MICROFINANCE AND CAPITAL MARKETS: THE INITIAL LISTING/ PUBLIC OFFERING OF FOUR LEADING INSTITUTIONS

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Council of Microfinance Equity Funds

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Ira. W. Lieberman
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ABOUT THE COUNCIL OF MICROFINANCE EQUITY FUNDS

The Council of Microfinance Equity Funds (CMEF) is a membership organization of private entities that make equity investments in microfinance institutions (MFIs) throughout the developing world. Council members seek both social and financial returns from their investments in these MFIs. The Council's purpose is three-fold: 1) to articulate and disseminate the knowledge and expertise about equity in microfinance of the Council's members among themselves and to other MFI stakeholders; 2) to present guidelines and principles for effective investment in MFIs; 3) to conceive of a future strategy for the role of investment capital in microfinance with a particular emphasis on attracting private investors in microfinance. ACCION International, the Council Coordinator, originally brought together the group to create the Council in 2002, and it was formally launched in 2003.

INTRODUCTION

Within the last few years a new phenomenon has taken place among the world's leading microfinance institutions—entry into new capital markets through Initial Public Offerings (IPOs). "Going public" launches microfinance institutions (MFIs) into a new frontier, presenting challenges but also providing new opportunities for the institutions and the clients they serve.

This paper discusses the history and IPOs/listings of the four leading microfinance institutions who have carried out such transactions—Bank Rakyat Indonesia (BRI), BRAC Bank in Bangladesh, Banco Compartamos in Mexico and Equity Bank in Kenya. The four institutions are well known throughout the microfinance industry for their exceptional growth, robust financial performance and ability to expand their outreach to the working poor. They are now listed on national stock exchanges and, in two cases, sold internationally. Listing details for each institution follow in Table 1.

As with any business going public, the IPOs and listings have allowed the four institutions to tap into the mainstream investor community and take advantage of myriad new opportunities. The success of the IPOs signals to the microfinance community that their businesses can approach the mainstream capital markets successfully for funding. To the capital markets, they signal that the microfinance sector is a potential source of profitable investment. The offerings have increased liquidity for investors by creating opportunities for equity investors to exit, a critical step in attracting private capital. And, through the disclosure requirements the institutions now face, as well as overall heightened scrutiny, the offerings have created strong incentives for improved and transparent governance.

These offerings resulted in another highly important step forward—MFI "value" information. Without adequate price and performance information with which MFIs could be evaluated, it was previously very difficult to attract private investors. The IPOs and listing have now established price information about the value of MFIs in the market as well as increased transparency through the required filing documents. Going forward, these will prove to be important benchmarks for similar institutions looking to access new capital markets as well as for potential investors. The market valuations affect all equity transactions for MFIs, even private placements of non-listed MFIs.

Given their profitability, strong management and social missions, it is not surprising that these four companies were able to successfully list their stock, and all four have shown remarkable growth since going public, both in share price as well as in overall organizational growth. As public companies and regulated banks, they are now being benchmarked against the banking sectors and other corporations in their respective countries.

Each of these institutions, however, had very different structures and purposes for their actions. One of the largest MFIs in the world, BRI became the first bank with a predominate focus on microfinance to go public, in October 2003. Its offering was part of a larger process in which the Indonesian government was slowly divesting its holdings in the banking industry. BRI's was only a partial privatization, with the state retaining a majority interest in the bank. Of the $489 million[1] raised by the IPO, 61% went to buy shares held by the government, while BRI retained the remainder as fresh capital. In the three years since the IPO its stock has increased 561% on the original price.

Although the offspring of one of the largest NGOs in the world, BRAC Bank's offering in July 2006 was on a far smaller scale than BRI's or Compartamos'. The company sold 50% of its share capital to the public, doubling the number of shares outstanding and raising $13 million to be used for the expansion of the bank's operations throughout Bangladesh. BRAC's stock has increased by 619% since the offer.

In contrast to BRI and BRAC Bank, none of the shares sold by Banco Compartamos in April 2007 were offered by the firm itself. Rather, the 30% of shares outstanding sold were part of a secondary offering, providing liquidity to existing investors. The firm received none of the proceeds. The offering opened at 12.8 times the book value and, within six months, saw a 48% increase over the initial price.

Unlike the others, Equity Bank, a top-performing MFI in Africa, did not actually have an IPO, but rather a listing of stock that was already held by many of their clients and employees. Its listing was made in order to offer these shareholders the benefits of the stock market. The primary benefit was the development of a market for Equity Bank stock, both allowing existing shareholders to buy and sell at will as well as opening the opportunity to buy to any new investor. The market discipline associated with the listing focused the bank's internal energies on improving effective governance and on positioning Equity Bank strategically in capital markets.

Despite their differences, however, the four institutions share similar characteristics that suggest only a few top MFIs will be able to step into the public realm. For example, each institution has long-serving senior management who have guided their organizations profitably as well as serious boards of directors and good-governance practices. The institutions have also all achieved massive scale within their respective markets, translating into a strong capital base and profits as well as positive market recognition. Moreover, their potential for future growth is quite high. In addition, the four have sought to anticipate and address their clients' needs through an increasing number of quality products and services, and they, for now, are respecting the components of the double bottom line. For more on the qualifications necessary for a successful capital-market listing, please see the summary and conclusions of section one.

In addition to these qualifications, however, a sophisticated or semi-sophisticated domestic capital market appears necessary for an institution to perform well through an offering. It is no coincidence that three of the IPOs listed on relatively active stock markets: Jakarta, Mexico and Nairobi. Even though BRAC Bank's stock has shown phenomenal growth, the overall amount raised was significantly lower than that of the

[1] Please note that all amounts, unless otherwise indicated, are stated in U.S. dollars.

other three companies due in part to the limited Bangladeshi market. MFIs in similar capital markets should adjust their expectations accordingly.

While each of the institutions has preformed well, it is still too early to predict a trend. Companies that have a social mission and are profitable, as well as the microfinance industry in general, have a certain cachet at the moment. Additionally, there has been a controversial but important discussion triggered by the Compartamos IPO regarding fair interest rates and the use of profits from businesses serving the poor.

Nevertheless, the initial success of these institutions has opened the door for the industry. The four are succeeding due to their initial profitability, past growth and bright future growth prospects. In each case the listings have been structured so as to preserve governance control among existing boards and maintain the social mission.

This paper is divided into three sections: the first discussing the history of each institution and its financial performance leading up to its capital-market listing; the second examining the listings from a capital-market perspective, the key features of each listing from a technical perspective and how the institutions have performed to date; the third reaching some tentative conclusions about the meaning of these listings for the microfinance industry more broadly. Ratio-analysis data of the MFIs is presented in Annex 2.

Table 1: IPO/Listing Details

Name of Institution	PT Bank Rakyat Indonesia (BRI)	BRAC Bank	Banco Compartamos, S.A.	Equity Bank Limited
Date of Offering	10/31/2003	12/11/2006	4/20/2007	8/7/2006
Total Shares Outstanding	11,764,703,700	10,000,000 [c]	427,836,876	90,564,550
Offering Number of Shares (% of total)	4,764,705,000[a] (41%)	5,000,000 (50%)	128,308,412 (30%)	90,564,550 (100%)
Total Value of Offering	$476,470,500	$12,588,500	$473,899,952	$86,941,968
Price Per Share at Offering	$0.10	$2.52	$3.65	$0.96
Implied Market Value of Company at Offering	$1,176,470,370	$25,200,000	$1,561,604,597	$86,941,968
Price Per Share as of 9/2007	$0.66	$18.12	$5.25	$1.88
52 Week High	$0.72	$20.06	$6.45	$2.24
52 Week Low	$0.47	$7.05	$3.65	$0.62
Earnings Per Share	$0.04	$0.95	$1.50 (as of 9/30/07)	$0.12
Price Earnings Ratio	16.5	19.1	11.85x (as of 9/30/07)	15.67
Book Value Per Share	$0.15 [b]	$2.64 [d]	$0.29 (at offering)	-
Percentage Increase on Initial Price	561%	619%	47.75 % (as of 9/30/07)	95.8%
Sellers' Proceeds	Government of Indonesia: $291 million BRI: $186 million	BRAC Bank received nearly 100% of the proceeds ($13 million), less underwriting fees.	Compartamos A.C. (NGO): $116 million ACCION Gateway Fund LLC: $143 million IFC: $42 million Individual shareholders: $172 million	No funds were raised.
Distribution of Shares by Type of Buyer	Domestic and international investors	General public: 80% Nonresident Bangladeshi: 10% Mutual funds: 10%	Mexico general public: 18% International Qualified Institutional Buyers: 82%	Kenya existing investors
Lock-up	12 months	3 years	180 days	2 years
Type of Offering	Primary and Secondary	Primary	Secondary	Listing

Currency is not in constant dollars or adjusted for inflation

Primary information sources are as follows: BRI – Offering Circular (10/31/03), BRAC Bank – Prospectus of BRAC Bank Limited (9/20/06), Banco Compartamos – Offering Circular (4/19/07) and Equity Bank – Information Memorandum (3/7/06).

a. Source: Indonesia Stock Exchange, BRI first issue information, November 10, 2003. http://www.idx.co.id.

b. This number is calculated using December 31, 2006 book value and the share price in this chart (September 10, 2007)

c. Source: Dhaka Stock Exchange Ltd., http://www.dsebd.org/forthcoming//bracbank.pdf.

d. This number is calculated using July 6, 2007 book value and the share price in this chart (September 10, 2007)

THE INSTITUTIONS

As we noted in the introduction, each of the institutions has approached the capital markets somewhat uniquely, partly a result of different political and economic conditions within each institution's respective country. In this section, we will briefly discuss the nature of these four MFIs, their histories as financial institutions, their growth and financial performance and their ability to reach scale and impact those without access to formal financial services.

I. BANK RAKYAT INDONESIA (BRI)

Established in 1895, BRI is among the oldest banks in Indonesia. Its unit *desa* system was established in 1984 and is currently one of the largest microfinance institutions in the world. [2] The unit *desa* system is essentially a network of village banks that provide microfinance and savings to poor rural farmers in Indonesia. The system emerged from efforts by the Indonesian government in the early 1970s to substantially increase the size of the rice crop by subsidizing the financing of inputs such as fertilizer and seeds. BRI administered the financing by establishing some 3,600 unit *desas* at its peak under the BIMAS (Mass Guidance) credit program. The unit *desas* were also responsible for providing rural, non-agricultural loans. Employment levels at the unit *desas* grew rapidly to some 14,000 employees. While the effort succeeded in terms of increasing the rice crop, it was clear by the early 1980s that the program of subsidized financing was very costly to the government. A non-payment culture developed rapidly, and the program became clearly unsustainable in the long run.[3]

In 1984, utilizing the infrastructure of the BIMAS program along with the technical assistance and advice of a Harvard Institute of Development team, the government and BRI developed the unit *desa* system. The key was the development of the KUPEDES loan product as well as a number of savings-deposit products introduced after KUPEDES.[4] Though the products have been somewhat modified over the last several years, the unit *desa* system remains much as it was designed in 1984. By 1986 the program reached its break-even point and took off on a remarkable period of growth.

From 1984 to 1996, BRI generated 18.5 million KUPEDES loans, and during 1996 the unit *desas* were extending some 160,000 loans per month, averaging $1,007

[2] For a comprehensive discussion of microfinance in Indonesia, in particular BRI's unit *desa* system, see Marguerite S. Robinson, *Microfinance Revolution Volume 2: Lessons from Indonesia* (Washington: World Bank Publications, 2002).
[3] See S. Charitonenko, Richard H. Patten and Jacob Yaron, "Indonesia: Bank Rakyat Indonesia—Unit Desa, 1970-1996, Sustainable Banking with the Poor" (the World Bank, May 1998), ix-x.
[4] Ibid., x-xiii.

