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MIBANCO, PERU: PROFITABLE MICROFINANCE OUTREACH, WITH LESSONS FOR ASIA

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with assistance from

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Contents

ABBREVIATIONS

ACP	–	Acción Comunitaria del Perú
ASA	–	Association for Social Advancement
BRAC	–	Bangladesh Rural Advancement Committee
BRI	–	Bank Rakyat Indonesia
COFIDE	–	Corporación Financiera de Desarrollo
EDPYME	–	small business and microenterprise development institutions
GNP	–	gross national product
IFC	–	International Finance Corporation
MFI	–	microfinance institution
NGO	–	nongovernment organization
PAR	–	portfolio at risk
ROA	–	return on assets
ROE	–	return on equity

NOTE: In this report, "$" refers to US dollars.

FOREWORD

Microfinance is widely recognized as an important tool in poverty reduction. With this recognition, emphasis on the development of the microfinance industry has been increasing everywhere, from major funding agencies like the Asian Development Bank to developing countries in the region and elsewhere. The industry has made considerable progress during the last decade. The landscape of the industry is also changing; regulated financial institutions are making inroads into the industry. Many service providers seem to recognize the business opportunities in the sector and the opportunities to combine business propositions with social missions or social missions with business propositions. The service providers have to find profitable ways of expanding the outreach. That is the only promising way to fill the still wide gap between the demand for financial services of the poor and low-income households and the supply of those services.

Mibanco's story is interesting in this respect. First, it began as a nongovernment organization with a strong social mission. Second, after transforming into a regulated financial institution—a microfinance commercial bank—its outreach expanded rapidly. But the bank maintained its focus on initial target groups—the poor and low-income households and their microenterprises. And it expanded profitably. Third, it operates primarily in urban areas. In Asia, most microfinance institutions (MFIs) have not paid adequate attention to urban microfinance. However, research studies seem to suggest that urbanization of poverty in Asia is increasing. In this context, Asian MFIs may need to pay greater attention to urban microfinance markets than in the past. Mibanco's experience can provide some lessons as well as inspiration, even though it comes from a far away region of Latin America.

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ABSTRACT

This paper presents the case of Mibanco ("my bank"), a leading microfinance commercial bank in Peru that grew out of the nongovernment organization Acción Comunitaria del Perú (ACP). ACP initially had to go through a difficult period because of macroeconomic instability in the country, but with the return of stability grew rapidly in the late 1990s. It was transformed into a commercial bank in May 1998. Mibanco experienced strong growth, expanded its depth and breadth of outreach and scope of services, and thereby enhanced its value to clients during the post-transformation period. Its loyalty to the original mission of serving the poor and low-income households and their microenterprises is reflected partly in the pro-poor housing loan product (Micasa—"my home") it introduced in 2000. Mibanco is also expanding its operations from urban to rural areas. The bank has diversified its sources of funds and increased its reliance on deposits. It also tapped capital markets through a bond issue in 2002. The story of Mibanco provides important lessons for policymakers, practitioners, and funding agencies; it is a story of commercial microfinance with a human face. Microfinance institutions in Asia that focus largely on the rural sector can benefit from its lessons.

I. INTRODUCTION[1]

The fundamental problem, and the most important challenge, in the microfinance industry is how to fill the enormous gap between the effective demand for a wide range of microfinancial services and the supply of such services on a sustainable basis. This is universal. In most countries including those, such as Bangladesh, Bolivia, and Indonesia, where the supply has grown rapidly over the last decade or so, a wide gap continues to exist. This is why microfinance institutions (MFIs), such as Mibanco, that grow rapidly and profitably are important. The industry's promise to narrow the demand-supply gap rests firmly on institutions like Mibanco.

Mibanco ("my bank") grew from the nongoverment organization (NGO) Acción Comunitaria del Perú (ACP), started in January 1969 by a group of business people with assistance from ACCION International.[2] ACP's objective was to create development opportunities for low-income Peruvians. In 1982, ACP began microlending operations in the southern section of metropolitan Lima, with assistance provided by Banco Wiese, one of the largest commercial banks in Peru.[3] This operation grew slowly in the 1980s and until about 1993. Since then it has experienced explosive growth. ACP evolved to be the first commercial bank in Peru, and second in Latin America, with its core business focused on providing financial services to the poor and low-income households and their microenterprises.

The story of Mibanco is fascinating: its growth has been remarkable, and performance exemplary in many respects. In less than 5 years since the transformation, it has joined a still small group of microfinance commercial banks in the global microfinance industry that profitably serve a large number of clients in the low end of the market. Mibanco provides important lessons for MFIs and other stakeholders in Peru and elsewhere. MFI leaders, policymakers, and promoters of sustainable microfinance in Asia in particular can learn important lessons from the Mibanco experience, although admittedly it is a small MFI, compared to such MFIs as the Association for Social Advancement (ASA) and the Bangladesh Rural Advancement Committee (BRAC) in Bangladesh, and Unit Desas of the Bank Rakyat Indonesia.[4]

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1 This paper has benefited from assistance provided by several colleagues. Joji Tokeshi and Edgard Rodriguez helped translate Mibanco's financial statements from Spanish to English. Joji Tokeshi also searched the web site of the Peruvian Superintendency of Banking and Insurance and that of Mibanco to obtain additional data and information. Abuzar Asra and Araceli Patricio helped prepare some statistical tables. Xianbin Yao and Elisabeth Rhyne reviewed the paper and provided useful comments to improve its quality. Inna Arciaga provided secretarial assistance. The paper was edited by Jay Maclean and Chona Murakami. Grant Curtis found funds to print the study in this form. The author gratefully acknowledges their help and support.

2 ACCION International is a nonprofit organization dedicated to poverty reduction through microfinance promotion. ACCION has been supporting a network of microfinance institutions throughout Latin America. It recently started operations in the African region. For details, see www.accion.org.

3 ACP started as a multiservice organization working in such areas of development as health, education, training, and credit. But it soon realized that it had to choose one area and focus on that to have a significant development impact.

4 For example, ASA had 1.976 million active borrowers at the end of 2002, with an outstanding gross loan portfolio of about $159 million. BRAC disbursed $294 million in microloans during 2002. Unit Desas had 27.6 million deposit accounts and 2.65 million loan accounts at the end of 2001.

II. Operations of Acción Comunitaria del Perú

ACP and Its Operations[5]

Like most other NGOs involved in microcredit in the region, ACP focused its operations on urban areas. Its aim was to serve the target group in Lima City and its suburbs. There were fertile grounds for its operations in these areas, with a large population of poor and low-income households, most living in shanty towns but involved in a wide range of microenterprises to earn their living, and without access to reliable financial services at reasonable prices. They were not seen as potential clients by any of the commercial banks in the city at that time. Nor did they have access to subsidized credit provided by government-owned or controlled institutions.

