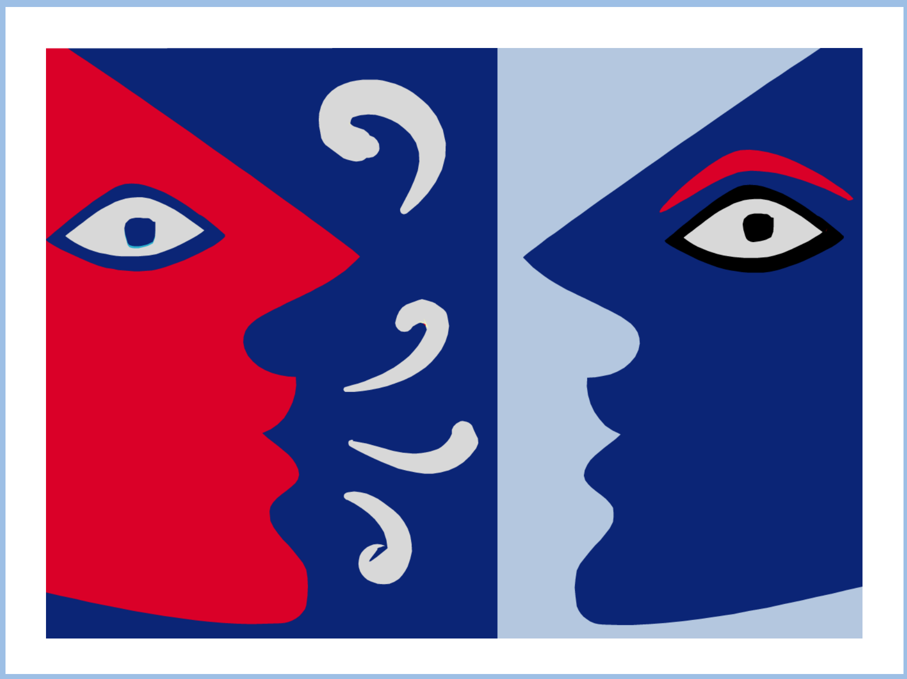
Dependency vs. Sustainability: Impacts of Foreign and Domestic Investment in MFIs

AN ONLINE SPEAKER'S CORNER DISCUSSION LED BY MARC DE SOUSA-SHIELDS AND HOSTED BY MICROLINKS.ORG



MAY 9 - 10, 2006

This publication was produced for review by the United States Agency for International Development. It was prepared by the QED Group, LLC, and International Resources Group.

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SUMMARY: Marc de Sousa-Shields

This was the ninth Speaker's Corner e-conference, which was a 2-day online discussion. The topic for this event was Foreign and Domestic Investment in MFIs. As a starting point for the discussion, we requested that participants view the audio slideshow presentation, *Financing MFIs: The Context for Transitions to Capital*, a narrated, online presentation that explores the reason for the existence of a gap between microfinance institutions' demand for finance and the current supply of private sector funds, which are controlled by investors who remain cool to investing in MFIs despite the microfinance industry's demonstrated profit potential. It explores specific challenges for the industry to mobilize commercial capital, including savings, debt and equity (both foreign and domestic), as well as the impact that continued donor subsidies have on microfinance commercialization. It concludes with suggestions to donors and other stakeholders on how to move the industry toward this vision as the best way to significantly expand outreach to the poor.

First of all, I would like to thank all of you who participated in this virtual conference. We had some very good thoughts and the beginnings of great conversations; the kind of which need to happen to propel the MFI financing debate forward.

On Day 1, The discussion regarding guarantees went some way to explore the theme of local versus international finance. We know guarantees are of growing interest among funders and seem to be useful to MFIs. But as Elissa McCarthy and others pointed out, guarantees often provide but a piecemeal solution to financing (and often an expensive one at that).

Clearly, other sources are required and we discussed this in detail on Day 2.International funds seem to be the most willing – but are they the most able? Demand by far still outweighs supply, despite recent advances of some funds in attracting large amounts of capital. Issues of foreign exchange risk being borne by MFIs (and their clients), was not addressed but remains an issue.

But can international funds supply the enormous demand? Clearly not. Local markets as a result remain central to the financing of MFIs, despite regulatory barriers facing bank lending, the obvious source of funds. Deposits are central, but as we know, large deposit- taking MFIs are still taking a good share of international financing. As Julie Abrams noted, and as we noted as early as 2004 in Financing MFIs: The Context for a Transition to Private Capital (USAID 2004), donor and some international fund capital is de facto the risk capital of the sector. So why do they lend to those MFIs most able to source private, local capital?