(approximately at GNP per capita), with some 70% of loans below this average. By the end of 1996, the loan portfolio was about $1.7 billion.[5]

Perhaps even more impressive was the growth in savings during this same period. Before the transformation of the village units from 1973–1983, savings mobilized through the national savings system totaled $30 million. As of end 1996, total unit *desa* savings approached $3.0 billion, or nearly $800,000 per unit *desa*, in 16.2 million savings accounts. Equally impressive is that the average size of these deposits in the primary savings products was US$184. This represented some 30% of the total number of savings accounts in Indonesia, serving 10% of Indonesia's population.[6]

The BRI unit *desa* system broke even after just 18 months in operation, in part due to the advantage of inheriting the BIMAS Program unit *desa* infrastructure. Profits of just $6 million in 1986 rose to $177 million by 1996. Return on average equity (ROE), which was 63% from 1990–1993, more than doubled to 134% in 1996[7]. Return on assets (ROA) averaged 4.6% over the seven years 1990–1996. The long-term loan-loss ratio of the program averaged 2.15% over this period of time, with the 12-month loan-loss rate at 1.59% in 1996.[8]

These high growth years for the unit *desas* ran parallel to the growth of the overall Indonesian economy, which experienced more than a decade of uninterrupted growth. In 1970 about 60% of Indonesians lived below the poverty line; by 1996 just 11% of the population lived below the poverty line.[9] This is a remarkable achievement for any developing economy. The unit *desas* benefited from this period of stable and strong economic growth. In turn the working poor in rural villages benefited from the extensive village network of BRI, the opportunity to save safely while earning a decent return and the loans offered under KUPEDES.

However, 1996 was a watershed year for the Indonesian economy. By 1997, the economy was deeply enmeshed in the East Asian crisis that spread rapidly throughout the region from its origins in Thailand.[10] Indonesia's GDP, which had expanded by some 8.0% a year for more than a decade, plunged by 13% in 1998.[11]

In the aftermath of the East Asian crisis, BRI was listed as part of a package of three banks who were majority owned by the Indonesian government. The crisis adversely affected the banking sector in Indonesia, forcing the government to intervene and re-capitalize many of the state-owned banks, especially large commercial banks such as BRI (BRI was re-organized in 1997 as a commercial bank prior to the crisis, however the

[5] Ibid., xiv. See also BRI Unit Products, Bank Rakyat Indonesia and USAID, International Visitor Program.
[6] Ibid., xv.
[7] It is not clear how much equity was allocated to the unit *desa* system, therefore its real equity base might be understated, and these very high returns on equity may be misleading.
[8] Ibid., xvii-xx. See also BRI Unit Products, Bank Rakyat Indonesia and USAID, International Visitor Program. See also Robinson, *Microfinance Revolution Volume 2*, 388, for the loan loss percentage data.
[9] Robinson, *Microfinance Revolution Volume 2: Lessons from Indonesia*, 38.
[10] For an excellent discussion of the crisis see Robinson, *Microfinance Revolution Volume 2*, 46-58.
[11] Ibid., 48.

government still owned all of its shares).[12] With high financial returns from the unit *desas* and a savings base in excess of the lending base, the larger bank was able to drain funds from the rural areas and intermediate these as corporate loans, often through politically tied lending. During the East Asian crisis this resulted in large-scale defaults and the need to re-capitalize the bank.

While the unit *desas*' loan portfolio, savings balances and profits were reduced substantially in dollar terms between 1997–2000, in Rupiah terms the system continued to grow and all measures of financial soundness remained solid,actually improving after 1998 when the crisis was at its deepest. (Please refer to Table 2 below.) As Robinson has noted, "By examining the unit *desas*' performance from 1996–2001 it would be impossible to learn that the country had been in deep crisis."[13]

Table 2: Unit Desa Savings and Lending

Indicator	1996	1997	1998	1999	2000
Value of Outstanding Loans					
Billions of Rupiah	4,076	4,685	4,697	5,957	7,827
Millions of U.S. Dollars	1,711	1,008	585	841	816
Number of Outstanding Loans (thousands)	2,488	2,616	2,458	2,474	2,716
Long-term Loss Ratio*	2.15%	2.17%	2.13%	2.06%	1.90%
Portfolio Status**	3.65%	4.73%	5.65%	3.05%	2.51%
Value of Savings					
Billions of Rupiah	7,092	8,837	16,146	17,061	19,115
Millions of U.S. Dollars	2,976	1,900	2,012	2,408	1,992
Number of Savings Account (thousands)	16,147	18,143	21,699	24,236	25,823

*The long-term loss ratio measures the cumulative amount due but unpaid since the opening of the unit compared with the total amount due. **Portfolio status measures the aggregate amount of overdue principal installments compared with total principal outstanding.
Source: BRI monthly unit *desa* reports

Yet, BRI as a corporate bank, 100% owned by the state, did not do as well during the crisis. The government had to intervene and re-capitalize it with an injection of government bonds into the bank's capital. The focus, starting in 2000, would be on micro, retail and small-and-medium-enterprise (SME) loans.[14] It's clear from data on BRI's outreach that the average size of the unit *desa*'s loans has been reduced and that the institution is reaching further down scale, with respect to average loan size as

[12] The Indonesian Government was forced to close 16 banks and transfer 54 distressed banks to IBRA, the Indonesian Bank Restructuring Agency. See Kawai, Lieberman and Mako, "Financial Stabilization and Initial Restructuring of East Asian Corporations: Approaches, Results and Lessons," *Managing Financial and Corporate Distress: Lessons from Asia*, ed. Adams, Litan and Pomerleano (Washington: Brookings Institution Press, 2000), 104. More than half of BRI's capital was impaired as a result of the crisis 1997/1998 and it accumulated large-scale losses. The government was forced to re-capitalize the bank, which it did in 2000. See Detlef Holloh, "Microfinance Institutions Study" (The Ministry of Finance of the Republic of Indonesia, Bank Indonesia, GTZ), 47.
[13] Robinson, *Microfinance Revolution Volume 2*, 397.
[14] Holloh, "Microfinance Institutions Study," 47. See also Robinson, *Microfinance Revolution Volume 2:* 398–399.

compared to per capita GNP. Average loan size was $878, or some 55% of GNI per capita, at the end of 2006. Savings balances continue to reflect the enormous core group of poor savers, with the average savings balance at $158, or some 9% of GNI per capita, at the end of 2006.[15]

BRI first listed on the Jakarta Stock Exchange in October 31, 2003. The IPO brought with it a new strategic focus for the institution; it would be a full-service commercial bank heavily focused on micro and small business (retail) lending. In fact, as part of a memo of understanding with the International Monetary Fund (IMF), the Ministry of Finance enjoined BRI from making corporate loans to new customers. The agreement with the IMF was to sell off the bank's corporate loans, but that aspect of the agreement was not fully implemented at the time of the IPO. The bank was instead required to develop a strategy that would build on its strengths—the unit *desa* system, retail or small-business lending and consumer lending.[16]

For the last few years, growth has been modest but steady, reflecting the maturity of the unit *desa* system and the need for the bank to regenerate its capital. Growth in borrowers has averaged 3.7% a year reaching a total of 3.5 million borrowers at the end of 2006. The loan portfolio has grown to $3.0 billion. Savings accounts have somewhat peaked, growing at 1.23% per year over the last three years and, in fact, declining by 4.1 % in 2006. However, the unit *desas* had 31 million savings accounts, with a total deposit balance of $4.9 billion at year end 2006.[17]

Financial performance remained very strong at the end of 2006, with a ROA of 6.88% and ROE at 129.96%.[18] The profit margin was 31.17%, and operating expenses to loan portfolio were 8.26%. Portfolio at risk was 5.07%, and the write-off ratio was less than one percent, at 0.83 %.[19] See Table 3 for a summary of BRI's microfinance operations.

Despite its great success to date, the unit *desa* system still faces a number of challenges and risks. These are discussed by Marguerite Robinson in her seminal work on Indonesia, *Volume II of the Microfinance Revolution: Lessons from Indonesia*,[20] and are as follows:

- **Political instability—**There exist threats from outside BRI with respect to the stability of Indonesia and its potential for radicalization as well as from the political direction of the government with respect to BRI's policies and lending activities.

- **Inappropriate regulatory environment—**The unit *desas* are required to comply with banking regulations that are inappropriate to its microfinance business,

[15] The MIX Market, http:www.mixmarket.org.
[16] Bank Rakyat Indonesia, Offering Circular (2003).
[17] Ibid.
[18] See footnote 6, where we comment on the potentially exaggerated returns on equity for the unit *desa* system.
[19] Ibid.
[20] Robinson, *Microfinance Revolution Volume 2: Lessons from Indonesia*, 398-402 (See "Challenges"). See also Rank Rakyat Indonesia, Offering Circular, 18-33 (See "Risk Factors").

a problem faced by a number of microfinance banks and regulated finance institutions.

- **Mission drift**—There is a danger that, having been re-capitalized and existing within a large commercial bank, BRI will stray from its mandate and resume corporate lending on a large scale.

BRI's achievements in microfinance to date are remarkable. The institutional infrastructure, systems and products that are in place allow it to continue performing as one of the giants of the industry. Also, in its earlier development BRI's management and the unit *desas*' management, for example Kamady Arief and Sugianto, were totally devoted to the development of microfinance and maintaining the integrity of the unit *desas*, as apart from the bank. A long serving Minister of Finance, Ali Wardana, supported them. It is not certain that the present leadership and future leadership of the bank, appointed after the crisis, will share this same vision for the future

II. BANGLADESH RURAL ADVANCEMENT COMMITTEE—BRAC BANK

BRAC is a non-governmental organization (NGO) begun in 1972 as a relief and rehabilitation effort after the Bangladesh War of Liberation. Over the years, BRAC has evolved into the largest national NGO in the world, It is involved in myriad social support services, financial services, business entities and training programs, all with the twin objectives of poverty alleviation and empowerment of the poor, especially women. BRAC is present in some 62,000 villages throughout rural Bangaldesh. Its social services include health services, diagnostic laboratories, community nutrition centers, schools, libraries, reading centers and handicraft production centers. BRAC also operates BRAC University, providing tertiary education.[21]

In short, BRAC is a highly successful social conglomerate. It has achieved its size and excellence under a highly dedicated management team led for more than thirty-five years by Fazle Abed and his tight-knit team.

BRAC manages a very extensive microfinance program: BRAC Economic Development Program. By the end of 2006, the program had reached 4.6 million poor, mostly women. BRAC's microfinance operations were conducted through 1,205 service offices. Its loan portfolio was $350 million with an average loan balance per borrower of $77, 14% of GNI per capita in 2006. Savings mobilization was more modest, with 45,000 savings accounts totaling $538,000. The average savings balance is $11, 2.86% of per capita income.

It is clear that BRAC reaches very poor clients. Moreover, BRAC continuously tries to reach further down the scale to the poorest of the poor, largely through grant programs

[21] BRAC Bank Limited's annual reports for 2003–2006, http://www.brac.net.

that prepare their clients economically until they are able to borrow.[22] Despite its effort to reach as far down the scale as is economically feasible, BRAC's microfinance operations have operated profitably with a ROA of 6.9%, ROE of 23%, operating costs of 13% and portfolio write offs at 0.63% as of end 2006.[23] BRAC's microfinance operations have extended to Sri Lanka, Afghanistan, and sub-Saharan Africa, making BRAC a multinational MFI. See Table 4 for a summary of BRAC's microfinance operations.

In addition to its microfinance operations, BRAC has been involved in operating a number of businesses—a poultry farm, cold storage facilities, internet service provision, land and housing operations, hospitality services and housing finance. BRAC also runs a number of programs that build employment skills and educate young people throughout Bangladesh.

However, BRAC did not choose to commercialize its microfinance operations; it remains within the NGO. Instead, BRAC's management chose to float BRAC Bank, a commercial bank servicing SMEs in Bangladesh—largely the "missing middle" with respect to financial services in many developing countries.

BRAC perceived an important economic and social opportunity in serving this missing middle and floated BRAC Bank Limited through an IPO on the Dakha and Chittagong Stock Exchanges on December 11, 2006. BRAC Bank raised some $13 million through the IPO, all of which will be utilized to expand the bank's operations throughout Bangladesh.[24]

By the end of 2006, BRAC Bank operated some 280 unit offices, had approximately 3,000 staff and 61,000 borrowers, with a gross loan portfolio of $293 million. During 2006, monthly loan volume averaged $5.8 million dollars, and average loan size was $4,761 dollars. Savings deposits totaled $344 million dollars coming from 259,000 savings accounts. During 2006 net profits were $5 million, up from $530,000 in 2003. ROA was 1.42% and ROE was 23% in 2006.