ACP adopted both solidarity and individual lending methodologies to provide its credit services. Technical assistance provided by ACCION International helped ACP build its capacity to grow over time. During the first 3 years its growth was lackluster. However, in 1986, its outreach increased rapidly—by 254%—and in 1987, its loan disbursements peaked at $5.8 million. Then, came the sharp deterioration of macroeconomic conditions in the country, particularly hyperinflation *(Table 1)*, which had a devastating effect on all financial institutions in Peru. ACP had to close two of its four branches in 1988. In 1989, it disbursed only $700,000 to 9,000 clients—far below the level of its 1986 operations. The portfolio quality also started to deteriorate in 1989. The portfolio at risk (PAR) over 30 days reached an alarming level of 9% in 1990 and then increased to a crippling level of 16% in 1991, even though the total numbers of borrowers in 1990 and 1991 were only about 3,000 and 2,200, respectively. Hyperinflation was a major factor that contributed to deterioration of the portfolio quality. However, ACP managed to lower its PAR substantially in 1992.

Table 1
Peru's Annual Inflation Rate
(1982–1992)

Year	Annual Inflation Rate (%)
1982	64
1983	111
1984	110
1985	163
1986	78
1987	86
1988	667
1989	3,399
1990	7,482
1991	410
1992	74

Source: World Bank, World Development Indicators 2002.

ACP entered a rapid growth path in 1994. As shown in *Table 2*, annual loan disbursements increased more than four-fold from $15.3 million in 1994 to $65.5 million in 1997. This was an extremely high level for an NGO in Latin America. ACP's loan portfolio of $2.28 million at the end of 1994 also more than quadrupled by the end of 1996 to $9.67 million. At the end of 1997, it had an active loan portfolio of $12.55 million.

Table 2
ACP Growth Indicators
($ million)

Indicator	1994	1995	1996	1997
Amount of Loans Disbursed[a]	15.33	39.36	58.64	65.47
Active Loan Portfolio[b]	2.28	6.77	9.67	12.55

[a] During each year.
[b] As of end of each year.

Source: www.accion.org.

[5] This section draws extensively, but not exclusively, on Campion et al. (2002).

The portfolio growth stemmed more from the increase in the number of borrowers than from the increase in the average active loan balance. The contribution of the increase in the number of borrowers to the portfolio growth ranged between 75% in 1994 and 93% in 1995, as shown in *Table 3*. This confirms that the growth path was primarily horizontal.

Table 3
ACP: Sources of Growth in Loan Portfolio
(%)

Source and Relative Contribution	1994	1995	1996	1997
Increase in Active Borrowers	75	93	88	78
Increase in Average Active Loan Balance	25	7	12	22
Total Contribution	**100**	**100**	**100**	**100**

Source: Author's computations.

ACP did well in terms of breadth of outreach as well, serving a large number of new clients every year, in addition to its repeat clients. As shown in *Table 4*, the total number of active borrowers increased more than threefold from 9,023 in 1994 to 33,549 at the end of 1997. Because ACP provided only working capital loans, it could focus on this single product and increase the number of clients rapidly.

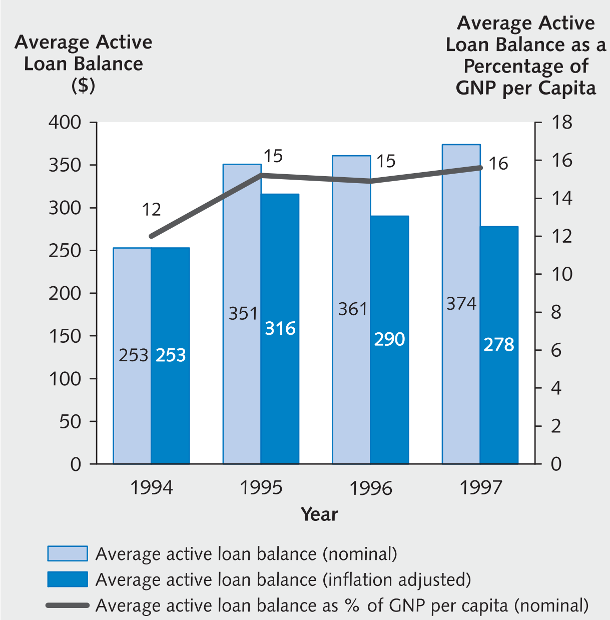
By end-1997, ACP's loans were still relatively small and ACP remained well within the boundaries of its mission to serve low-income households. At the end of 1994, the average active loan balance was only $253, about 12% of the gross national product (GNP) per capita. This increased to $374 by the end of 1997, but was still about 15.6% of the GNP per capita. The inflation-adjusted average active loan balance was only $278 in 1997 *(Figure 1)*. ACP's clients were largely poor people living in shanties in Lima and suburbs. About 61% of the clients were women, who suffered disproportionately from many aspects of poverty.

Table 4
ACP Outreach
(year-end positions)

Year	Number of Active Borrowers	Number of New Borrowers	Percentage of Women Borrowers
1994	9,023	6,566	58
1995	19,254	15,163	57
1996	26,768	17,524	59
1997	33,549	18,253	61

Source: www. accion.org

Figure 1
ACP: Depth of Outreach



Note: For the inflation adjustment, the consumer price index, base year=1994, was used.

Source: Author's computations based on data from www.accion.org.

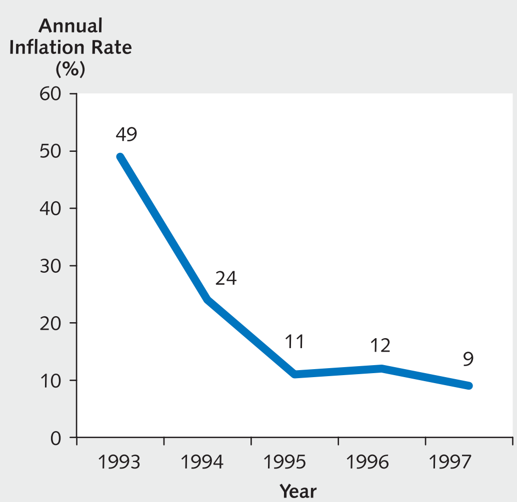
There were at least three remarkable features of ACP's growth during 1994–1997.

