



## EMERGING OPPORTUNITIES FOR MICROFINANCE IN WEST AFRICA

Executive Summary of research report into the growth and investment potential for the period 2009-2013



Microfinance in the Anglophone West African countries of Nigeria, Ghana, Sierra Leone and Liberia is beginning to emerge as a viable, prosperous, and growing industry. Of those living below the poverty line, the majority remain financially excluded, producing a massive potential demand for microfinance. In spite of the eager market, microfinance has been relatively slow to take hold in West-Africa in comparison with similar regions elsewhere in Africa, Latin America or Asia. The sector in this region is now catching up rapidly. The combination of recently found political stability, market potential, entrance of international microfinance networks and increased experimentation in institutional products and services has started to attract the

interest of commercial investors. Such investors will need insightful data on this industry including market trends and future growth estimates to make informed decisions and effectively allocate their capital.

DARC Foundation and Goodwell West Africa, in partnership with Alitheia Capital, JCS Investment, and First Bank commissioned a study to take stock of the Anglophone West Africa microfinance market and to gain insights on its growth and investment potential, to address the serious information gap faced by investors and industry observers.

The study was conducted by Intellectap in late 2008/early 2009. The report presents the outcome of such study, based on interviews with over 50 microfinance practitioners, bankers, investors and others involved in the sector, and on quantitative data from 34 microfinance organisations.

Table 1: Country Highlights

Country	Regulation & Market highlights
Nigeria	<ul style="list-style-type: none"><li>• 2005 Microfinance Bill enforces transformation into Microfinance Banks (MFBs), as new regulated entities</li><li>• New regulatory framework has enabled investments from new sources including High Net-worth Individuals (HNIs), commercial banks and international networks</li></ul>
Ghana	<ul style="list-style-type: none"><li>• No separate law for microfinance</li><li>• Industry defined by highly evolved domestic apex and association networks</li></ul>
Sierra Leone	<ul style="list-style-type: none"><li>• Dependent on donor funds, which are channeled through end-to-end support by apex institutions.</li><li>• Microfinance Bill expected in 2009</li></ul>
Liberia	<ul style="list-style-type: none"><li>• Only two formal microfinance providers</li><li>• The Central Bank, UNCDF, UNDP and Cordaid are implementing the Launch of an Inclusive Financial Sector (LIFS) to support the development of the microfinance sector</li></ul>

The current state of the region can be described by **four trends** that characterize its microfinance industry and provide pointers for its future growth and evolution.

### **Trend # 1: Emerging structure and leadership**

Microfinance in the region has evolved from an informal field of disjointed initiatives into an industry that has benefited from the structure and order established by the central banks, apex bodies and associations, thereby attracting investors, networks and technical service providers. In Nigeria, the Central Bank is the prevailing force leading this process by means of clear regulation, continuous monitoring, and fostering development and dissemination. In Ghana, Sierra Leone and Liberia, the apex bodies play a similar role.

**Trend #2: Focus on Micro, Small, and Medium Enterprises (MSMEs); unrealised potential for microfinance**

Most for-profit MFIs focus on lending to SMEs and salaried employees. Portfolios are mostly urban and average loan balances are above USD 1,000. Commercial banks have also downscaled to focus on this MSME market, thus leaving the classical microfinance market with loan sizes less than USD 1,000 mostly underserved.

**Trend #3: Adoption of new products, methodologies and technology**

MFIs in the region demonstrate a willingness to innovate and try new technologies, products and operating models to pursue growth. Within **technology**, MFIs are focusing on Management Information Systems (MIS) and mobile banking. While adoption remains low due to capital constraints and intermittent power supply, the rate of use is likely to rise in the near future. The **product range** of many MFIs has also grown in recent years, including innovations in savings, insurance and Islamic lending products. Microfinance lending **methodology** is another area that has seen a recent change. Though the sector has been predominantly based on individual lending, some institutions are experimenting with joint liability based group lending models.

**Trend #4: Low access to commercial growth capital**

With donor funding waning and client deposits inadequate to fuel MFI growth plans, MFIs in the region seek access to commercial growth capital, especially debt. Benchmarked against other regions, Africa still remains one of the most under-leveraged microfinance markets.<sup>1</sup> Local commercial banks hesitate to extend loans citing their traditional focus on collateral based lending and competing demands for capital internally given their own downscaling plans. International funding from institutional investors is also limited given the foreign exchange risk inherent in such transactions and the impact of the global financial crisis.