Although BRAC is considered one of the most successful microfinance institutions, its unique structure and development present several challenges that the organization will have to meet:

- **A non-profit structure—**Currently BRAC's microfinance strategy operates under an NGO structure that does not allow the mobilization of savings or the ability to raise funds commercially. This strategy differs markedly from the approach taken by BRI and Equity Bank, for example, which provides microfinance and SME services through full-scale commercial banks. Compartamos also operates as a commercial bank, but is focused on microfinance and has not yet mobilized savings in a significant way. Although BRAC's strategy reflects its personal development and there is no single best model to be

[22] Ibid.
[23] The MIX Market.
[24] BRAC Bank Limited, Prospectus (2006).

prescribed, there are certain advantages to operating as a commercial entity. These include:

1. the ability to offer clients a range of savings products and deposit insurance as allowed by the government,
2. the ability to use savings mobilization as a primary funding source for the bank,
3. the ability to offer a range of loan products and other financial services and
4. access to branch infrastructure and the technology of a bank, including ATMs, credit and debit cards, management information systems (MIS) and back office operations.

One long-term possibility for BRAC is to merge its microfinance operation into the bank. Not having sufficient inside knowledge of BRAC, nor of the regulatory issues and political/ economic and social considerations in Bangladesh, we are not making such a recommendation. We are simply speculating about whether such a change will make sense in time.

- **Succession—**One of the major factors of BRAC's success has been the commitment and savvy of its founding management team. Now the team is beginning to grow older together, and BRAC has begun to address the question of succession.[25] Management of succession will be a key issue for the success of the institution as well as for the industry as a whole going forward.

III. BANCO COMPARTAMOS, S.A. (COMPARTAMOS)

Compartamos is one of the largest microfinance institutions in all of Latin America.[26] Its origin lies in a Mexican youth organization to improve the life of poor Mexicans, living in marginalized communities. Compartamos was launched with a village banking pilot program in 1990 as an NGO titled *Asociacion Programa Compartamos*.[27] Compartamos operated as an NGO until 2000. In 2000, with a client base of 64,000 borrowers, it became a regulated for profit financial institution in the form of a SOFOL (*Sociedad Financiera de Objecto Limitado*—a financial institution with limited objectives). Finally, in June 2006, the institution became a licensed commercial bank.[28]

Compartamos was started by three young and highly talented social entrepreneurs, who have since remained as senior managers,[29] with Carlos Labarthe serving as managing director and a board director, Carlos Danel serving as co-managing director and a board

[25] BRAC Bank Limited, Prospectus, 35-38 (See "Officers and Director").
[26] For a comparison of Compartamos with other large LAC MFIs, see Beatriz Marulanda and Maria Otero, "The Profile of Microfinance in Latin America in 10 Years: Vision and Characteristic" (ACCION International, April 2005).
[27] Banco Compartamos, Offering Circular (2007), 86. Elisabeth Rhyne and Andres Guimon, "The Banco Compartamos Initial Public Offering," *InSight*, no. 23 (June 2007), 1.
[28] Richard Rosenberg, "CGAP Reflections on the Compartamos Initial Public Offering: A Case Study on Microfinance Interest Rates and Profits," no. 42 (June 2007).
[29] Banco Compartamos, Offering Circular, 83.

director and Ivan Mancillas serving as vice president of business development and an alternate board director. The team's talent, passion, commitment to the mission, and willingness to draw on external expertise has been a critical factor in success. Additionally, from the beginning Compartamos has had a serious and committed board of directors including representatives of the Harp family, Mexican business leaders and, in recent years, representatives of outside equity investors, such as the World Bank Group's International Finance Corporation (IFC), ProFund and ACCION International.

Compartamos' early financing was somewhat typical for MFIs at the time. In the initial years, the management secured funding in increasing amounts from various donors. Then in 1996, it received a grant of $2 million from the Consultive Group to Assist the Poor (CGAP) to support its expansion and capacity-building efforts.[30] With this financing, Compartamos was able to reach the take-off stage.

By 1996 growth was robust and remained so until the institution went public. From 1996–2000, Compartamos expanded its client base at 24% a year as an NGO. As a regulated financial company from 2000–2006, growth averaged 46% a year.

By the end of 2006, Compartamos reached 600,000 clients with its loan portfolio at $271 million. All profit measures were exceptionally strong as a result of high real-interest rates and exceptionally low loan-loss rates. At the end of 2006, ROA was 23%; ROE, 57.53 %. Portfolio at risk was 0.62%, and loan write offs were 0.57%. See Table 6 for a summary of Compartamos' microfinance operations.

Yet Compartamos continues to reach down the scale to some of the poorest populations in Mexico, with an average loan size of $440 at end 2006, 5.45% of GNI per capita. Compartamos operates 187 branches in 28 states of Mexico. Loans are focused towards rural villages and women entrepreneurs (98% of its clients) who lack adequate access to finance.[31] The client base is widely diversified across Mexico's regions, but the largest concentration of clients is in the poorest, indigenous states, such as Chiapas, Guerrero, Oaxaca and Veracruz.

Although Compartamos has diversified its products over the years, 87.4 % of its total loans belong to its Income Generator (IG) Loan program for women. This program places women in groups of 15 and together they provide a solidarity guarantee.[32] Also, all clients of the Income Generator Loans are provided with basic life insurance coverage at no extra cost to the borrower due to an alliance established with Seguros Banamex.[33]

Unable to mobilize deposits as a SOFOL, Compartamos financed this expansion through a combination of retained earnings from strong profit performance and an injection of

[30] Ibid., 5. Richard Rosenberg and Robert Christen initially evaluated Compartamos and recommended that CGAP fund its expansion. Ira Lieberman was the CEO of CGAP at the time and brought that proposal to CGAP's Credit Committee as one of CGAP's earliest and largest grants. Rosenberg and Christen continued to provide advice to CGAP's management in its early years.

[31] Rhyne and Guimon, "The Banco Compartamos Initial Public Offering," 2.

[32] Ibid., 3. Banco Compartamos, Offering Circular, 71.

[33] Ibid., 88.

$6 million in equity investments from international investors focused on microfinance. The international investors included ACCION International, ProFund and IFC.[34] However, it was Compartamos' ability to tap both the inter-bank market and the capital markets that made a substantial difference in its ability to expand it client base. That early entry into the capital markets in turn conditioned the institution and the market for its IPO. In July 2002, Compartamos issued $20 million of bonds, with a three year maturity rated by Standard & Poor's as MxA+, and in February 2004, with a 34% guarantee from IFC, Compartamos raised five-year bonds in an amount of $50 million, rated by Standard & Poor's and Fitch Mexico as mxAA.[35]

In June 2006, Compartamos received a commercial banking license from the Mexican Ministry of Finance and Public Credit (Hacienda—its short name in Mexico) and changed its name to Banco Compartamos S.A., Institución de Banca Multiple. Commercial bank status allows Compartamos to continue diversifying its sources of funding and its product offering, especially the mobilization of savings deposits.

On April 20, 2007, Compartamos went public through an IPO that listed it on the Mexican Stock Exchange and also offered shares to international institutional investors under U.S. Securities and Exchange Commission (SEC) Rule 144A. The offering was unusual for an IPO in that the bank received none of the proceeds from the sale; it was a 100% secondary offering that raised some $474 million and allowed the principal shareholders—Accion, IFC, Compartamos (the original NGO)—as well as the individual Mexican shareholders—managers and directors, who had founded and run Compartamos since 1990—to recoup their investment and, as it turned out, very substantial profits.[36]

Compartamos' IPO focused attention on its profitability and robust ROA and ROE performance, in large part due to its quite high interest rates. The IPO also generated quite a bit of controversy in the microfinance industry and also the business press[37] due to the large returns to Compartamos' investors.

Setting aside the external controversy over high interest rates and excessive profits from the public offering, Compartamos has a number of internal issues to deal with:

[34] Ibid, 3. Rosenberg, "CGAP Reflections on the Compartamos Initial Public Offering," 5. ACCION's investment of $2 million in Compartamos was funded by USAID and CGAP funding for ACCION's Gateway Fund that was intended for equity investments in unspecified MFIs. USAID also provided Compartamos with an additional $2 million through ACCION in 2000 that went partially to the NGO for technical assistance and primarily to the for-profit institution as a loan.

[35] Banco Compartamos, Offering Circular, P. Also IFC documents.

[36] Banco Compartamos, Offering Circular.

[37] *BusinessWeek* online, December 13, 2007—"The Nobel Prize-winning microfinance pioneer refuses to mention the words 'Compartamos' and 'microfinance' in the same breath." See also Keith Epstein and Geri Smith, "The Ugly Side of Microlending: How big Mexican banks profit as many poor borrowers get trapped in a maze of debt," *BusinessWeek*, December 13, 2007. http://www.businessweek.com/magazine/content/07_52/b4064038915009.htm. Keith Epstein and Geri Smith, "Online Extra: Microlending: It's no cure-all," *BusinessWeek*, December 13, 2007. http://www.businessweek.com/magazine/content/07_52/b4064045922248.htm.

- **Cash mobilization and handling—**At present, Compartamos' regional offices do not handle cash. Instead, clients use other commercial banks throughout Mexico based on agreements Compartamos has negotiated with these banks. Compartamos has the dual task of cash management—of converting the present offices/ branches to real banking branches able to handle cash securely—and the need to develop systems to move that cash to regional and/or central depository facilities. This has to happen if Compartamos intends to mobilize deposits in the future.

- **Savings mobilization—**How should Compartamos approach the costly and very intensive effort of mobilizing savings from its clients? Compartamos needs to design savings products are both economically viable for the bank as well as appealing to its clients. Savings are an important potential service for Compartamos' poor clients, but they can be a costly alternative way to fund the bank if not handled properly. Also, the branch offices will need to be able to physically handle the increased inflows of clients once savings products are available. This will require significant investments in the present offices to convert them to full branches or the build-out of new branches in some cases that can mobilize savings with adequate security and also handle the traffic flow.

- **Diversification of product offering—**Compartamos will need to diversify its product base to become a full service bank for its clients. Currently, village-group loans dominate the product offerings; individual loans, housing rehabilitation loans, money transfers and remittances and insurance products could add fee income and provide Compartamos' clients with a wider range of services.[38]

- **Competition—**Finally, given its very high profitability, high real rates of interest to its clients and overall strong financial performance, it seems reasonable that Compartamos will face strong competition in the future from other banks or non-traditional financial institutions in Mexico, such as Banco Azteca and the recently licensed Banco Wal-Mart. Compartamos will need to decide how to step down the pricing curve (i.e., reduce its interest and fees, while still remaining profitable and competitive for the long term and continuing to serve the needs of its traditional client base).

IV. EQUITY BANK LIMITED

Equity Bank was founded in Nairobi in 1984 as the registered building society Equity Building Society (EBS). It focused initially on providing term loans and mobilizing deposits. The bank opened several branches in the nearby Central Province during its initial years of operation. Less than a decade after its inception, the high risk of term loans, stagnant deposit base, lack of capital, poor management and a difficult

[38] Banco Compartamos, Offering Circular, 85-86 (See "Our Strategy").

macroeconomic and political environment led the bank to the brink of collapse. Despite its license as a mortgage lender, its initial portfolio consisted primarily of unsecured equipment loans to coffee and tea farmers. The Central Bank of Kenya declared EBS insolvent in 1993, when more than 50% of its loan portfolio was at risk of default and deposits were being used to cover operating expenses.[39]

Realizing that the bank needed help, in 1994 the chairman recruited James Mwangi, current Equity Bank CEO, and began a major restructuring effort led by Mwangi. The effort focused on the economically active poor—micro and small, salaried employees, small commercial farmers and medium-sized enterprises in both urban and rural areas. In addition, the bank began a major marketing effort to mobilize savings deposits. The vision evolved over the years, but ultimately the goal was to become the leading retail bank in East Africa by providing the full range of financial services to the economically active poor.[40] The new management team placed significant emphasis on training and recruiting quality staff and developed a culture of service to the clients above all.

James Mwangi serves currently as the managing director of Equity Bank and is highly regarded in Kenya and throughout the microfinance industry for his managerial excellence and his commitment to growth while also serving the poor. He has begun to assemble a management team in the bank to focus on its long-term growth. Like Abed at BRAC, and Labarthe and Danel at Compartamos, Mwangi has a unique capacity as a social entrepreneur and manager to build Equity Bank for the future.[41] He has also created incentives for his management team by providing them with share ownership in the bank. The listing on the Nairobi Stock Exchange and the increase in the value of Equity Bank's shares provides an important compensation incentive to attract talent to the bank that other non-public banks and MFIs will find hard to match.[42]

During its restructuring, EBS reached out selectively to the international microfinance community for assistance. In 1999,funding from MicroSave-Africa and Swiss Contact, followed soon after by assistance from the British Department of International Development (DFID), made a major difference in Equity Bank's turnaround. For example, a DFID grant of $411,000 allowed EBS to upgrade the technology and increase the scale of its mobile banking units that reach clients in remote rural areas. The mobile units began operating in 2000 with $262,000 of EBS' own capital.