- First, this growth was achieved while maintaining a reasonably good level of portfolio quality. PAR over 30 days was consistently below 5% during 1994–1995. Although it rose to about 7.5% in 1996, ACP managed to bring it down to 5% by the end of 1997.
- Second, ACP maintained its focus on the target market, as stated earlier.
- Third, neither its rapid growth nor its focus on the low end of the market deterred it from

being profitable. ACP was one of the most profitable MFIs in the region. In 1995, it generated a massive 83.5% return on equity (ROE). In 1996 and 1997, its ROE was 46.6% and 30.1%, respectively, even higher than those of commercial banks in the country (www.microrate.com). ACP's commercial pricing policy, high loan recovery rates, and high turnover of loans contributed to these high returns.

ACP's overall achievements were facilitated in no small measure by the macroeconomic stability in the mid-1990s *(Figure 2)*, effective technical assistance provided by ACCION International, and, of course, by the high quality and dedication of its staff and management.

Figure 2
Peru's Annual Inflation Rate 1993–1997
(%)



Source: World Bank, World Development Indicators 2002.

Search for a New Institutional Modality

Although ACP grew rapidly, it needed access to more funds to sustain its rapid growth. Being an NGO, ACP did not have access to certain sources of funds, such as from Corporación Financiera de Desarrollo (COFIDE), a second-tier, state-owned financial institution. The ability to leverage funds in the debt market was also limited. Nor could it access capital markets or mobilize public deposits legally. ACP wanted to remove these hurdles. For this, ACP first examined the feasibility of transforming itself to a *financiera,* a regulated finance company for which only $3.0 million was required as minimum capital. Then, when the Peruvian Banking Superintendency created a new law in 1994 to encourage transformation of NGOs into regulated financial institutions known as small business and microenterprise development institutions (EDPYME), ACP studied the feasibility of transforming to an EDPYME. ACP's formal proposal on establishing an EDPYME was approved by the Banking Superintendency in October 1996.[6]

In the meantime, Peruvian President Fujimori, in a public address in July 1996, challenged the Peruvian formal banks to establish a bank dedicated to serve micro-entrepreneurs. Later in the year, the Government established a technical committee of microfinance experts to carry out a study on this issue. The Inter-American Development Bank provided technical assistance to the Government for the study. In February 1997, when the President attended the Micro Credit Summit in Washington D.C., he announced his commitment to create a microfinance bank in Peru (Campion and White 1999, p. 97).

The presidential committee was interested in ACCION International's involvement in the initiative. ACCION International provided technical assistance to the committee on the condition that the new bank should have no government ownership and would be owned 100% by the private sector. ACCION International and ACP jointly submitted a concept paper to the presidential committee to transform ACP into a

[6] For an EDPYME, the minimum capital requirement was only $263,000. However, with this level of capital, EDPYME was not allowed to mobilize any deposits. For deposit mobilization, an EDPYME required a higher level of capital, a good rating, and special approval from the Banking Superintendency.

new bank, drawing on the experience of transforming PRODEM (a microfinance NGO) in Bolivia into BancoSol, a microfinance commercial bank. ACP also carried out a feasibility study on the intended transformation of ACP into a commercial bank. The Banking Superintendency approved this study in November 1997. The Government's support expedited the process of approval (Campion and White 1999, p. 97–98).

III. Mibanco, The Microfinance Commercial Bank

Ownership Structure and Transition

On 4 May 1998, Mibanco opened its doors to the public as a microfinance commercial bank.

Five investors came forward with a total initial equity capital of $14.0 million. ACP became the majority owner, with 60% of the total shares. The other social investors were ProFund[7] and the ACCION Gateway Fund.[8] Two commercial banks, Banco Wiese Sudameris, and Banco de Credito del Perú, were the only private sector investors. This initial ownership has undergone changes, as may be seen from *Table 5*. In November 1999, the Andean Development Corporation also became a shareholder.[9] Banco de Credito del Perú sold its shares in November 2001. Banco Wiese has also sold its shares. [10]

At the end of 2002, ACP accounted for 66.35% of ownership of Mibanco while other social investors (ProFund and ACCION International) accounted for 24.19%.[11] Private individuals were holding 3.1% (www.mibanco.com). Thus, Mibanco is still a bank owned largely by social investors. Perhaps this dominance explains why it has managed to remain largely within the boundaries of its original social mission during the post-transformation period. But there may be other factors as well.

Table 5
Mibanco Ownership Structure
(%)

Owners	June 1998	December 2002
ACP (founder NGO)	60.00	66.35
Profundo	19.68	17.81
Accion Gateway Fund	7.00	6.38
Banco Weise Sudameris	6.66	–
Banco de Credito del Perú	6.66	–
Andean Development Corporation		3.82
Private Individuals		3.10
Mibanco		2.54
Total	**100**	**100**

Source: www.microrate.com; www.mibanco.com

The year 1998 was obviously a transitional year for Mibanco. With the transformation, Mibanco agreed to administer ACP's loan portfolio at no cost for the first year and paid a $1.0 million premium in cash to ACP for access to ACP's client base. The transition of clients from ACP's portfolio to Mibanco's books, however, did not take long because the term of most of ACP's loans was less than 5 months. Mibanco also improved its operating systems, procedures, and governance to ensure compliance with regulatory requirements and to manage its growth more efficiently.

7 ProFund is a for-profit investment fund. It provides equity and quasi-equity capital to MFIs to expand their operations on a sustainable and large-scale basis. Its main target market is the small businesses and microenterprises of Latin American and the Caribbean (for details, see www.profundinternacional.com).

8 The ACCION Gateway Fund is a closed-end, limited-liability company that invests directly in regulated financial institutions or NGOs that are being transformed into regulated financial institutions. The Fund is a wholly owned, for-profit subsidiary of ACCION International.

9 The Andean Development Corporation is the largest multilateral source of financing for the Andean region. Five countries—Bolivia, Colombia, Ecuador, Peru, and Venezuela— are principal shareholders, and 22 Andean banks also have shares. Recently, Spain became the first shareholder outside the region.

10 These private banks became more interested in serving the microfinance market directly.

11 An ownership structure characterized by a high stake of the founder NGO is considered, in general, as inappropriate for a financial institution for two reasons: (i) it can lead to governance and operational problems, as was the case with Corposol/Finansol in Colombia (Lee 2002, p. 152–174); and (ii) an NGO does not have "deep pockets" to respond with additional capital in the event of a crisis.

