing high quality inputs, which are more resistant to climate events, advice and warnings to farmers, and providing support with access to markets so that farmers can benefit from opportunities further up the value chain.

Concluding thoughts from Kaspar Wansleben, CEO

Reflections on 10 years of LMDF and the coming decade

What is your perception of the impact of the Fund over the last 10 years?
LMDF was really the first fund with a dedicated mission to serve smaller and emerging institutions. This had led to impressive results in terms of clients reached and portfolio growth, i.e. 20% to 30% per annum. More precisely, over the last 10 years, LMDF has essentially had two missions:

1. To expand financing to small and emerging institutions with a strong social focus to allow them to grow and reach more clients.
2. To involve the Luxembourg's private sector and private investors and to construct a viable investment environment. The Fund aimed to be attractive to both institutional and individual investors.

During the past decade, the Fund has worked hard to formalise its social performance processes and to measure the impact of its microloans.

The growth in the Fund and the continued support of our investors is testament to achieving these aims. However, things have been different over more recent years. Indeed, in some countries, the microfinance sector has reached a certain degree of maturity, i.e. growth rates have shrunk as fewer clients remain unreached. In this context, LMDF reinforced its focus on small MFIs financing local niche markets, as we believe this is a legitimate impact case. The Fund has also realised that the microfinance model has reached certain limitations and now is looking at less standard business models, such as asset financing.

What changes do you see going forward?
We are currently going through a moment of profound disruption and I am not entirely sure what the future of the sector will bring. However, I can confidently assert that the next 10 years will not be a simple continuation of the last 10 years.

The growth in the Fund and the continued support of our investors is testament to achieving these aims.

Digitalisation is particularly bringing important changes to the microfinance sector. We recently did a field study in Kenya, in order to understand how digital finance interacted with microfinance, and, unsurprisingly, we found that finance is not automatically good if it is digital. The human touch and adaptation to needs of individual clients is still at the heart of microfinance and transferring it to digital models is challenging. Yet digital solutions bring numerous advantages too. The ability to transfer money will facilitate the work of loan officers and micro-entrepreneurs, limiting travel costs and time. Digital channels are certainly accelerating the transformation of the microfinance sector, and this requires all stakeholders.

For microfinance, the next 10 years will not be a simple continuation of the last 10 years // LMDF

From our perspective, this means that we need to acquire a broader range of skills and competences to address the different emerging sub-sectors in the microfinance sector. This is necessary in order to fulfill our mission and to keep our role of being a bridge between investors and MFIs located overseas.

We need to look for opportunities and increase our outreach, but also to really understand the best ways to interact in the value chain.

How will the Fund adapt to emerging trends in microfinance?

For the next 10 years, we need to be ready to look at a greater diversity of approaches, models and types of MFI, as this is likely to become much broader in the future. Based on this, we are going to determine which kind of emerging models are really interesting, taking into account both the needs of our end clients and our investors (well-functioning business models).

Finally, we aim to increase our focus on agricultural finance. This is a crucial sector, and especially so given the COVID-19 health crisis. We need to look for opportunities and increase our outreach, but also,to really understand the best ways to interact in the value chain, which is an area that has not received sufficient focus from the industry.

LMDF aims to increase its focus on agricultural finance as this is a crucial sector // LMDF

Subscriptions for shares issued by the Fund may only be accepted on the basis of the current prospectus accompanied by the latest annual report and the latest semi-annual report, if more recent. Such documents can be obtained free of charge at the registered office of the Fund or downloaded from the website www.lmdf.lu.

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