Technical assistance from MicroSave and Swiss Contact, based on market research in Kenya, resulted in a new focus for EBS—on the development of a product design that

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[39] Gerhard Coetzee, Kamau Kabbucho and Andrew Mnjama, "Understanding the Rebirth of Equity Building Society in Kenya" (MicroSave-Africa, August 2002), 4-5. Also see Douglas Pearce and Myka Rensch, "Equity Building Society Reaches Rural Markets," (CGAP Case Study, Agricultural Microfinance, August 2005), 1.

[40] Coetzee and others, "Understanding the Rebirth of Equity Building Society in Kenya." AfriCap, Investment Report, January 2003, 10. Pearce and Rensch, "Equity Building Society Reaches Rural Markets," 2–3 (on the mobile banking product) 3–4 (on technical services assistance to EBS).

[41] Equity Bank, Information Memorandum (Nairobi, Kenya, 2006), 10 (on shareholdings of management team) and 42-45 (description of the management team).

[42] Ibid.

would be appropriate for the microfinance and small business market. Just as BRI was able to implement a massive savings program through carefully researched product design, EBS developed a range of savings products that met its clients' needs. Savings provided a source of low cost capital, allowing the bank to rapidly expand its branch footprint throughout the country while also enabling it to validate clients' creditworthiness prior to lending. In order to receive a loan, a client had to open an account and save with EBS for a minimum of six months.

Commenting on Equity's business model, AfriCap Microfinance Investment Company, Ltd., a Mauritius-based microfinance investment fund, noted:

> The company attracts savings by providing comparatively high rates, flexible products and outstanding customer service. As an example, the savings account offers a very low minimum balance, no fixed fees and no restrictions on withdrawals and deposits. Loyal savers are progressively converted into borrowers on the basis of their savings patterns. As a result the company incurs little additional marketing costs while building its loan portfolio.[43]

The bank also offered a full range of loan products; however, until recently the bank's strength has been in its savings products.[44] Portfolio at risk has remained high by microfinance standards, even though the bank has performed as well or better than many of its banking competitors in Kenya. Equity needed to invest a significant amount of funds and effort in management information system (MIS) software and credit-risk management systems in order to comply with changing banking regulations in Kenya and, perhaps more importantly, to tighten its control over its portfolio performance.

However, EBS also needed more equity capital to support its large deposit base and rapid expansion. In April, 2003, AfriCap focused on equity investments in emerging MFIs throughout Africa, investing $1,500,000 in EBS and becoming its first external strategic investor. Moreover, AfriCap also provided technical services funding and support through its Technical Services Facility (TSF), and two members of its management team joined EBS' board of directors as EBS also sought to strengthen its governance as part of the bank's overall re-organization and restructuring effort. [45]

EBS' new strategy, new management team, external technical assistance and investors have paid off. Between 1993 and 1997, deposits grew by 823%, the loan portfolio expanded by 1,525% and profitability improved by 323%. The bank broke even in 1998 and closed the year 2002 with net earnings of almost $2 million.[46]

In 2000, EBS was being compared to other MFIs. For example, it was compared to Kenya Rural Enterprises (K-Rep), the first MFI to convert to a fully licensed bank in Africa that at the time had 15,451 clients, 369 million Ksh in loans and a market share of

[43] AfriCap, Investment Report, 10.
[44] Coetzee and others, "Understanding the Rebirth of Equity Building Society in Kenya," 14.
[45] AfriCap, Business Plan, Portfolio Summary (2006).
[46] AfriCap, Investment Report, 10.

just 2%. Equity Bank was also compared to FALU, a limited liability company that had 15,000 clients, 231 million Ksh in loans and a market share of 1%, as well as the Kenya Women's Finance Trust (KWFT), an NGO with 19,618 clients, 265 million Ksh in loans and a market share of 1%. It was the rural cooperatives serving small farmers, SACOs, that controlled the market, with over a million active clients, 23 billion Ksh in loans and 94% market share.[47] However, as member based cooperatives, the SACOs were largely unregulated and many proved unstable with poor governance and concentrated lending to farmers with a narrow range of crops.

In 2004, when EBS was given a full banking license following its turnaround and initial take-off phase, the bank began to grow dramatically. By 2006, the year the bank decided to go public, there were few that continued to benchmark EBS as an MFI. Rather, Equity Bank Limited, as the bank was renamed, was now benchmarked against the Kenyan banks.

Box 1: Market Intelligence 2006: Selected Indicators for Equity Bank (2005 data)[48]

- Cost of Funds (0.91%): Ranked 1. (1.25% in 2004)
- Return on Capital Employed (31.40%): Ranked 3. (17.17% in 2004)
- Total Income / Total Assets (16.45%). Ranked 4. (16.39 % in 2004)
- Number of Branches (36): Ranked 4. (89% increase over 2004)
- Number of employees (884). Ranked 5. (53% increase over 2004)
- ROA (4.37 %): Ranked 5. (3.25% in 2004)
- Before-tax Profit (501 million Kshs): Ranked 8. (129% increase over 2004)
- Total Net Operating Income (1,803 million Kshs): Ranked 9. (74% increase over 2004)
- Total Income (1,885 Kshs): Ranked 11. (71% increase over 2004)
- Net interest income (866 million Kshs): Ranked 12. (119% increase over 2004)
- Total assets (11,457 million Kshs): Ranked 13. (71% increase over 2004)
- Total liabilities (9,863 million Kshs): Ranked 13. (81% increase over 2004)

Source: Market Intelligence Banking Survey 2006.

Equity Bank Limited's growth has been meteoric. From 2003–2006 the number of borrowers has increased from 59,000 to 240,000 at an annual average of 66%. The portfolio has grown from $15 million in 2002 to $158 million at year end 2006, an annual average growth rate of 82%. The number of savings accounts during this same period has grown from 156 thousand to just over a million, a 61% average growth rate, while deposit balances grew from $28 million to $236 million, a 72% average growth rate.

Equity Bank was able to grow explosively, while maintaining relatively sound financial performance. Portfolio at risk remained a problem throughout this period, which Equity Bank sought to address with a significant investment in MIS and with technical assistance on credit risk management, supported by CGAP.

At the end of 2006, the bank's ROA was 4.85%; its ROE, 40.36%. The profit margin was 31.53%. Capital adequacy was 11% and the debt-to-equity ratio at 8.10%. Operating

[47] Coetzee and others, "Understanding the Rebirth of Equity Building Society in Kenya," 12-13.
[48] Box prepared by Marguerite Robinson for a note on Equity Bank, November 2006.

expenses increased rapidly as well to keep pace with expansion, at 77% on average per year from 2003–2006; however, at 42.38%, operating expenses as a percentage of loan portfolio were high. Also, portfolio at risk stayed stubbornly high at 12.19%. [49] See Table 7 for a summary of Equity Bank's microfinance operations.

Equity Bank continued to reach down the scale throughout this period of explosive growth, indicated by an average loan balance of $444, or 65.64% of GNI per capita, and savings on average of $165, or 36.73% of GNI per capita, as of 2006.[50]

Equity Bank Limited, just as the other institutions, faces a number of issues:[51]

- **Risk management—**Equity Bank's portfolio at risk, risk management systems and control over its very diverse portfolio of lending products remains the area that most needs attention. CGAP is currently assisting Equity Bank with technical assistance in this area. In addition, a major investment and effort by the Bank's management to upgrade its MIS is designed to address these areas.

- **Competition—**Equity Bank's expansion has led it to bump up against the large corporate banks in Kenya. Competition amongst these banks is really heating up and there is a question whether or not these banks will begin to reach down the scale with respect to loans and savings mobilization and compete with Equity Bank directly;

- **Growth management—**Equity Bank has high costs as a result of its expansion and has had to absorb a very large number of personnel in a short period of time. While the bank grows exponentially it is hard to also attack issues such as productivity and efficiency, but that will become a necessity at some point in time;

- **Expansion opportunities—**Equity Bank has ambitions to expand throughout East Africa. Interestingly, the bank is likely to bump against BRAC who has its own ambitions to enter some 10 countries in Africa. BRAC is a formidable competitor and is already having significant success at an early stage in Uganda. Will Equity Bank go it alone in East Africa? Will it meet nationalistic and political resistance? Does it have the management capacity to expand internationally? These are but a few of the questions that will need to be answered before the bank moves forward on an international strategy.

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[49] Equity Bank Limited's annual financial statements and the MIX Market.
[50] The MIX Market.
[51] Equity Bank, Information Memorandum, 48-50 (See "Risk Factors").

V. Summary and Conclusions

What is it about these four institutions that have qualified them for capital market listings and IPOs? What lessons can other large MFIs considering this step take from the success of these institutions?

Management excellence

Each of the institutions in question has long-serving senior management who are outstanding social entrepreneurs and managers. Their respective institutions have consistently generated profits. The exception is BRI, which had very dedicated heads of the unit *desa* program and the bank, including former managing director of the unit *desa* system Sugianto, former president of BRI Kamardy Arief and former Indonesian Minister of Finance (1968–1983) Ali Wardhana, whose current leadership is concentrated in the larger bank and less known in the microfinance industry.[52] Also, when BRAC Bank, the subject of the IPO, was established, BRAC's senior management hired highly experienced bankers to run the bank rather than using the NGO management directing the microfinance operations.

Any decision to take an institution public, particularly an institution like Compartamos and BRI that wishes to raise funds from international institutional investors, requires significant reflection on the quality of the current management, noting whether they can manage the institution profitably in the future while also providing returns to investors.

Good governance

A second condition precedent for an IPO is the existence of a serious board as well as well-instituted good-governance practices. For international institutional investors financing under U.S. SEC Rule 144A, that would include practices that comply closely with the U.S. Sarbanes–Oxley Act guidelines respecting such matters as independent and qualified audit committees and MIS and accounting systems that provide high standards of internal controls. They also will look to the independence and qualifications of directors.

The four institutions we have examined have all made a serious effort to recruit serious boards of directors and to implement good-governance practices. Becoming regulated financial institutions has certainly been an important factor in these institutions' improving their governance and going public. Best-governance practices remain a very under-examined issue in the microfinance sector, and more attention will need to be spent on it as MFIs seek to attract significant amounts of external capital or, as in this case, go public.[53]

[52] Ali Wardhana became Coordinating Minister of Economics, Finance and Industry and continues to serve as an economic advisor to the government. Although he remained in the background, Wardhana has been a vital supporter to the unit *desa* system. See also Robinson, *Microfinance Revolution Volume 2*, xxxi.

[53] Ira W. Lieberman and Elizabeth Rhyne, "The Practice of Corporate Governance in Shareholder-Owned Microfinance Institutions" (Consensus Statement of the Council of Microfinance Equity Funds, May 2005). See also Equity Bank Limited, Information Memorandum, Corporate Information, Board of Directors, Governance, 37–41.

Ownership incentives

In two of the institutions that listed—Equity Bank and Compartamos—management and director ownership has become an important issue. It stands to reason that long-serving management and directors should have incentives tied closely to the long-range success of their institution. The fact that these individuals have been rewarded for their success is a good signal to the industry in general and should also enable the industry to attract first-class talent as the very critical issue of management succession is addressed in a number of MFIs. In both of these cases, management acquired their shares through investment. However, as public entities they will be able to use incentives such as options or stock grants as incentives for existing management and employees and, as appropriate, to attract new management into the company.

Many MFIs have operated with the same senior management team over the last 15–20 years or more, from the early emergence of microfinance in the developing world. Incentive compensation could play an important role in an orderly succession both out of and into these institutions. That is the normal case in for-profit institutions, both financial and industrial. BRI, with majority ownership by the Indonesian government, could presumably not offer such incentives. In the case of BRAC Bank, the very small ownership stake of the senior management of the NGO speaks highly of their individual commitments to the Bangladeshi poor.

Despite these two examples, incentives have an important role to play as MFIs structure themselves on commercial terms and become shareholder-owned institutions. We would expect to see stock options as an important form of incentive compensation for management recruitment and employee stock plans as more MFIs go public in the future.