Mibanco's Growth and Outreach

Table 6
Mibanco: Growth Indicators
(year-end positions, $ million)

Indicator	1998	1999	2000	2001	2002	2003 End-March
Total assets	28.62	29.87	45.37	72.95	105.04	119.00
Total loan disbursements[a]	–	58.26	83.76	106.54	153.40	–
Total active loan portfolio	12.69	20.63	37.13	61.45	92.59	96.52
Total equity	14.05	14.57	15.31	18.24	23.38	25.74

[a] Amount disbursed during the year.

Source: www.accion.org; Balance Sheets of Mibanco.

Mibanco experienced strong growth after the transformation, as shown in *Table 6*. The relatively low inflation rate facilitated this growth.[12] During 1999–2002, Mibanco's total assets increased by about 252%, gross loan portfolio by about 379%, and total equity by 71%. This was an impressive achievement for any type of financial institution. The data for the first quarter 2003 indicate that, as one would expect, this growth continues.

Although the portfolio of the bank continued growing rapidly during the post-transformation period, the relative contribution of the increase in the number of active borrowers to growth has declined, while that of the increase in average active loan balance has increased significantly, in comparison with the pre-transformation period. As shown in *Table 7*, the increase in the latter contributed 40–52% of the annual portfolio growth during 1999–2002. This indicates that Mibanco has been growing both horizontally and vertically, in contrast to ACP growth that was primarily horizontal, as was shown earlier.

Table 7
Mibanco: Sources of Growth in Loan Portfolio
(%)

Source and Relative Contribution	1999	2000	2001	2002
Increase in Active Borrowers	52	47	41	40
Increase in Average Active Loan Balance	48	53	59	60
Total Contribution	**100**	**100**	**100**	**100**

Source: Author's computations.

The growth of Mibanco could also be seen clearly in the liabilities segment of its balance sheets. As shown in *Table 8*, it has achieved impressive results in mobilizing deposits. Time deposits increased six-fold during 1999–2002, while savings deposits increased from a meager $44,000 in 1999 to $10.43 million by the end of 2002. Total deposits at the end of 2002 amounted to $44.29 million, more than an eight-fold increase over the level of 1999. This growth led to an increase in the deposit-to-loan ratio from 28% in 1999 to 48% in 2002, deposit-to-total-liabilities ratio from 35% to 54%, and deposit-to-total-liabilities-and-equity ratio from 18% to 42%. The first quarter 2003 data seem to suggest a more robust deposit growth for 2003 than that achieved in 2002. Between the end of December 2002 and the end of March 2003, time deposits increased by 33%, savings deposits by 18.5%, and total deposits by 24%. This has improved the deposit-to-loan ratio to 57%.

With these growth rates in both lending and deposit operations, Mibanco stood as one of the flagship MFIs in the Latin American region at the end of 2002, as may be seen from *Table 9*. Very few regulated MFIs have achieved such growth profitably within such short periods without running into quality and operational problems.

Scope of Operations

Mibanco started with a single loan product—working-capital loans. One initial core operating

[12] The Peruvian annual inflation rates were 7% (1998), 3% (1999), 4% (2000), and 2% (2001).

principle was to focus on "doing one thing and doing it well." The working-capital loans continue to remain the major lending activity. However, recognizing and responding to the profitable opportunities in the market, Mibanco expanded its scope of operations over time. First, it expanded its menu of loan products. In 1999, the bank launched two new loan products: one for the purchase of fixed assets, and the other for the expansion of market stalls. In October 2000, an innovative housing loan product known as *Micasa* ("my home") was introduced after a 2-month pilot testing. In 2002, it introduced rural loans. Second, Mibanco expanded its deposit services. It began to offer passbook savings in July 2000. In addition, it also provided time deposits and started to offer checking accounts in 2002. Third, it began to offer money transfers and other financial services.

Table 8
Mibanco Deposits: Composition and Growth
(year-end positions, $ million)

Indicator	1999	2000	2001	2002	2003 End-March
Time deposits	5,067	7,685	20,063	30,593	40,698
Savings deposits	44	1,407	4,205	10,432	12,358
Other	249	375	1,550	3,266	1,909
Total	5,360	9,467	25,818	44,291	54,965
Deposit/Loan Ratios (%)	28	26	42	48	57
Deposit/Total Liabilities Ratios (%)	35	32	47	54	59
Deposit/Total Liabilities Plus Equity Ratios (%)	18	21	35	42	46

Source: Balance sheets of Mibanco; ratios are author's computations

At the end of 2002, Mibanco had 28 branches—24 in Lima and one in each of four provinces. It is planning to expand this network to 35 branches by the end of 2003, and add automated teller machines at each of its locations.

These measures have not only improved access to its services for an ever increasing number of clients, but also improved the quality of its services.

Breadth and Depth of Outreach

Mibanco has also experienced a remarkable improvement in breadth of its outreach *(Table 10)*. The number of active borrowers more than

Table 9
Mibanco's Comparative Position
(as of 31 December 2002)[a]

MFI	Country	Year	Equity ($ million)	Active Loan Portfolio ($ million)	Active Borrowers (number)	Average Active Loan Balance ($)	Total Assets ($ million)	Total Deposits ($ million)
BancoSol	Bolivia		24.1[b]	80.9	42,290	1,913	96.3	–
Caja los Andes	Bolivia		5.8[b]	64.6	51,229	1,261	71.6	34.6
FIE FFP	Bolivia	2001	4.4	27.4	22,613	1,217	29.2	11.0
Prodem FFP	Bolivia	2000	4.9	24.7	26,000	950	32.0	–
Financiera Calpia	El Salvador		8.5	44.8	44,771	998	57.4	22.8
Banco Ademi	Dominican Republic	2000	15.3[b]	50.5	16,408	3,078	61.2	16.4
Finamerica	Colombia		2.2	16.0	18,281	873	–	–
EDYFICAR	Peru	2001	4.3	20.0	20,975	953	21.6	–
Compartamos	Mexico		10.9	43.0	144,991	297	–	–
Mibanco	Peru		23.4	92.3	99,121	931	105.0	44.3

[a] All data are for 2002, unless otherwise stated.
[b] End of 2000.
FFP = Fondo Financiera Privado.

Sources: Various web sites, mainly www.accion.org; www.bellanet.org; and www.imi-ag.de.

Table 10
Breadth of Mibanco's Outreach

Year	Number of Active Borrowers	Number of New Borrowers	Percentage of Women Borrowers
1999	41,344	19,755	62
2000	58,088	29,657	58
2001	77,942	35,196	57
2002	99,121	42,821	–

Source: www.accion.org.

doubled during 1999–2002, increasing from 41,344 at the end of 1999 to 99,121 at the end of 2002. However, the proportion of women in the total client base decreased from 62% in 1999 to 57% in 2001. On the deposit side, although passbook savings accounts were introduced only in July 2000, there were about 84,000 passbook savings accounts by the end of 2001.