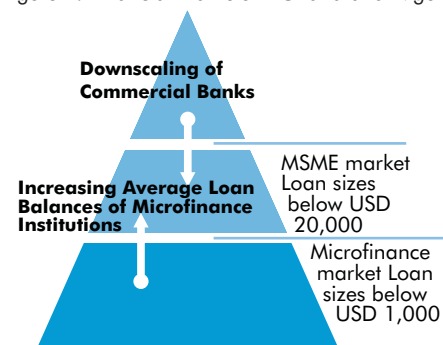
**West Africa Microfinance Market Potential: Unrealised Opportunity**

One key characteristic that makes this region extremely attractive from an investment perspective is its huge market potential. The total demand for micro, small and medium enterprise credit in this region is estimated to be between USD 8 bn to USD 48 bn. Country wise estimates are presented in Table 2 below.

Table 2: Demand for Credit by Country

	Nigeria	Ghana	Sierra Leone	Liberia
Potential clients based on poverty lines <sup>2</sup>	10.4mn - 21.3mn	1.3mn	0.5mn	0.6mn
Microcredit Demand (USD) <sup>3</sup>	3.1bn -19.2bn	0.3bn - 0.9bn	24mn -0.2 bn	13.9mn -167.3mn
MSME Credit Demand (USD) <sup>4</sup>	2.9bn - 17.3bn	1.7bn - 10.3bn	61.9mn -0.5bn	40.2mn -0.2bn

Figure 2: Financial markets in Ghana and Nigeria



<sup>1</sup> Leverage in the region is 2.6 as compared with 4.9 in Asia and 3.2 in Eastern Europe and Central Asia per MIX 2007 global benchmarks  
<sup>2</sup> For Nigeria the national and international poverty lines (NPL and IPL) have been used, NPL for Ghana, IPL for Sierra Leone and IPL for Liberia  
<sup>3</sup> Based on a range of loan sizes Nigeria USD 300-900, Ghana USD 200-700, Sierra Leone USD 50-350, Liberia USD 25-300  
<sup>4</sup> Based on a range of loan sizes Nigeria USD 1000-6000, Ghana USD 800-5000, Sierra Leone USD 400-3000, Liberia USD 500-2000

The current supply by formal and informal providers of finance has reached only 12% of likely microfinance clients (based on IPL), supplying merely 9.4% of estimated credit requirements. Estimates suggest that 2.7 mn clients were reached out to and USD 1.3 bn in credit was disbursed in the region in 2007. This presents a huge potential for future microfinance activity fueled by the right financing and capacity development.

### A fast growing market; in search of efficiencies

Financial data analysis of the 34 MFIs in the study sample presents an industry characterized by fast growing portfolios, a relatively low financial leverage, high profitability, but significant operating cost ratios and higher portfolios at risk, given the greater focus on MSME lending.

Table 3: Financial Performance Indicators

Indicator	Anglophone West Africa <sup>^</sup>	Africa 2007*
Portfolio Yield	41.9%	33.4%
ROE	17.5%	-3.2%
ROA	4.7%	-1.1%
Operating Expense Ratio	30.5%	17.4%
Debt/Equity Ratio	3.4	2.7
PAR@30 days	6%	4.8%

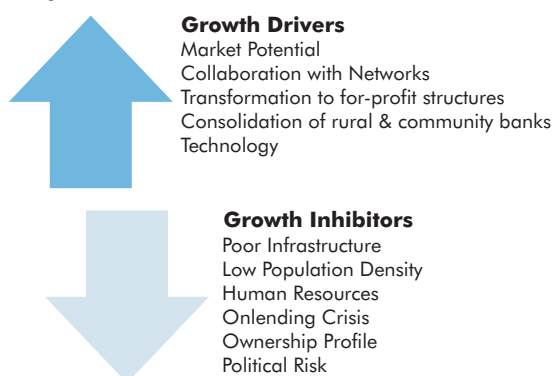
<sup>^</sup> Based on sample of 34 MFIs in the region  
 \*Africa benchmarks are sourced from the MFI benchmarks developed by MIX

The aggregate loan portfolio in the study sample grew at a very high CAGR of 78 percent from 2004 to 2007, while in comparison the client base increased only by 48 percent, indicating that such growth has come from increase in loan sizes and not greater client outreach. West African MFIs show higher yields from their portfolios, especially when compared to the average yield of their African counterparts. However, their operating expenses are fairly high and portfolios at risk are higher than elsewhere leaving scope for improvement in efficiency and quality of operations (See Table 3).

