



### *Helping to Improve Donor Effectiveness in Microfinance*

## **APEX INSTITUTIONS IN MICROFINANCE**

### **What is an apex institution?**

An apex institution is a second-tier or wholesale organization that channels funding (grants, loans, guarantees) to multiple microfinance institutions (MFIs) in a single country or region. Funding may be provided with or without supporting technical services.

### **Why are apex institutions attractive to donors?**

Donors often use apex institutions to deliver funding and technical services in countries where MFIs appear too small or numerous for direct funding relationships. Apexes are attractive because they permit donors to pass the difficult and time-consuming task of MFI selection to a local institution that is assumed to have the requisite skills.

### **Overall, how have apexes performed?**

The majority of apex institutions have unfortunately produced disappointing results, often because they were set up in countries without a critical mass of good MFIs with the capacity to absorb apex funding.

### **What are the characteristics of a good apex institution?**

1. The apex has a clear goal of **nurturing the development of sustainable microfinance providers** (including banks). Evidence shows that developing permanent, sustainable MFIs—not maximizing the number of MFIs—is the most effective way to expand the number of poor people served.
2. The apex is **politically independent**, with a strong board able to protect the institution from political intervention, thus ensuring that management can make decisions on technical grounds.
3. The apex receives funding based on a **realistic assessment of the number of qualified MFIs** in the country or region that can absorb apex funding.
4. Apex funding of MFIs is based on **clear selection criteria**, such as portfolio quality, depth of outreach, management quality, and progress toward eventual sustainability. The apex must have the authority to discontinue funding to MFIs that fail to meet these criteria.
5. Apex loans are **tailored to the cash flow patterns and planning needs of MFIs**, not pre-set disbursement plans.
6. The apex monitors MFIs on the basis of a **few, precisely defined performance targets** that are seriously enforced.
7. Apex **management is of very high quality**, possessing a blend of microfinance expertise, managerial and financial skills, and integrity.

### **Common challenges faced by apex institutions:**

- *Apex planners almost always overestimate the number of MFIs that can meet sound selection criteria.* The number of viable MFIs is a genuine constraint for most apexes. Even when PKSF, an apex in Bangladesh, used broad eligibility criteria, only 10% of initial applicants qualified for funding. Apexes in Kenya (K-Rep), the Dominican Republic (FondoMicro), Colombia (Fundación Carvajal) and Pakistan (PPAF) have all had more money than qualified MFIs to fund.
- *Replicating a ‘successful’ apex model in another context is rarely successful.* Among the twenty-eight apexes studied by Fred Levy (see sources below) from Argentina to Yemen, no such thing as a “one-size-fits-all” model was found.

- *Donors and other stakeholders pressure apexes to disburse funds quickly.* Apex institutions that are serious about selection criteria often cannot disburse funds quickly because they typically find fewer qualified MFIs than were anticipated. Other apexes succumb to disbursement pressure and fund low-quality MFIs.
- *Political pressure adversely affects MFI funding decisions.* Government involvement in an apex can compromise its mission by inducing the apex to disburse funds to unqualified MFIs. In Sri Lanka, NDTF suffered heavy political intervention. As a result, almost none of the MFIs it funded met the apex's own minimum criteria and the outreach of those MFIs was limited.
- *Apexes rarely build bridges between MFIs and commercial funding sources.* Some stakeholders assume apexes will pave the way for commercial funding to MFIs, but this goal is rarely included in the apex mission. The availability of cheaper apex funding is, in fact, more likely to reduce incentives for MFIs to seek commercial funding.
- *Apex funding of commercial banks and finance companies rarely encourages their continued provision of microfinance services after the funding ends.* As the experience of GlobalMicro in Paraguay demonstrates, microlending by banks has a high probability of continuing only when a bank's own money is at risk and when apex financing is packaged with intensive technical assistance.

### **How can donors support the development of good apex institutions?**

#### ***Apex Design***

- Prior to creating an apex, perform a rigorous financial and operational analysis of a fairly large sample of the MFIs the apex would fund. This analysis should also help determine the size of the apex.
- Minimize disbursement pressure. Where possible, provide modest funding at first, and base later increases on demonstrated demand from quality MFIs. Where initial funding must be large, lengthen the disbursement period and educate all stakeholders not to expect large disbursements in the early years. If practical, create a temporary investment mechanism (e.g. social-purpose government bonds) where the apex can place unused funds without provoking criticism about idle money.
- Identify appropriate apex managers during the design phase rather than assuming that high-quality apex management can be found later.

#### ***Apex-Donor Relationship***

- Strengthen the strategic focus on viable MFIs. Improve apex tools for measuring the quality of MFI loan portfolios, the financial sustainability of their operations, and their client outreach.
- Focus evaluation of the apex and donor or government reporting requirements on such goals as MFI portfolio quality, sustainability, and outreach.
- Tie future donor or governmental disbursements to apex performance.
- Ensure political independence of the apex. Limit or eliminate government participation on the board and name private directors who are both powerful and committed to the apex's technical independence.

#### ***Apex Operations***

- Reduce restrictions on how MFIs use apex funds, except where detailed reporting on the use of funds is necessary to prevent fraud.
- Monitor MFIs according to institutional performance targets contained in their business plans. Focus the relationship (appraisal, contract requirements, reporting, and monitoring) on the institutional viability of the MFI.

Sources: This *Donor Brief* is based on Fred Levy, "Apex Institutions in Microfinance," CGAP Occasional Paper No. 6 (January 2002) and "Microfinance Apex Assessment Framework" by Richard Rosenberg and Brigit Helms (CGAP, forthcoming 2002).

**Where to go for more information. Papers:** "Water, Water, Everywhere....," CGAP Donor Brief No. 3 (May 2002); "The Second Story: Wholesale Microfinance in Latin America," by Marguerite Berger, Allison Beck, and Maria Lucia Lloreda (IADB paper, forthcoming September 2002). **Websites:** See [www.microfinancegateway.org/viewpoint\\_archive.htm](http://www.microfinancegateway.org/viewpoint_archive.htm) for "Capital vs. Capacity" discussion and *Format for Appraisal of Microfinance Institutions* at [www.cgap.org/html/p\\_technical\\_guides04.html](http://www.cgap.org/html/p_technical_guides04.html).