According to Mibanco's mission statement, it is committed "to continued economic development of small and microenterprises" (ACCION International, 2002, p. 11). Has it drifted away from this mission over time? What is the depth of its outreach?[13] Is Mibanco serving more poor clients now than, say, in 1999? We have examined Mibanco's poverty outreach from different angles, and all seem to suggest that Mibanco appears to have deepened its poverty outreach in recent years.

Mibanco's focus on the lower end of the market is shown by the size distribution of its loan portfolio *(Table 11)*. At the end of July 2001, about 21% of its loan portfolio was less than $250 while 30% was in the $250–500 category. Also, microenterprise loans accounted for 67% of the total number of loans at the end of 2002.

The nominal average active loan balance of Mibanco increased by 148.3% from $375 in 1998 to $931 in 2002 *(Figure 3)*. The nominal average active loan balance as a percentage of GNP per capita, which is arguably a better proxy measure

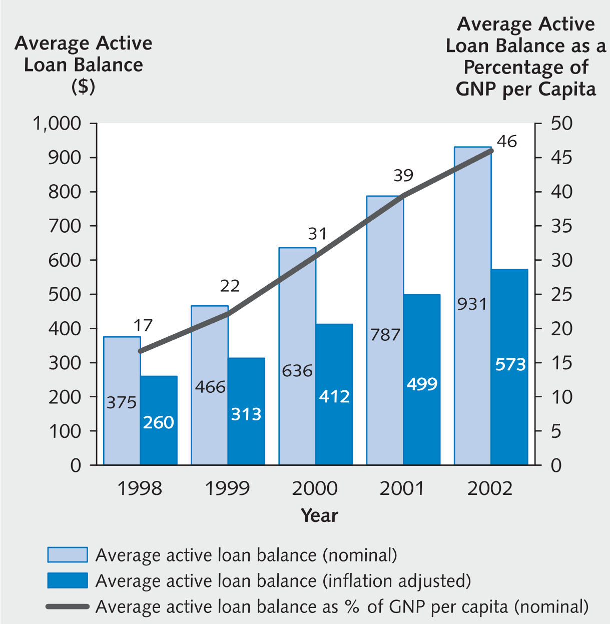
Table 11
Mibanco's Percentage Distribution of Gross Loan Portfolio by Size of Loans
(as of July 2001)

Size Category	Percentage of Total Portfolio
Less than $250	21
$250 – 500	30
$500 – 750	18
$750 – 1,000	8
$1,000 – 1,500	12
$1,500 – 2,000	3
$2,000 – 4,000	6
more than $4,000	2
Total	**100**

Source: ACCION International (2002, p. 16)

of the depth of outreach, also increased between the same years from 16.7% to 46%. Both measures

Figure 3
Mibanco's Depth of Outreach



Note: For the inflation adjustment, the consumer price index, base year=1994, was used.

Source: Author's computations based on data from www.accion.org.

[13] Depth in this paper refers to the level of poverty of the clients. Because of difficulties in direct measurement of depth, proxies are used for the purpose. The most common proxy is loan size. The other proxy measure is average active loan balance as a percentage of GNP per capita. Schreiner (2002), who proposed an excellent framework of outreach, defines depth of outreach in a more precise way.

seem to suggest a decline in Mibanco's depth of outreach. However, the inflation-adjusted average active loan balances show a somewhat different picture. They increased by only 120% from $260 to $573 between the same years. This tends to support the assertion that Mibanco continues to serve the low end of the market.

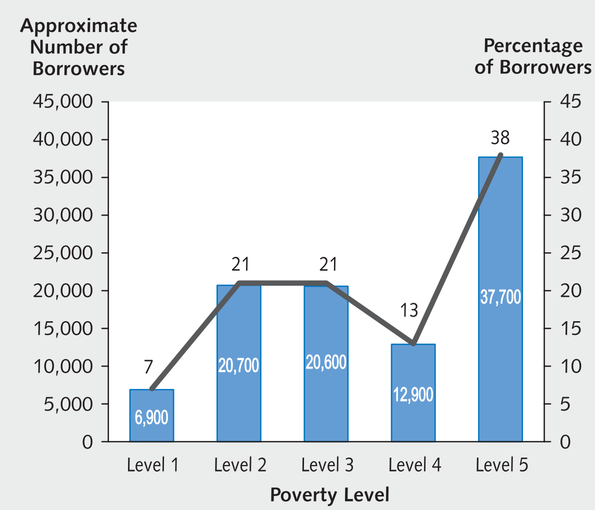
Loan sizes can increase not only because of inflation but also because of other factors including (i) improvement of lenders' information base on clients over time, enabling the lender to make bigger loans; (ii) organic growth of clients' activities that makes larger loans necessary and possible; and (iii) a policy decision by a lender to make larger loans, irrespective of the above factors (Gonzales-Vega et al. 1997, p.151–152).

Mibanco appears to have pursued a business strategy to expand its growth, and has moved itself up-market to some extent. At the same time, it has also been able to provide larger loans to its preexisting clients because the bank has better information on which to assess the risks associated with lending them larger amounts. *Micasa* loans, with relatively large average loan sizes, have also been a factor responsible for the increase in overall average loan size in 2001–2002. However, it is possible that an increasing number of its clients have expanded their microbusinesses and stayed loyal to the bank in order to obtain progressively bigger loans. About 55% and 57% of the active borrowers at the end of 2001 and 2002, respectively, were repeat clients. The bank has responded positively to these repeat clients. Thus, it appears that the average loan size has increased due to a combination of these factors, and that the bank has not taken a conscious policy decision to move away from the low end of the market. More importantly, Mibanco has served clients in the up-market without leaving its initial target group behind or at their expense. The *Micasa* housing loan product is also reaching poor clients partly because of its pro-poor characteristics (see Box, p. 12).

According to ACCION International, "Mibanco's clients are market vendors, seamstresses, bakers, pot-makers and others who support their families by starting small, often home-based businesses. Many live in the *pueblos joveness*, the very poor shantytowns on the outskirts of Lima" (see www.accion.org). ACCION's poverty outreach survey in 2002, based on data on clients who received a working capital loan between April 2001 and April 2002 from three of Mibanco's 28 branches, threw more light on the depth of outreach. The ACCION researchers compared the poverty rate of Mibanco clients with that of a sample of Lima's population, using both the national and Lima poverty lines, and found that "nearly half (49%) of Mibanco's clients are living in poverty, compared with 40% of the Lima population sample. Twenty seven percent of Mibanco clients are also classified as poor based on the lower national poverty line, compared with only 22% of the Lima sample" (ACCION International 2003, p. 5). According to ACCION, "this finding tells a story that is consistent with informal observations: a small percentage of Mibanco's clients have either very low or very high income levels, suggesting that Mibanco is serving Lima's poor and near-poor majority" *(Figure 4)*.