### Looking ahead: Future Prospects

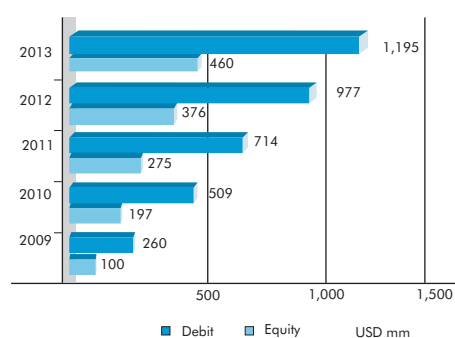
Anglophone West Africa’s microfinance market potential and some of the recent efforts by microfinance networks, regulators and capacity building bodies will support its future growth and evolution into a vibrant industry.

Figure 2: Growth Drivers and Inhibitors



A major growth constraint is the amount of funding available to microfinance organisations. The total capital requirements and estimated mix of equity and debt funds through 2013 are shown in Figure 3. Microfinance organisations are predicted to hold cumulative Gross Loan Portfolios of some USD 3.1 bn by 2013. To fuel this growth, MFIs require some USD 1.6 bn of fresh capital over the next 5 years, of which USD 460 mn in equity and USD 1.2 bn in debt.

Figure 3: Projected Capital Requirements



As the sector transforms and becomes more commercial, savings, equity and debt are expected to form the three major sources of financing for this market.

<sup>5</sup> Susu are traditional financial groups in Ghana that allows members access to credit for a fee, and provides a way to save.

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Client savings, while expected to increase, fueled by mobilization efforts by MFIs and decreasing inflation, will remain inadequate to support growth. However, consolidation amongst rural and community banks and transformation of NGOs are expected to create more investment opportunities for commercial debt and providers.

### **Investment Opportunities**

The Anglophone West African market can prove strategic to commercial debt and equity providers, if the right financing and technical assistance decisions are taken.

*Debt:* With the number of donors contracting there is an opportunity to provide start-ups with concessional debt that is low cost, long term, patient and flexible, that can build institutions. Growing NGOs will need concessional and commercial debt along with public deposits in large volumes from diversified sources. This debt is expected to come from MIVs and to some extent, local banks in the short term.

*Equity:* The current markets in Anglophone West Africa pose several opportunities for savvy microfinance equity investors, depending on risk appetite and return expectations. Within existing enterprises in the region, promising opportunities include buying out Nigerian high net-worth individuals (HNIs) and cherry-picking top performers in Nigeria and Ghana.

For investors looking for early stage investment opportunities, there exist some high potential MFIs in the process of transforming to for-profit structures in which they could take early stakes. The market can also support new MFIs that target the traditional microfinance client segment that is currently underserved in the region. In addition, there is high demand for blended financing facilities such as a combination of equity with debt, technical assistance or donor funding.

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This is an initiative of Goodwell Investments, Alitheia Capital, JCS Investment, DARC Foundation, and First Bank. Research was carried out by Intellecip. The full report can be ordered for USD 100/copy (excluding shipping/courier cost) by sending an e-mail to [info@goodwell.nl](mailto:info@goodwell.nl)

**Goodwell Investments** is a Dutch for-profit business development company that invests in entrepreneurial microfinance organizations on a socially and commercially sustainable basis. Goodwell aims to improve access to affordable financial services for millions of people in the 'Base of the Pyramid' in order to contribute to poverty alleviation and sustainable development. Goodwell is launching Goodwell West-Africa in partnership with Alitheia Capital and JCS Investment. Goodwell West-Africa is a private equity investment company for the microfinance sector in Nigeria and Ghana. For more information, please visit [www.goodwell.nl](http://www.goodwell.nl)

**Alitheia Capital** is a Nigerian investment manager and advisor. Its mission is to broaden the ownership of businesses and real estate. Alitheia enables socially sustainable investing and provides the opportunity for investors across the economic pyramid to invest in key sectors of the economy via structured investment vehicles. For more information, please visit [www.thealitheia.com](http://www.thealitheia.com)

**JCS Investment Ltd** is a Ghana based fund management company with a focus on microfinance and small business investments. An important objective of the company is to support business development in local communities. For more information, please visit [www.jcs.com.gh](http://www.jcs.com.gh)

**DARC Foundation** is a non-governmental organisation established to build the capacity of development institutions through quality technical assistance. DARC has successfully carried out various developmental programs for the non-profit and microfinance sectors in Nigeria. DARC provides technical assistance to several sectors including: Health, Education, Insurance, Finance, Arts and Culture. For more information, please visit [www.darcnig.org](http://www.darcnig.org)

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