Scale

Each of these institutions has achieved massive scale within its respective market, translating into a strong capital base and profits. As banks by any international measure, the four are quite small, but within their markets BRI and Equity Bank are important. BRAC has also reached substantial scale, especially if we look at the combined microfinance and SME operations (the latter within BRAC Bank). Compartamos is a niche bank in Mexico, but it is among the largest MFIs in the country and Latin America. The profitability, return on assets, return on equity and low loan-loss ratios of these institutions rank them among the best performing banks and financial institutions in their respective markets. Clearly these four institutions are among the best of the MFIs. As such they were able to list and issue their shares to both domestic and international investors. The performance to date of their post-IPO stocks is a reflection of their long-term growth potential. Even if we assume that their growth rate will slow by 50% by the end of 2011, collectively their scale or outreach to the working poor is very significant—projected at some 11 million borrowers and 41 million savers.[54]

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[54] Projections prepared by Bruce Campbell take the historical growth rate of each of the institutions compared to the number of borrowers and then reduce their rate of growth stepwise between 2007–2011 so that by the end of 2011 the growth rate has been reduced by 50%. For savings, the projections focus only on Equity Bank and BRI. At present BRI dominates these numbers. However, Compartamos is beginning to experiment with savings, and BRAC is mobilizing a large amount of savings in its SME bank. Were both

Brand image and market recognition

When an investment advisor looks towards taking these institutions public there is a convincing story that can be told. Simply, the four institutions have performed exceptionally well, and they benchmark well within the industry and within their respective financial sectors. In marketing terms, they carry a very strong brand image that is recognized favorably by the investing public in their countries and increasingly by knowledgeable investors in international markets.

Quality of Products and Services[55]

It seems clear that each of the institutions has figured out what it takes to meet and anticipate client needs. Microfinance institutions operating within a bank are better able to offer a full range of products and services to their clients, including a diversity of savings products, insurance, money transfers, remittances, e-banking and mobile banking as circumstances warrant. Although to date the four institutions' have not expanded to offer a full suite of financial products and services. However, BRI does offer a range of savings products, and Equity Bank offers products for both savings and loans. Compartamos serves as an agent for insurance product offerings.

Moreover, as these banks add small-business finance on a sound basis, they are able to improve their economics—for example, through larger average loan and deposit size—without abandoning their social mission. For the moment, BRAC has chosen to keep the microfinance and SME operations separate. Compartamos is strictly a microfinance bank and has yet to mobilize savings in a meaningful way. However, BRI and Equity Bank combine these offerings.

In contrast to these four institutions, the ProCredit banks have been very successful in difficult markets, keeping their microfinance and small-business lending at the core of their financial services and then adding a full array of financial services as client demand requires.[56]

The quality of services and products is not only reflected in high profits, low loan-loss ratios and low portfolio at risk (Equity Bank is something of an outlier with respect to portfolio at risk), but also, in the cases of BRI and Equity Bank, in savings that provide low cost of funds to these institutions. Not only can these banks reach a critical mass of clients, but in the future we expect that they will reach them with a variety of products and services that allow the banks to add to fees and earn income as well as providing for their clients' needs. BRAC Bank, Equity Bank and ProCredit Banks have seen the advantage of serving the "missing middle"—small business in addition to micro-entrepreneurs—but BRAC does this by separating the two sets of target clients between

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of these two institutions to succeed as we expect, then the four might well reach 45 million savers in the next five years.

[55] For an interesting discussion of this issue see Elisabeth Rhyne and María Otero, "Microfinance Through the Next Decade" (ACCION International, November 2006), 14 (See "Quality Gap") and 21–28 (See "Who Will Deliver Microfinance").

[56] Ira W. Lieberman, "Appraisal of ProCredit Bank Serbia, Microfinance Program for the Bor Region, World Bank Bor Regional Development Project," June 6, 2007 (mimeo).

its NGO offering microfinance and its bank offering small and medium enterprises finance, while the other two offer a range of financial services through their commercial banks. Again, these actions serve to add to the quality and branding of each bank.

Technology and Infrastructure

Each of the four institutions discussed have had to build an extensive infrastructure of branches or service offices to reach their clients. For example, Equity Bank in its prospectus discusses moving from 31 branches in 2005 to 61 branches by 2009. Since its founding in 2001, BRAC Bank has grown to 18 branches and 313 regional marketing/ field offices. BRI has an extensive village network that exceeded 3,900 unit *desas* at its peak, and Compartamos now faces the task of converting a very extensive service-office network to full bank branches if they are going to intermediate savings. Along with this growth, however, comes a need to continuously invest in technology such as ATMs, credit and debit cards and MIS systems. BRI and Equity Bank have discussed the extensive investments required in MIS systems, the former as a use of proceeds and the latter before listing. It seems clear that MFIs that want to go public will need to be up-to-date technologically and demonstrate their ability to compete in the banking sector with the latest in technological product and systems.

The Social Bottom Line

Microfinance has received a great deal of positive publicity in the last few years. There seems to be an important market segment of individual investors and institutions that will invest a portion of their funds in institutions that support a double bottom line. Initially, debt funds that could guarantee their investors a minimum social return were uniquely placed to tap into this market segment. We have seen this in the development of microfinance funds such as Blue Orchard, the Responsibility Fund, Deutsche Bank's Microfinance Fund, the Calvert Social Funds and the Calvert Foundation, which also makes loans to and invests in MFIs. Sound MFIs with the qualifications to go public are perfectly placed to tap into this positive market sentiment and growing segment of investors keen to invest in socially responsible institutions.

The question then is whether IPOs and the entry of commercially funded equity investments make it harder for MFIs to focus on the social bottom line. The evidence from the four IPOs/listings discussed in this paper seems to suggest that for the moment these institutions are respecting the financial and social components of the double bottom line. Will market pressure to maintain the stock price force these institutions into mission drift over time? That remains to be seen and is certainly one of the risks.

Outside Strategic Investors

With the exception of BRI, these institutions had participating internationally recognized external investors take equity stakes prior to the IPO. In addition to the capital they provided, strategic investors such as IFC, ACCION, AfriCap, ShoreCap International or their respective equity funds served as an important measure of confidence in the institution prior to the IPO/listing. In addition, each of these institutions, with the possible exception of BRAC, has received significant technical assistance from the donor community and microfinance experts in order to ensure that their product lines, lending methodologies, credit management systems, MIS, management structures and governance processes, among other areas, met or exceeded industry standards.

Benchmarking

As a result of their profitability and growth, the institutions that have listed or gone through an IPO are increasingly being benchmarked or measured in terms of performance against regulated financial institutions. They are supervised by the respective banking regulation and supervisory authority in their countries and are increasingly being rated by international rating agencies such as Fitch and Moody.[57] Also, market research on these institutions from investment banks and brokerage firms will rate them against banks rather than other microfinance institutions.

Accounting and Management Information Systems

Each of the institutions was audited by internationally recognized accountants. Without adequate investment in software, accounting systems and MIS, it is difficult to prepare the years of audited financial statements, disclose financial information and reconcile the documents with U.S. GAAP or international accounting standards. Each of the institutions that listed and/or went through the IPO, were able to meet disclosure requirements.

[57] Equity Bank was rated by MicroRate and Planet Rate, both specialized microfinance rating agencies.

Table 3: Bank Rakyat Indonesia (BRI)			
Year of Establishment	1895		
Country	Indonesia		
Number of Branches	324 and over 3,900 unit *desas*		
Mission	"To perform the best banking activities by delivering services mainly to small and medium enterprises in order to support economic development. To provide excellent services to its customers through a widely distributed network supported by professional human resources and to conduct good corporate governance practices. To provide optimal profit and benefit to its stakeholders."		
Number of Borrowers (year over year growth %)	2004	3,210,678	3.6
	2005	3,313,532	3.2
	2006	3,455,894	4.3
Average Loan Balance per Borrower	2006	$878	
Gross Loan Portfolio (year over year growth %)	2004	$2,044,532,205	18.9
	2005	$2,321,540,457	13.5
	2006	$3,035,685,400	30.8
Average Loan Balance per Borrower/GNI per Capita (%)*	2005	54.74	
Number of Savings Accounts (year over year growth %)	2004	31,271,523	4.7
	2005	32,252,741	3.1
	2006	30,907,566	(4.1)
Average Saving Balance Per Saver	2006	$158	
Saving Balance (year over year growth %)	2004	$3,503,488,748	8.0
	2005	$3,748,591,984	7.0
	2006	$4,869,688,137	3.0
Average Savings Balance per Borrower/GNI per Capita (%)*	2005	9.08	
ROA (%)	2006	6.88	
ROE (%)	2006	129.96	
Profit Margin (%)	2006	31.17	
Borrowers per Staff Member	2006	90	
Operating Expenses/Loan Portfolio (%)	2006	8.26	
Portfolio Risk (%)	2006	5.07	
Write Off Ratio (%)	2006	0.83	

All data taken from The MIX Market, http://www.mixmarket.org.
**2006 data unavailable*

Table 4: Bangladesh Rural Advancement Committee (BRAC)-Microfinance NGO			
Year of Establishment			1972
Country			Bangladesh
Number of Branches			1205 (referred to as team offices)
Mission	“BRAC works with people whose lives are dominated by extreme poverty, illiteracy, disease and handicaps. With multifaceted development interventions, BRAC strives to bring about change in the quality of life of poor people in Bangladesh.”		
Number of Borrowers (year over year growth %)	2004	3,993,525	14.3
	2005	4,159,793	4.2
	2006	4,550,855	9.4
Average Loan Balance per Borrower	2006		$77
Gross Loan Portfolio (year over year growth %)	2004	$243,146,287	20.6
	2005	$268,859,260	10.6
	2006	$350,160,812	30.2
Average Loan Balance per Borrower/GNI per Capita (%)*	2005		13.75
Number of Savings Accounts (year over year growth %)	2004	27,208	0.7
	2005	32,548	19.6
	2006	45,234	39.0
Average Saving Balance Per Saver	2006		$11
Saving Balance (year over year growth %)	2004	$538,405	(2.7)
	2005	$437,523	(18.7)
	2006	$515,572	17.8
Average Savings Balance per Borrower/GNI per Capita (%)*	2005		2.86
ROA (%)	2006		6.90
ROE (%)	2006		23.27
Profit Margin (%)	2006		26.94
Borrowers per Staff Member	2006		186
Operating Expenses/Loan Portfolio (%)	2006		12.91
Portfolio Risk (%)	2006		3.76
Write off Ratio (%)	2006		.63

All data taken from The MIX Market, http://www.mixmarket.org.
**2006 data unavailable*

Table 5: BRAC Bank—SME bank			
Number of Borrowers (year over year growth %)	2004	-	-
	2005	37,584	-
	2006	61,526	63.7
Average Loan Balance per Borrower	2006	$4,761.09	
Gross Loan Portfolio (year over year growth %)	2004	$99,975,273	98.6
	2005	$178,133,580	78.2
	2006	$292,930,698	64.4
Average Loan Balance per Borrower/GNI per Capita (%)	2006	1,013	
Number of Savings Accounts (year over year growth %)	2004	-	-
	2005	124,289	-
	2006	258,601	108.1
Average Saving Balance Per Saver	2006	$1,333.32	
Saving Balance (year over year growth %)	2004	$140,343,076	128.8
	2005	$202,610,141	44.4
	2006	$344,798,781	70.2
Average Savings Balance per Borrower/GNI per Capita (%)	2006	283.69	
ROA (%)	2006	1.42	
ROE (%)	2006	23.0	
Profit Margin (%)	2006	16.09	
Borrowers per Staff Member	2006	20.2	
Operating Expenses/Loan Portfolio (%)	2006	6.54	
Portfolio Risk (%)	2006	3.76	
Write off Ratio (%)	2006	0.63	

All data taken from 2006 Annual Report and Prospectus

Table 6: Banco Compartamos, S.A. (Compartamos)			
Year of Establishment	1990		
Country	Mexico		
Number of Branches	187 (located in 28 different states)		
Mission	"Compartamos is a social company committed to the people. We generate development opportunities within the lower economic segment, based on innovative and efficient models on a wide scale as well as transcending values that create external and internal culture, fulfilling permanent trusting relationships and contributing to a better world"		
Number of Borrowers (year over year growth %)	2004	309,637	43.8
	2005	453,131	46.3
	2006	616,528	36.1
Average Loan Balance per Borrower	2006	$440	
Gross Loan Portfolio (year over year growth %)	2004	$101,023,790	59.4
	2005	$180,630,956	78.8
	2006	$271,098,542	50.1
Average Loan Balance per Borrower/GNI per Capita (%)*	2005	5.45	
ROA (%)	2006	23.18	
ROE (%)	2006	57.35	
Profit Margin (%)	2006	44.82	
Borrowers per Staff Member	2006	192	
Operating Expenses/Loan Portfolio (%)	2006	33.45	
Portfolio Risk (%)	2006	0.62	
Write Off Ratio (%)	2006	.57	