Applying the distribution of clients in the sample survey across different poverty categories

Figure 4
Distribution of Mibanco's Borrowers by Poverty Level



Level 1 = 0-50% of Lima poverty line (LPL)
Level 2 = 50-75% of LPL
Level 3 = 75-100% of LPL
Level 4 = 100-120% of LPL
Level 5 = greater than 120% of LPL

Source: ACCION 2003.

to the total number of Mibanco's active borrowers at the end of 2002, ACCION researchers estimated that Mibanco was reaching about 48,000 poor microentrepreneurs and their households, including 6,900 with incomes less than 50% of Lima's poverty line. Considering that Mibanco had only 41,344 active borrowers at the end of 1999, it certainly served more poor clients in 2002 than in 1999, even if it is assumed that Mibanco was exclusively serving the poor in 1999.

It is essential to examine deposit services when discussing outreach. Poor and low-income households use Mibanco's passbook savings facilities extensively. There were about 84,000

Mibanco's Pro-poor Housing Loan Product

Lima, the capital city of Peru, has some 8 million people. About 82% of them live in poor households. Most of them do not have legal title to their property, but over half or more of the poor households plan to improve or expand their homes every year. They, however, have little or no access to appropriate loans for this purpose.

Mibanco, in its search for potential new growth areas and ways to better serve its target clients, identified this market and developed a new loan product, *Micasa* ("my home"). The product was pilot tested during August-September 2000 in two branches, and launched in October 2000 throughout the entire branch network. In less than 12 months, 3,000 clients were served with a portfolio of $2.6 million. By end of September 2002, the total number of active clients increased to 6,954 and the active portfolio to $8.1 million, accounting for about 9% of the total active loan portfolio of the bank. The product was generating profits for the bank. With *Micasa*, Mibanco is reaching a poorer set of clients than it does with its microenterprise loans. *Micasa* also demonstrated that subsidized interest rates are not necessary to support the housing strategies of the poor.

Micasa has pro-poor features:

- The product supports existing housing strategies ("progressive building") of poor and low-income households, such as converting wooden walls to brick and adding doors and windows.
- It is offered to both Mibanco's traditional microenterprise clients and low-income workers living in the same communities. By adding the latter to its target group, the bank has ended up serving poorer households.
- *Micasa* loans are secured, not with mortgages, but mainly with household assets. Taking a mortgage increases transaction costs of both the bank and the clients and, thus, discourages poor households from using the product.
- Loans have longer maturity than microenterprise loans at a relatively lower interest rate than that of the latter. Although the maximum term is 36 months, the majority opts for a shorter term. The interest rates are approximately 4/5 the rate of microenterprise loans. The interest rates, however, do not include a subsidy, and are high enough to cover the full cost. These rates on loans in Peruvian Soles range from 70% per annum for loans less than $860 to 50% per annum for loans larger than $2,860.
- Loans are not tied to any technical assistance in the planning, supervision, or implementation of the clients' construction projects. This is compatible with poor households' strong preference to make their own design decisions.
- Loan applications for new clients typically take only 3 days from the time the application is submitted to the time the loan is disbursed. Repeat loans for the same purpose are processed in one day.

These features help both the bank and the clients. The bank can expand the portfolio rapidly on a profitable basis, using its preexisting infrastructure. Clients can obtain the loans with low transaction costs to meet their demand and use them flexibly. They can obtain a series of loans if the previous loan has been fully repaid. Mibanco expects that these loans will account for as much as 50% of the bank's total portfolio within a few years. Whether such high portfolio concentration is desirable, however, is highly questionable.

Source: Adapted from ACCION International (2002).

such accounts in December 2001, indicating that, on the deposit side, the bank has expanded its depth of outreach significantly in recent years. As Mibanco gathers more experience in passbook savings mobilization, this service is likely to expand further in the future, and many more poor families are likely to benefit from it.

Time deposits continue to be the most important source of Mibanco's deposits, accounting for 74% of total deposits at the end of March 2003. The bulk of these deposits admittedly comes from up-market clients, who have not directly contributed to the depth of its outreach. However, this is an important strategy of Mibanco—to obtain adequate loanable funds to finance its growing lending operations. Using deposits of rich people to finance lending operations for the low end of the market is not only good financial intermediation but also makes sense from a cost-efficiency point of view because administrative costs of large deposits are much lower than those of small deposits. Also, this may be justified from the point of view of diversification of the term structure of funding.

Reliance on Borrowings and Capital Markets

To finance its lending operations, Mibanco relies on commercial borrowings in addition to deposits. Loans from other financial institutions accounted for 54.5% of its total liabilities at the end of 1999, for 61.3% at the end of 2000, for 40.3% at the end of 2001, and for 34.7% at the end of 2002. This declined further to 32.4% by the end of March 2003.[14] These lending institutions include both semicommercial and commercial sources, and national as well as international financial institutions. It has borrowed from COFIDE[15] and Agencia para la Cooperación Internaciónal de España (Campion, et al., 2002, p. 183–184). Banco de Credito del Perú also extended a $3.2 million, 3-year loan with a 50% guarantee from ACCION International's Latin America Bridge Fund in October 2001. In 2001, it also borrowed from Hivos-Triodos Fund in The Netherlands. The International Finance Corporation (IFC) lent $5.0 million for a 5-year period in 2002. The long-term nature of IFC funding is expected to improve Mibanco's capacity to expand medium-term housing loans in particular, without running into risk of maturity mismatches between its assets and liabilities. It has also borrowed recently from Dexia Micro-Credit Fund.[16]

In December 2002, as part of its $30 million bond program to raise funds from capital markets, Mibanco issued bonds for $6.0 million with a 50% guarantee from the United States Agency for International Development. Local pension funds bought 82% of the bonds. It is likely that Mibanco will go to capital markets in the future without guarantees from external parties but with the backing of its financial strength.[17] Although borrowings increased in absolute terms and bond issue added a new source of funding, impressive performance in deposit mobilization has caused a structural change in Mibanco's liabilities, as may be seen from *Table 12*.

With the rise in deposits and other liabilities during the post-transformation period, Mibanco's leverage ratio increased from 1.05 in 1999 to 3.5 in 2002, as shown in *Figure 5*. This rose further to 3.62 by the end of March 2003[18] because of the sharp increase in total deposits during the first quarter. However, the leverage ratio still remains low in comparison with the maximum of about 10, permitted by the capital adequacy requirements for commercial banks. This indicates

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14 Author's computations based on balance sheet data.

15 COFIDE was first created as a state development bank in Peru. It was converted to a strictly second-tier, apex funding institution in 1993. It began supporting microfinance institutions in 1994.

16 The Dexia Micro-Credit Fund is one of the few funds dedicated to commercial financing of MFIs in the world. It has been incorporated in Luxembourg. For details, see www.blueorchard.ch.

17 There is at least one precedent for this. The Financiera Compartamos, a leading MFI in Mexico, issued a $15.0 million bond in the Mexican capital market in 2002. This was backed fully by the Standard and Poors A+ rating (www.accion.org). However, according to Jansson (2002, p. 10), "not all microfinance institutions believe bond issuance is the preferred strategy. Caja Los Andes in Bolivia, for example, believes itself better served by expanding the amount and extending the tenure of term deposits. Term deposits require less up-front effort and can be tailored to each client."

18 Author's calculations based on balance sheet data.

Table 12
Mibanco: Evolution of the Structure of Liabilities
(% of total liabilities)

Category	1999	2000	2001	2002	2003 End-March
Savings Deposits	0.3	4.7	7.6	12.8	13.3
Term Deposits	33.1	25.6	36.7	37.5	43.6
Other Deposits	1.6	1.3	2.8	4.0	2.0
Loans from Other Financial Institutions	54.5	61.3	40.3	34.7	26.3
Bonds	0.0	0.0	0.0	7.0	6.2
Other Liabilities	10.5	7.1	12.6	4.0	8.6
Total	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

Source: Author's computations based on data from balance sheets of Mibanco.

that Mibanco can comfortably increase its deposit and other liabilities further to harness the growth potential in the market for a few more years without fresh equity.

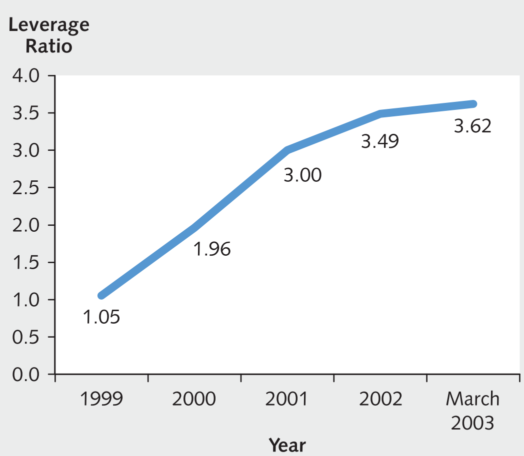
Portfolio Quality

Has Mibanco sacrificed portfolio quality to achieve high growth rates? Data indicate that this has not been the case. PAR over 30 days increased slightly in 2001 and 2002, as shown in *Figure 6*. Perhaps the political instability during 2000 and 2001 that resulted in a downturn in the economy may have had some effect on this deterioration. But the PAR still remained low at 2.84%, at the end of 2002. At the end of March 2003, it was 2.81%. Given the rate at which the loan portfolio increased, containing PAR below 3% can even be considered an impressive achievement.

Efficiency

Mibanco has grown to be a large financial intermediary during the last 5 years, as shown earlier. Its loan portfolio exceeded $100 million by the end of 2002. The loan portfolio-to-total-assets ratio increased from 80% in 1999 to 86% in 2002, and the number of active borrowers increased to almost 100,000. When compared to the averages for its peer group of MFIs, "Latin America large broad category,"[19] given in the MicroBanking Bulletin, Mibanco is the largest in size and scale of operations. Yet, it is not as efficient as its peer group. Mibanco's operating expense ratio for 2001 was 19.0% *(Figure 7)*, while its peer

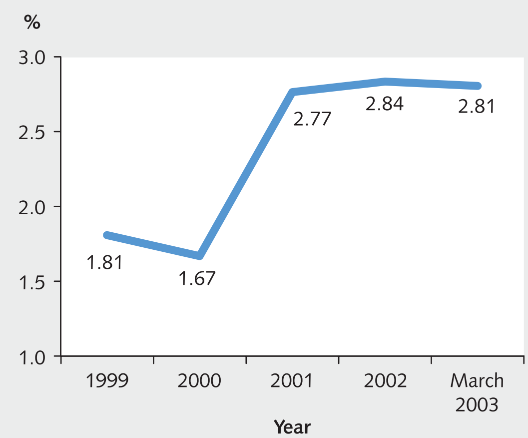
Figure 5
Mibanco: Leverage Ratio[a]



[a] Defined as the ratio of total liabilities to total equity.

Source: Balance sheets of Mibanco

Figure 6
Portfolio at Risk

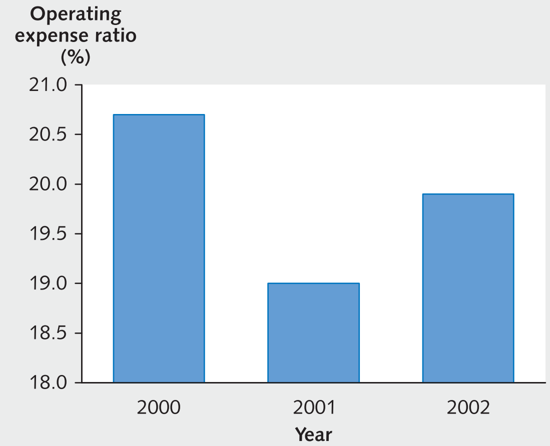


Source: www.sbs.gob.pe

[19] With Mibanco, this group includes 11 MFIs: Banco Ademi, Banco Solidario Zenador, Banco del Desarrollo, BancoSol, Caja Los Andes, CM Arequipa, FIE, Finamerica, Prodem, and Solucion (The MIX 2002, p. 43).

group average was only 15.5% (The MIX 2002, p. 47). This is a serious challenge for Mibanco particularly because the market in which it operates is likely to become more competitive in the medium term. Currently there is no intense competition for the bank in most of its operating areas. Perhaps this may explain its relatively low efficiency level as well as its strong profitability. However, Mibanco's management is aware of this issue, and is making a concerted effort to address it.

Figure 7
Mibanco Operating Expense Ratio[a]



[a] Total operating expenses as a percentage of average total assets. Because Mibanco has been mobilizing deposits, total assets was considered as better denominator for this calculation than average gross loan portfolio.