All data taken from The MIX Market, http://www.mixmarket.org.
**2006 data unavailable*

Table 7: Equity Bank			
Year of Establishment	1984		
Country	Kenya		
Number of Branches	36		
Mission	"Mobilize resources to maximize value and economically empower the microfinance clients and other stakeholders by offering customer-focused quality financial services and solutions"		
Number of Borrowers (year over year growth %)	2004	59,306	(9.0)
	2005	110,112	85.7
	2006	239,541	117.5
Average Loan Balance per Borrower	2006	$444	
Gross Loan Portfolio (year over year growth %)	2004	$40,088,984	81.7
	2005	$38,303,996	(4.5)
	2006	$106,374,014	177.7
Average Loan Balance per Borrower/GNI per Capita (%)*	2005	65.64	
Number of Savings Accounts (year over year growth %)	2004	413,095	63.8
	2005	556,000	34.6
	2006	1,014,474	82.5
Average Saving Balance Per Saver	2006	$165	
Saving Balance (year over year growth %)	2004	$57,932,010	30.3
	2005	$108,240,431	86.8
	2006	$167,645,004	54.9
Average Savings Balance per Borrower/GNI per Capita (%)*	2005	36.73	
ROA (%)	2006	4.85	
ROE (%)	2006	40.36	
Profit Margin (%)	2006	31.53	
Borrowers per Staff Member	2006	172	
Operating Expenses/Loan Portfolio (%)	2006	42.38	
Portfolio Risk (%)	2006	12.19	
Write off Ratio (%)*	2005	1.92	

All data taken from The MIX Market, http://www.mixmarket.org.
**2006 data unavailable*

THE CAPITAL MARKET LISTINGS/OFFERINGS[58]

The previous section of this paper analyzed each of the four MFIs that have conducted IPOs or listed and demonstrated that these MFIs are strong performers with opportunities for future growth. Given their profitability, strong management and social missions, it is not surprising that all four companies were able to successfully list their stock, generally with great demand. It is also important to note that all four companies' stocks have shown remarkable growth since going public.

Yet, each of these institutions had different structures and purposes for their action. In fact, unlike the other three MFIs, Equity Bank did not actually have an IPO, but rather a listing of stock that was held by many of their clients and employees This section is intended to describe the individual nature and causes for each IPO or listing. We will explain the reasons each of these companies believed there was an advantage to going public, as well as the performance to date of each company's stock after the IPO.[59]

I. BRI LISTING/OFFERING

On October 31, 2003, BRI became the first bank with a predominant focus on microfinance to go public. By the time of its IPO, BRI had passed its stage of dramatic growth and was a mature institution. The BRI IPO was part of a larger process where the government was slowly trying to divest its holdings in the banking industry. In part, this was a way to raise funds for the Indonesian treasury as well as to allow the government to follow through with its IMF commitments after the East Asian crisis.[60]

BRI was listed on the Jakarta Stock Exchange, but shares were also offered, under U.S. SEC Rule 144A, to international institutional investors without a listing on any of the U.S. or other major stock exchanges. Some 41% of BRI's capital stock was sold, and therefore, it was only a partial privatization, with the state retaining a majority interest in the bank. The IPO raised close to $489 million, of which 61% went to reimburse the Government of Indonesia. The rest of the proceeds were retained by BRI, with the intent to "fund future growth [and] investment in technology," according to the BRI Offering Circular.[61]

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[58] Unless otherwise noted, the information in this section of the paper comes from the offering memorandum or prospectus the MFI published before its IPO. See the two "IPO Details" tables for more information.
[59] All stock price data is as of September 10, 2007. All numbers are converted at the time of the transaction. For example, if BRI went public on November 10, 2003, we have converted November 10, 2003 Indonesian Rupiah to November 10, 2003, U.S. Dollars. Currency exchange fluctuation will affect data.
[60] "Jakarta Puts Its Banks on the Block," *BusinessWeek*, October 31, 2005. http://www.businessweek.com/magazine/content/05_44/b3957084.htm.
[61] BRI, Offering Circular, October 31, 2003. Also see Table 7 below.

BRI's stock has performed exceptionally well since the IPO, with a 561% increase on the original price in just three years. The lock-up period for the offering was twelve months and expired on November 10, 2004. From the time of the offering to the date the lock-up period expired the price increased 143%. From July 7, 2004, the monthly return has varied from -19.5% (August 2005) to 24.4% (November 2004) with an average monthly return of 4.12%. As of September 10, 2007, BRI's shares were trading at some 4.4 x times book value and at a price earnings multiple of 16.5.

Box 2: BRI IPO Details

- Underwriter or Advisor/Sponsoring Stockbroker: PT Bahana Securities
- Listed on the Jakarta Stock Exchange, Surabaya Stock Exchange, and internationally for institutional investors under rule 144A, U.S. SEC
- Trading Symbol: BBRI (Indonesia), BYR (Germany), BKRKF (U.S.)
- Auditors: Ernst and Young Prasetio, Utomo and Co.
- The proceeds were used to fund future growth, invest in technology, expand branch and unit network, enhance regulatory capital and for the government to raise money through divestment.

Primary Information Source: Offering Circular (10/31/07). Currency is not in constant dollars or adjusted for inflation.

II. BRAC BANK OFFERING

In July 2006, prior to the IPO of BRAC Bank, BRAC's microfinance division approached the capital markets in order to securitize its microfinance portfolio. This allowed it to raise BDT 12.6 BN (US $180 million equivalent). The securitization was structured by RSA Capital, Citigroup, FMO and KFW.[62]

On December 11, 2006, BRAC Bank was floated on the Dhaka and Chittagong Stock Exchanges. BRAC Bank raised some $13 million through the IPO, all of which will be used to expand the bank's operations throughout Bangladesh. The company sold 50% of its share capital to the public (this doubled the number of shares outstanding), and all proceeds were received as paid in capital by the bank. None of the existing shareholder sold at the time of the offering; however, the IFC did receive an exemption from the lock-up period, allowing it to sell immediately if it chose to.[63]

The distribution of the IPO allowed for one third of the company to be owned by the Bangladeshi public, with another 8% split between non-resident Bangladeshis and mutual funds. The lock-up for BRAC will last three years, an exceptionally long holding period when compared to the usual 90 days to six months that are required by international markets. BRAC's stock showed phenomenal growth in its first year. Its stock has

[62] "Bangladesh: Citigroup Supports World's First AAA-Rated Microcredit Security," Citibank, July 2006, www.citigroup.com/citgroup/press/2006/060706b.htm. Also, see Rahman, R. and Mohammed, S.S., "BRAC Micro Credit Securitization Series I: Lessons from the World's First Micro-Credit Backed Security (MCBS)," Analytics Ltd, March 2007, Boston.

[63] Paul Christensen (bank director, BRAC Bank), comments and discussion.

increased by 619% from the initial price. As of September 10, 2007, BRAC Bank's shares traded at a multiple of 6.86 times book value and at a price-earnings ratio of 19.1 times.

The BRAC IPO provided several benefits to the bank and shareholders. First, by raising funds it allowed the bank to expand its operations into new markets. It will also allow institutional investors such as ShoreCap and the IFC to exit some of their investment. Investors gained market advantages, including greater liquidity and price discovery. BRAC can presumably go back to the market or to international markets to raise more capital if it so chooses, assuming its performance remains strong.

Box 3: BRAC IPO Details

- Underwriter or Advisor/Sponsoring Stockbroker: Southeast Bank Limited, Dhaka Bank Limited, The Trust Bank Limited, IDLC of Bangladesh Limited, LankaBangla Finance Limited, Prime Bank Limited, Bank Asia Limited, EXIM Bank of Bangladesh Limited, GSP Finance Company, Bangladesh
- Listed on the Dhaka Stock Exchange Limited and Chittagong Stock Eschange Limited.
- Trading Symbol: BRAC (Bangladesh)
- Auditors: KPMG
- Rating Agency: Credit Rating Information Services Ltd.
- "The proceeds will strengthen the capital base of the Bank and augment business expansion. The fund thus raised through this public issue would be generally used for investment and creation of assets."

Primary Information Source: Prospectus of BRAC Bank Limited (9/20/06). Currency is not in constant dollars or adjusted for inflation.

III. COMPARTAMOS OFFERING

Banco Compartamos went public on April 20, 2007. The company sold 29.9% of the shares outstanding.[64] In contrast to the other IPOs discussed here, in this case none of the shares sold were offered by the firm itself. Rather, all the shares sold were part of a secondary offering so the firm received none of the proceeds from the sale. This IPO received substantial press because of its huge success and the very substantial returns to its investors. ACCION International, for example, had invested $1 million in Compartamos and earned some $143 million as a result of the IPO.

The proceeds of the sale went mainly to the following four groups; the ACCION Gateway Fund ($147 million), the Compartamos NGO ($93), the IFC ($42 million) and individual shareholders, namely the management and directors of the bank ($136 million). Compartamos NGO plans to use their proceeds to continue its work on

[64] Lauren Burnhill, "Bringing Microfinance to Scale: Lessons from the Compartamos IPO" (presentation, ACCION International, August 24, 2007), slides 3-4.

improving health and nutrition for poor Mexicans, while ACCION and the IFC will use their proceeds towards furthering their development objectives.[65]

Of the shares sold, 18 % were offered to the general public in Mexico, and 82% were offered to international, Qualified Institutional Buyers (the U.S. SEC has both an asset test and a qualitative test to ensure that investors are “financially sophisticated” in order to purchase securities sold under Reg. 144a). Some 158 institutional buyers purchased shares. Of these institutional buyers, 58% were hedge funds and 42% were traditional financial institutions. The opening price of the stock was MXN 40.00, or $3.65. The offering opened at 12.8 times book value or at a market cap of $1.56 billion for Compartamos. The offering was oversubscribed thirteen times. As of August 13, 2007, the price was $5.4, which implies a premium of 48% over the issue price and a market valuation for Compartamos of $1.9 billion.[66] As of September 10, 2007, Compartamos' shares traded at 4.73 times book value and at a price-earnings multiple of 11.85 times earnings.

According to the detailed report on the Compartamos IPO by ACCION International, “The initial impetus behind the Compartamos IPO came from a normal process of ownership evolution. A sale of a portion of total shares held would allow the shareholders to redeploy capital that was otherwise tied up.” The report goes on to explain that another advantage of an IPO is that diversification of the ownership base prevents “major disruptions in governance, management and strategic direction that abrupt ownership can bring.”[67]

Why was the Compartamos IPO so successful and what were the factors leading to its success? According to the report by ACCION International, the following factors were in play: [68]

- **Local financial market—**The Mexican Bolsa (stock exchange) is well developed and liquid with a sound regulatory environment,[69] There had been few recent IPOs, and there had been a lack of banking IPOs. In fact, the acquisition by foreign banks of Mexican banks such as Banamex had taken a number of important financial bank stocks off the Mexican Bolsa.

- **Compartamos' structure—**Compartamos had demonstrated sustainable growth, strong growth potential, superior management, socially valuable operations, good client relationships and strong governance.

[65] Rosenberg, “CGAP Reflections on the Compartamos Initial Public Offering,” 14-15.
[66] Burnhill, “Bringing Microfinance to Scale: Lessons from the Compartamos IPO,” slide 3.
[67] Rhyne and Guimon, “The Banco Compartamos Initial Public Offering,” 4-5.
[68] Ibid., 13.
[69] As a result of the Tequila Crisis, the regulatory environment for banks and the stock exchange had improved significantly.

- **Global Factors—**At the time of the IPO, high liquidity in global markets combined with a global recovery of IPOs, a strong financial sector and the emerging recognition of microfinance helped boost the success of Compartamos.

- **IPO process—**Compartamos benefited from the excellent commitment of underwriters, who were able to tap into both domestic and international markets.

- **Economic/ political factors—**At the time of the IPO, the macroeconomic situation was very stable. This was because of a low-risk spread for Mexican paper, a general interest in Mexico as an emerging investment market and a stabilized political environment following the elections.