Source: www.mibanco.com.

The Bottom Line: Profits and Profitability

Mibanco reported a relatively small net income of $223,000 for 1999, the first full year of its operations.[20] Thereafter, its net income grew rapidly. During 2000–2002, it increased by 337%. As shown in *Table 13*, the ROE also improved from a low of 1.53% in 1999 to 23.24% in 2002. The ROA was 5.17% in 2002. Both the ROE and ROA in 2002 were much higher than those reported for the banking sector as a whole—8.43% and 0.85%, respectively. Its full-cost pricing policy and high business turnover are two major reasons for the profitability.

Table 13
Net Income and Profitability

	1999	2000	2001	2002	2003 End-March
Net income after tax ($'000)	223.00	1,243.00	3,180.00	5,433.00	1,364
Return on equity (%)[a]	1.53	8.12	17.43	23.24	–
Return on assets (%)[a]	0.75	2.77	4.36	5.17	–

[a] Author's computations based on data in balance sheets and income statements.

Prospects for Mibanco's Future Outreach

Mibanco's prospects for continued rapid increase in outreach appear good. According to some estimates, Peru has more than 6.8 million microenterprises, some 2.76 million of which are enterprises with 1–5 workers. The share of microenterprises with access to credit from MFIs is less than 5% (Berger et al. 2003, p. 9). Their demand for financial services continues to be vast. MFIs, including Mibanco, seem to have barely scratched the surface of their market potential.[21] The untapped market for microfinancial services remains large. This is true not only for microcredit, but also for savings mobilization, local money transfers, remittance and payment services, and micro-insurance. In this context, a dynamic institution like Mibanco seems to have vast market potential for expanding profitably not only the breadth but also the depth and other dimensions of its outreach.

[20] Because it began operations in May 1998, making 1998 a transitional year, the figures for 1998 do not reflect a normal situation. Hence, 1998 should not be considered a good year for comparison.

[21] Other suppliers include other commercial banks, finance companies, and municipal savings and credit banks, owned by city governments and EDPYMEs.

IV. Lessons for Asia

Mibanco's experience offers valuable lessons for microfinance practitioners, policymakers, and promoters, particularly for those interested in developing the microfinance industry in Asia.

- Low-income segments of capital cities are a significant source of demand for a wide range of financial services. This segment can be served profitably. The relative neglect of this market in most Asian countries means that Asian MFIs currently concentrating only in rural areas are missing a good opportunity to serve the poor on an increasing scale, with profits. This, however, does not mean that their rural operational modalities can be simply extended to service urban areas.
- Governments do not have to own MFIs to ensure financial services for the poor and low-income households and their microenterprises. Peruvian President Fujimori's Government was first keen to have an ownership stake in a dedicated microfinance bank, but changed its position later, based on sound and strong technical advice from experts in ACCION International and other organizations. If the Government insisted on a stake in ownership for itself, Mibanco perhaps would not have come into being, at least as quickly as it did. A delayed transformation of ACP would have made many poor and low-income households worse-off.
- Governments can encourage private ownership and solutions in many ways. For example, Mibanco was able to increase its *Micasa* loans partly because of a 5-year loan extended by the state-owned COFIDE. The Government, however, did not dictate the interest rates and other terms and conditions under which these funds should be relent by Mibanco. Nor did it attempt to target the funds at a particular segment of the market to achieve its own development objectives or priorities. By staying away from both micromanagement and inappropriate interventions, the Government allowed Mibanco to develop a sustainable housing loan program for the poor and low-income households, and created strong incentives for Mibanco to expand this operation. Through this course of action, the Government indirectly helped many poor clients and potential clients.
- When MFIs establish partnerships with well-established and strong providers of technical service, rapid growth is easier than otherwise would be the case. ACP's strong partnership with ACCION International was a crucial factor in its sustained growth.[22] Similarly, the partnership between Mibanco and ACCION International ensured a reliable source of technical advice when needed.
- MFIs can deepen their poverty outreach a great deal without expensive and cumbersome targeting mechanisms if they develop demand-driven, pro-poor products instead of merely offering products developed by others for different environments. Some new products can be introduced with small incremental investments within the existing branch network and lending infrastructure, while some others may need larger investments.
- Transforming NGOs into regulated financial institutions does not necessarily lead to a mission drift. Although average loan sizes tend to increase after transformation for various reasons, transformed entities could continue to serve an increasing number of original target clients while diversifying their client base. Moreover, with new pro-poor

[22] However, there are MFIs in Latin America and Asia that have grown rapidly without such technical partners. A case in point is Fondo Financiera Privado FIE in Bolivia. The Association for Social Advancement (better known by its acronym ASA) in Bangladesh also did not rely on external technical assistance for its growth. Both institutions are profitable.

products, it is possible to deepen their outreach. This is an important lesson for those matured microfinance NGOs in Asia, which, at least for now, do not seem to have a strong interest in becoming regulated financial institutions because of perceived potential loss of their social mission. While adopting a business approach within the constraints of their social mission is not an easy task for MFIs, there are effective ways of approaching this issue, as shown by Mibanco.

- Extending financial liberalization to an extent that would allow international social investors and local and international private investors to make equity investments is likely to produce beneficial effects on the development of the microfinance industry in the medium to long term. This, in turn, would enhance the welfare of poor households that otherwise have to forego productive investments, save in nonfinancial assets, and suffer from greater volatility of income and consumption. They may have to turn to informal commercial financial markets where they have to pay a high "poverty premium" for financial products and services.

V. CONCLUSIONS

The case of Mibanco tells a compelling success story and illustrates that matured, well-functioning microfinance NGOs can be successfully transformed into regulated financial entities, provided that there is a supportive legal framework for such transformation. And after transformation, they can be expected to continue to serve the poor and low-income households and their microenterprises better, on a larger scale, and profitably. There are other success stories that support this conclusion. Governments in Asia and funding agencies interested in developing a sustainable microfinance industry in Asia need, among other things, to take more interest in creating preconditions for successful transformation and providing critical assistance for transformation. NGOs have to play a proactive role to improve themselves and make their institutions both suitable and attractive for transformation.

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Web Sites

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Dexia Micro-Credit Fund, Switzerland: *http://www.blueorchard.ch*

Internationale Micro Investitionen Aktiengesellschaft: *http://www.imi-ag.de*

Mibanco, Peru: *http://www.mibanco.com*

MicroRate, Washington, DC: *http://www. microrate.com*

ProFund: *http://www.profundinternacional.com*

Superintendency of Banking and Insurance, Peru: *http://www.sbs.gob.pe*