- **Microfinance sector in Mexico—**At the time of the IPO, competition was not yet too strong. Investors could expect Compartamos to maintain profitability for some time.

The Mexican market for small scale lending is becoming increasingly crowded. Compartamos may face competition from Banco Azteca, a large consumer lender tied to Grupo Elektra that provides consumer loans to the poor directly from Elektra's retail outlets. Banco Wal-Mart, has recently announced that it is also interested in becoming a large-scale lender for consumer goods, adding further competition.[70] Interestingly, Mexico's microfinance lender, Financiera Independencia, went public on November 1, 2007, listing some 20% of the company (136 million shares) on the Mexican Bolsa and the international markets. HSBC's ownership in Financiera Independencia was reduced from 20% to 18.7% by the offering. Grupo Bursatil handled the local placement, while Credit Suisse handled the international issue.

Box 4: Compartamos IPO Details

- Underwriter or Advisor/Sponsored Stockholder: Credit Suisse First Boston (CS)Banamex and Banorte for Mexican Tranche
- Listed on the Mexican Stock Exchange and internationally for institutional investors internationally under rule 144A, US-SEC
- Trading Symbol: COMPART (Mexico)
- Auditors: PricewaterhouseCoopers, S.C.
- Rating Agency:S&P (mxAA-, as of October 30, 2007 Fitch (A+Mex) as of march 2, 2007
- Major investors desired an IPO for liquidity and the ability to use proceeds for philanthropic activities and to take on riskier projects. From IPO memorandum, "We will not receive any proceeds from the sale of Shares by the selling shareholders. The selling shareholders will receive all of the net proceeds from the sale of shares."

Primary Information Source: Offering Circular (4/19/07). Currency is not in constant dollars or adjusted for inflation.

[70] Epstein and Smith, "The Ugly Side of Microlending." Also see Keith Epstein and Geri Smith, "Wal-Mart Banks on the 'Unbanked,'" *BusinessWeek*, December 13, 2007. http://www.businessweek.com/magazine/content/07_52/b4064042918153.htm.

IV. EQUITY BANK LISTING

As previously mentioned, unlike the three other banks, Equity Bank did not execute an IPO. Instead the firm went from being traded over-the-counter (OTC) to being listed on the Kenyan Stock Exchange on August 7, 2006. According to the board's objectives, as provided in the *Equity Bank Investor Briefing 2006*, the purpose of the listing was "to offer shareholders and the Bank the benefits of the stock market, liquidity, and price discovery."[71] Other objectives included "the need to consolidate and cement effective corporate governance," the attempt to position Equity strategically in the capital markets, and the desire to allow Kenyan's to own and be a part of the success of the bank. Prior to the IPO, there was an agreement made that current shareholders would not divest of their shares for two years following the listing as a way of locking in large shareholders and aligning their interests with existing and new owners.[72]

On April 23, 2007 after its initial listing, Equity Bank issued 181,129,100 new shares by allotting two ordinary shares to owners for every one ordinary share registered in their name. This allocation led to a large increase in the volume of trading.[73] Equity's stock has shown excellent growth, with a 96% increase on the initial price. A recent publication of the African Alliance, an investment banking group located in Africa, described the excellent prospects for expansion for Equity. They write that by "providing banking services to the masses and generally expanding its distribution channels and services, Equity Bank Limited will be a star performer."[74]

In addition, a second event occurred after the listing that gives credibility to this view that Equity bank will be a star performer. On November 14, 2007, Equity Bank and Helios EB Investors, LP, ("Helios") subscribed for 90.5 million new ordinary shares in the bank at KES 122 (U.S. $1.94 per share, where 63 KES equals $1, versus the original listing price at $0.96 per share) per new ordinary share. The purchase price equated to EBL's weighted trading average, as traded on the Nairobi Stock Exchange for the three months ending October 22, 2007. The investment will substantially increase EBL's capital, and Helios will become the largest shareholder in EBL at 24.99%. The transaction awaits regulatory approval from the Kenyan Central Bank and the Capital Markets Authority; moreover, the Nairobi Stock Exchange will be asked to approve the listing of Helios' shares.

The share sale is not only important for the liquidity it brings to Equity Bank, but also because Helios is a prestigious investor making equity investments in Africa. Helios' principals are Africans with a strong record in equity investing, backed by capital from such investors as the U.S. Overseas Private Investment Corporation (OPIC), the Commonwealth Development Corporation (CDC), the IFC and the Soros Fund Management.[75]

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[71] Equity Bank, Investor Briefing, 2006, 2.
[72] Marguerite Robinson, "Note on Equity Bank," November 2006.
[73] See http://www.Bloomberg.com.
[74] African Alliance, "Kenya Banking Industry Review: Sector Report," April 2007.
[75] Equity Bank Limited, Press Release, November 14, 2007.

Box 5: Equity Bank Listing Details

- Underwriter or Advisor/Sponsoring Stockbroker: Suntra Investment Bank and Dyer and Blair Investment Bank Limited
- Listed on the Nairobi Stock Exchange
- Trading Symbol: EQBNK (Kenya)
- Auditors: Ernst & Young since 2004, Mungai & Associated were the auditors 2003 and prior.
- Rating Agency: Planet Rating
- There were no proceeds because the stock went from OTC to the Nairobi Stock Exchange. No new stock was issued. The listing was done to "offer shareholders and the Bank the benefits of the stock market, liquidity and price discovery." "Opportunity to enhance corporate governance and disclosure standards."

Primary Information Source: Information Memorandum (3/7/06). Currency is not in constant dollars or adjusted for inflation.

V. Summary and Conclusions

The stock market offers these four companies benefits and opportunities that they did not have prior to their IPO's. Most of these benefits are similar to the advantages that going public creates for any business: the ability to raise funds from capital markets, liquidity, price discovery, improvements in governance, greater transparency in accounting and information provision and the ability to invest in new technology or branch expansion as well as a means to provide incentives to management and employees and to address succession and recruit future management. Going public also provides an opportunity for equity investors to exit, critical in attracting private capital. We would expect to see some MFIs in the future use the fact that they have tradable shares for acquisitions and mergers. There are some concerns that going public may affect the ability of these companies to maintain there social purpose, but each of these companies has been diligent in maintaining an ownership structure that will not allow large changes in their mission.

One important externality of the IPOs is transparency. Through the information memorandum and other filing documents, the public can gather detailed information on the MFIs that go public. In one case, the Compartamos offering, this generated an increasingly controversial debate regarding the commercial model of microfinance. Closer observation of the business operations of a company like Equity Bank or Compartamos is proof of the commercial viability of microfinance. As ACCION's report states, "The Banco Compartamos IPO is a powerful validation of the commercial model of microfinance…"[76]

However, others have argued that the closer observation of business operations that accompanies all commercial transactions and especially IPOs can cause MFIs to focus disproportionately more on investor needs rather than client needs, resulting in interest rates that are too high. Although various solutions have been proposed, including profit

[76] Rhyne and Guimon, "The Banco Compartamos Initial Public Offering," 15.

limits for MFIs and “truth in lending” policies to ensure that customers clearly understand effective interest rates, we suggest that in time natural market competition will bring down both interest rates and profits.

It is certainly too early to come to any conclusions about the stock performance of these four banks, but it is difficult not to notice that all four have shown good to excellent growth. Although it is premature to call it a trend, it would be of value to continue following these stocks to see if there are some common factors driving their performance. The following reasons listed below for the strong performance of their stocks post listing are, at present, primarily conjecture on our part:

Growing popularity of microfinance

There may be an “irrational exuberance” for microfinance stocks. The double bottom line and social appeal of these banks may cause this rise. Microfinance is part of the *zeitgeist* of socially responsible investment. In fact, there are relatively few choices for investors who want to take an equity stake in microfinance, and the decision by these MFIs to list enhances the appeal for those institutional investors interested in this niche market.

Undervaluation

Some of these banks may have been under priced at the time of the IPO in order to ensure a highly successful offering. Since there was little comparable history in offering MFIs to the market, the tendency of the advisors would be to under price to demonstrate success. Also, for local investors, there may be little offering in their domestic market that matches the quality of these institutions. For example, if we take the case of Mexico, some of the large Mexican banks were taken private after the Tequila Crisis in 1995, when they were acquired by international banks—Banamex by CitiCorp and Bancomer by BBVA.

Brand premium

There may be a brand premium for these MFIs. Each of these companies is well known and generally well respected in their countries, and investors may desire their stock for this reason rather than standard performance measures. Also, where the institution, as is the case for BRI, Equity Bank and Compartamos, has competitive dominance over its market niche, there are expectations that they will continue to generate profits for some time into the future.

External factors

We may be experiencing a unique convergence of factors, including:

1. huge liquidity in international capital markets in part due to the very large U.S. trade deficits and large Eurodollar holdings held abroad (however, the recent financial crisis over mortgage-backed securities may in fact sap liquidity from the market for some time);
2. surpluses in exporting powers such as China and oil and gas exporting countries;
3. professional investors keenly interested in emerging market opportunities (in this respect, perception of country risk would make it relatively easy to market the Compartamos, Mexico offering to international investors, while the offering of

BRAC Bank in Bangladesh or Equity Bank in Kenya would have been correspondingly more difficult);

4. the dearth of good product offerings in microfinance that offer investors a quality institution and also an exit opportunity, made the offering of these institutions uniquely atrractive;
5. the rapid growth of emerging-market stock exchanges all seeking good listings again made these institutions attractive as a nice market in the emerging-markets sector.

These factors may have created the ideal scenario for a quality MFI to have an IPO with an attractive valuation. How long this will last is anyone's best guess as markets continue to evolve and conditions in the international economy change.

This leads to an overall conclusion that there is an emerging market opportunity for a number of other MFIs to go public in the near future. Each institution will need to assess its own reasons for doing so, as the cost of an IPO is quite high, not only in professional fees and other expenses, but also in management and staff time spent preparing the offering and participating in a "road show" for interested institutional investors. It is not a spur of the moment decision; rather it takes substantial time and funds to execute an IPO.

In discussion with microfinance equity fund managers and investors in the microfinance industry, the views of the IPOs were mixed.[77] Many of the fund managers recognized that this would provide additional validation for microfinance as a subset of the formal financial sector and perhaps more important, a new investment opportunity in emerging markets. Fund managers indicated that the IPOs would make it easier to raise funds from private investors. However, that also means more competition, as larger financial groups already in the business—CitiCorp, Credit Suisse, Deutsche Bank—are seeking to expand their investments in the sector, while groups such as JP Morgan are said to be planning entry soon. Also, deep concern has been expressed over the high price-earnings and book-value multiples at which the shares of the four institutions were trading. The concern is that this irrational exuberance might produce a microfinance "bubble," and it would be much more difficult for the fund managers to invest at "acceptable" or reasonable prices. However, it seems clear that these are among the best of the microfinance institutions throughout the world, and it is doubtful that the next-in-line MFIs would command such multiples.

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[77] Meeting, Council of Microfinance Equity Funds, Amsterdam, October 10-11, 2007.

OVERALL CONCLUSIONS

Our conclusions are straightforward and simple: four excellent MFIs decided for their own reasons to issue an IPO or list on their domestic capital markets and, in two cases, to also raise funds from institutional investors internationally. The industry has been moving in this direction for some time. We have tried to demonstrate in the first section of this paper how excellent these institutions are. It is that excellence in management, governance, systems and technology, methodology and product line that has allowed these institutions to achieve massive outreach to the lower-income segments and yet remain highly profitable at levels that most banks would envy.

As public institutions and regulated banks, these institutions are now being benchmarked against the banking sector in their respective countries. As successful as they have been, rapid growth brings problems. Each of these institutions will need to face a series of issues to continue to be among the best. However, given the quality of their management, we assume they will address those concerns.

Going public is not a spur of the moment decision; it is very costly. Preparing the information, data, audited financial statements required for due diligence by an advisor, prospectus and a package for institutional investors is a time absorbing and costly event. The "road shows" to visit with potential investors are also demanding and costly as are the legal, audit and financial advisory fees. An MFI has to think carefully through the decision to go public. However, there are clear advantages—the ability to raise capital from an alternative source, to provide incentives for management and staff, to allow partial or complete exits by equity investors in these firms, to raise capital for technology investments and branch expansion, and eventually, but not yet a use of proceeds, to acquire or merge with other MFIs.

Interestingly, three of the MFIs that have gone public have had strategic equity investors and several have received extensive external technical assistance to reach their present level of excellence. Equity Bank has recently concluded a deal, subject to regulatory approval, to sell a 25% interest in the bank to a private equity firm, post its listing, at a price reflecting its recent trading price, considerably in excess of the listing price. The best structure and sequencing seems to be the combination of the two—a strategic investor followed by a listing/ IPO. Though, Equity Bank attracted strategic investors both before and after its listing. One thing is clear—the strategic international investor gives the market an added measure of confidence, which is important for an IPO in a sector that up to now has little comparable experience for the institutional investors in the market to analyze.

Each institution's shares have performed well in their respective capital markets; we could perhaps call it a bit of "irrational exuberance." However, it is still early, and we will see how the shares perform over time. Companies that have a social mission and are profitable have a certain cachet as does the microfinance sector for the moment. We would expect that trend perhaps to strengthen in time. The initial success of the IPOs has opened the door for the industry. It has also generated a controversial but important discussion on consumer protection and fair interest rates. There are a number of MFIs or groups that could go public over the next few years. Some are already deep into their preparation, and one in Mexico formally announced. We believe this will increase competition, allowing for a natural decrease in interest rates and an increase in attention focused on customer needs. MFIs interested in going public should learn from the experiences of these four institutions.

Finally, it is clear that these institutions are also poised to achieve massive outreach to their potential client base—the working poor without formal access to finance. BRAC is an interesting case as it has now become a multi-national NGO in microfinance in Asia and Africa. We could see BRAC and Equity Bank either collaborating or competing throughout East Africa over the next five or more years.[78]

We have projected conservatively that if these four institutions that went public continue to grow, but at a declining rate over the next five years (2007–2011), they could together reach some 16 million borrowers and have 41 million savings accounts, without projecting savings from BRAC and Compartamos. We fully expect Compartamos to mobilize savings starting in 2008. Interestingly, with the exception of Compartamos, they are also reaching a large number of SMEs. Perhaps even more important is the quality of their products and services. We expect these four institutions to become more diverse and fully meet the financial needs of their clients going forward.

[78] Joining them in seeking expansion in Africa is AfriCap, which recently re-capitalized at $50 million on October 25, 2007. Ira Lieberman led an advisory team that assisted in this effort. AfriCap was the first strategic investor in Equity Bank, and it could collaborate in the future expansion of Equity Bank or of BRAC. Alternatively, all three could compete. Any of these options should give a boost to the growth of microfinance in Africa.

Annex 1: Poverty Data for Locations of the Four MFIs

	Bangladesh		***Indonesia***		***Kenya***		***Mexico***	
Year	2000	2005	2000	2005	2000	2005	2000	2005
Population	128.9 million	141.8 million	206.3 million	220.6 million	30.7 million	34.3 million	98.0 million	103.1 million
Population Growth % (Annual)	2	1.9	1.3	1.4	2.2	2.3	1.4	1
Life expectancy at birth, total (years)	61.5	63.9	65.8	67.8	48.4	49	74	75.4
Fertility rate, total (births per woman)	3.2	3	2.4	2.3	5	5	2.4	2.1
Mortality rate, infant (per 1,000 live births)	66	54	36	28	77	79	25	22
GNI per capita* (current US$)	390	470	590	1280	430	540	5110	7310
Adult literacy rate (% ages 15 and older)	34.2	na	79.5	90.4	70.8	73.6	87.3	91
GINI Coefficient**	33.42	[2000]	34.3	[2002]	42.5	[1997]	46.05	[2004]
UN Human Development Rank***	137 (medium development)		108 (medium development)		152 (low development)		53 (medium development)	

All data except the UN HDR rank and GINI is from WDI database (http://publications.worldbank.org/WDI/).

* Atlas Method

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*** Among 177 Countries

Annex 2: Basic Ratio Analysis for BRAC Bank, Equity Bank, Compartamos, and BRI

		BRAC	Equity Bank	Compartamos	BRI	
		Financial Reports	**Financial Reports**	**Financial Reports**	**Financial Reports**	**MIX Data**
Debt/Equity	**2006**	**13.18**	**8.10**	**1.36**	**8.17**	**19.46**
	2005	20.55	6.19	1.66	8.19	16.28
	2004	15.97	4.28	1.55	7.60	16.37
	2003	10.47	7.21	1.83	10.20	17.89
	2002	-	6.73	1.98	13.90	15.30
Debt/Assets	**2006**	**92.95%**	**89.01%**	**57.61%**	**89.09%**	**95.11%**
	2005	95.36%	86.09%	62.34%	89.12%	94.21%
	2004	94.11%	81.05%	60.73%	88.37%	94.24%
	2003	91.28%	87.82%	64.69%	91.07%	94.71%
	2002	-	87.07%	66.46%	93.29%	93.87%
Capital/Assets	**2006**	**7.05%**	**10.99%**	**42.39%**	**10.91%**	**4.89%**
	2005	4.64%	13.91%	37.66%	10.88%	5.79%
	2004	5.89%	18.95%	39.27%	11.63%	5.76%
	2003	8.72%	12.18%	35.31%	8.93%	5.29%
	2002	-	12.93%	33.54%	6.71%	6.13%
ROE	**2006**	**23.00%**	**40.46%**	**56.12%**	**29.28%**	**143.26%**
	2005	26.50%	24.74%	53.54%	28.75%	111.32%
	2004	19.97%	15.48%	47.51%	33.40%	116.08%
	2003	-	24.01%	53.82%	37.02%	106.70%
	2002	-	-	-	-	
ROA	**2006**	**1.42%**	**4.86%**	**22.66%**	**3.19%**	**7.58%**
	2005	1.36%	3.88%	20.47%	3.23%	6.42%
	2004	1.36%	2.54%	17.86%	3.44%	6.42%
	2003	-	3.00%	18.65%	2.92%	6.05%
	2002	-	-	-	-	

Profit Margin	**2006**	**16.09%**	**22.35%**	**31.06%**	**20.21%**	
	2005	16.42%	19.12%	27.30%	22.08%	
	2004	14.61%	13.14%	26.49%	23.39%	
	2003	12.98%	-	28.17%	17.11%	
	2002	-	-	26.37%	11.33%	
Deposits/Loans	**2006**	**117.71%**	**149.47%**	**0.00%**	**137.86%**	**160.41%**
	2005	113.74%	163.78%	0.00%	128.48%	161.47%
	2004	140.38%	176.83%	0.00%	132.12%	171.36%
	2003	121.85%	201.56%	0.00%	160.33%	188.65%
	2002	-	184.46%	0.00%	176.84%	195.49%
Deposits/Assets	**2006**	**76.64%**	**81.58%**	**0.00%**	**80.44%**	**88.57%**
	2005	79.46%	78.97%	0.00%	79.04%	83.61%
	2004	81.56%	75.76%	0.00%	76.98%	84.02%
	2003	77.00%	85.78%	0.00%	80.58%	83.92%
	2002	-	83.17%	0.00%	80.64%	82.47%
Loans/Assets	**2006**	**65.11%**	**54.58%**	**89.08%**	**58.35%**	**55.21%**
	2005	69.86%	48.22%	81.95%	61.52%	51.78%
	2004	58.10%	42.84%	78.24%	58.27%	49.03%
	2003	63.19%	42.56%	71.22%	50.26%	44.48%
	2002	-	45.09%	74.69%	45.60%	42.19%
Borrowers/Employee	**2006**	**20.2**	**180.9**	**192.5**	**89.7**	
	2005	22.8	124.6	197.4	88.3	
	2004	-	111.9	198.4	88.1	
	2003	-	184.0	212.7	111.7	
	2002	-	195.4	194.6	143.7	
Depositors/Employee	**2006**	**84.9**	**727.7**	**0.0**	**801.9**	
	2005	75.3	629.0	0.0	859.0	
	2004	-	779.4	0.0	857.7	
	2003	-	712.4	0.0	1,075.7	
	2002	-	742.3	0.0	1,328.7	

Cost per Borrower	**2006**	**$310.67**	**$180.98**	**$190.78**	**$252.31**	
	2005	-	$212.30	$200.00	$240.29	
	2004	-	$170.13	$164.46	$207.44	
	2003	-	$104.00	$145.53	$215.83	
	2002	-	-	-	-	
Operating Expense/Loan Portfolio	**2006**	**6.54%**	**27.99%**	**45.83%**	**9.62%**	**31.88%**
	2005	6.44%	31.69%	54.81%	10.89%	35.91%
	2004	8.20%	35.72%	52.93%	10.61%	34.77%
	2003	-	-	49.47%	13.24%	43.37%
	2002	-	-	-	-	
Capital Adequacy Ratio	**2006**	**7.05%**	**10.99%**	**42.39%**	**10.91%**	**4.89%**
as calculated (capital/assets)	2005	4.64%	13.91%	37.66%	10.88%	5.79%
	2004	5.89%	18.95%	39.27%	11.63%	5.76%
	2003	8.72%	12.18%	35.31%	8.93%	5.29%
	2002	-	12.93%	33.54%	6.71%	6.13%
Savers/Borrower	**2006**	**4.20**	**4.02**	**0.00**	**8.94**	
	2005	3.31	5.05	0.00	9.73	
	2004	-	6.97	0.00	9.74	
	2003	-	3.87	0.00	9.63	
	2002	-	3.80	0.00	9.25	
Average Deposit Size	**2006**	**$1,333.32**	**$232.70**	**-**	**$448.62**	**$157.56**
	2005	$1,630.15	$224.73	-	$306.31	$116.23
	2004	-	$159.30	-	$283.26	$112.03
	2003	-	$176.32	-	$302.26	$108.64
	2002	-	$178.79	-	$275.68	$92.97
Average Loan Balance	**2006**	**$4,761.09**	**$626.35**	**$429.70**	**$2,910.25**	**$878.41**
	2005	$4,739.61	$692.85	$398.04	$2,320.56	$700.62
	2004	-	$627.50	$316.35	$2,088.21	$636.79
	2003	-	$338.65	$302.58	$1,816.23	$554.80
	2002	-	$368.28	$281.69	$1,441.65	$439.78

Portfolio at Risk >30 days	**2006**	**3.76%**	**12.19%**	**1.13%**	**5.07%**	
as reported by The MIX	2005	5.92%	51.54%	1.24%	4.76%	
	2004	8.33%	22.21%	0.56%	4.78%	
	2003	5.98%	28.76%	0.70%	6.04%	
	2002	5.97%	8.29%	1.11%	4.37%	
Loan Write-off Ratio	**2006**	**0.63%**		**0.57%**	**0.83%**	
as reported by The MIX	2005	1.69%	1.92%	0.51%	1.43%	
	2004	2.78%	0.40%	0.24%	1.59%	
	2003	2.59%	1.87%	0.31%	0.79%	
	2002		3.35%	0.18%	2.61%	
Capital Adequacy Ratio	**2006**	**13.53%**			**18.82%**	
as reported in financial statements	2005	9.39%			15.29%	
	2004	10.15%			16.19%	
	2003	14.29%			19.64%	
	2002	23.27%			12.62%	
Pct. Of GNI	Loan	1013.00%	118.18%	5.88%	227.36%	68.63%
	Savings	283.69%	43.91%	-	35.05%	12.31%

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Council of Microfinance Equity Funds

ABOUT THE STUDY

This paper discusses the Initial Public Offerings/listings of the four leading microfinance institutions that have carried out such transactions—Bank Rakyat Indonesia, BRAC Bank (Bangladesh), Banco Compartamos (Mexico) and Equity Bank (Kenya). The study attempts to determine the conditions under which a public offering or listing is suitable for a microfinance organization. It does this by analyzing the development of each of the four institutions and how that development influenced the decision to "go public." It also examines the purpose, structure and process of the offerings and listing in order to extract applicable lessons. The Council hopes that this research will be helpful to all that are involved in microfinance, especially investors and microfinance institutions seeking new entries to capital markets.

ABOUT THE COUNCIL

The Council of Microfinance Equity Funds is a membership organization of private entities that make equity and other investments in MFIs in the developing world. Council members seek both social and financial returns from their investments in these MFIs. The Council's purpose is three-fold: 1) to articulate and disseminate the knowledge and expertise of the Council's members among themselves and to other MFI stakeholders; 2) to present guidelines and principles for effective investment in MFIs; and 3) to conceive a future strategy for the role of investment capital in microfinance. The Council was conceived in 2002 and officially launched in 2003. ACCION International serves as coordinator of the Council's activities.

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