There are many good reasons for donors and some funds to continue to finance big, successful deposit-taking MFIs. From a sector building perspective, however, there are at least as many reasons why they might not. From an equity perspective, certainly development funding (whether from donors or many of the funds that act as their proxies) has stunted the natural progression of start-up, growth, and then sale of MFIs. No one, it would seem is pushing for mergers and sales of MFIs as would be the case in any other industry (a theme not broached in this conference, but one that should have generated more discussion if it had). Local, profit oriented owners might be so pushy.

As microfinance grows and matures, financing will have increasing impact on the direction and nature of the sector. The role of donors and funds – and possibly networks/PVOs- will be critical, I believe, in the transition to private capital, not only for funding, but for the important work of understanding how to best form contracts, negotiate loans, find suitable investors etc. Finding appropriate local funders as well as continuing to improve deposit mobilization capacity is also critical. As one participant noted, conscientiously weaning MFIs off development intervention friendly capital and onto private sources should be a strategic pillar of advancing the sector. Private capital is after all, the only conceivable way in which billions of clients can be served sustainably.

WELCOME POST: Justin McFadden

Dear Colleagues,

Welcome to this two day Speakers Corner event on Dependency vs. Sustainability: Impacts of Foreign and Domestic Investment in MFIs!

This discussion will focus on the presentation entitled Financing MFIs: The Context for Transitions to Private Capital. To view and listen to this presentation please go to http://www.microlinks.org/mficapitalpresentation/.

Participants are highly welcome to speak their minds in a frank and open fashion.

The theme/question for today, DAY 1, will soon follow this posting and will be brought to you by our moderator for this event, Marc de Sousa-Shields.

Marc manages Enterprising Solution's small enterprise and capital markets practices, which provide advisory services on SME and MFI finance. Marc has worked for over fifteen years in economic development initiatives internationally. Before co-founding Enterprising Solutions, Marc co-founded and was the Executive Director of the Social Investment Organization in Canada. He has also worked at a senior level for both banks and financial cooperatives. Much of his consulting work focuses on exploring how to harness conventional and social investments to socially responsible MFIs and SMEs in emerging markets. Marc's practice also includes program, project, and institutions evaluation. He is the Research Director for Financing MFIs: Transitions to Private Capital a three year research project of USAID managed by Chemonics International.

DAY ONE: SOURCES OF LOCAL FUNDING

Post By: Marc de Sousa-Shields

The first eight CGAPs MicroFinance Capital Markets Update reports less than 5% of all significant MFI financing deals are from local sources.

While the reports are biased towards international fund suppliers who are hooked into the international funding scene, it appears significant local funding is not taking place at the scale still required to meet MFI portfolio funding needs.

I would like to know of the groups thoughts on this volume issue. Are there more local sources?

Perhaps later in the day we can turn to the quality issue of foreign over domestic capital.

Post By: Elissa McCarter

I agree that there is much too little focus on raising local capital, particularly since the majority of banks in places where we work are over liquid. Some of the recent focus on guarantee mechanisms for local bank financing, rather than wholesale lending direct from the international financier or donor, is moving in the right direction. But it remains to be seen just how much guarantees have been successful. I believe that USAID/AMAP is supporting research on this subject right now.

At the very least, donor and international / quasi commercial funding should avoid pumping more liquidity into over liquid markets if there is a way to free up this money. The problem is finding the right approach to local commercial banks and incentives that prompt them to take an interest and test the risk of microfinance markets.

CHF International has been relatively successful at raising commercial capital in the Middle East. To date we have leveraged over $42 million in commercial capital from nine bank partners in the Middle East. This is managed capital, wherein CHF originates loans for a fee and shares the profit and risk. Approximately 15% of our total outstanding portfolio is managed bank capital.

In Lebanon, for example, CHF's MFI AMEEN SAL originates and services loans for three banks in both USD and local currency. In Jordan (MEMCC) and West Bank/Gaza (ACP), CHF's MFIs have a combination of direct borrowing and partnering arrangements with local banks.

In Jordan and Bosnia (LIDER), we have been able to secure several local lines of credit, but these are usually for smaller amounts $500,000 - $1million in local currency at a time, and for 1-2 years renewable.

One lesson is that by starting small and establishing the relationship with local banks, we are able to improve amounts, terms and conditions of the local financing over time. But the reality remains: for the bigger sums and longer terms, the risk appetite for local banks is too small and we end up "piece-mealing" together our financing needs on a frequent basis, which eats up time, effort and money. We have to complement this with larger financing from donor and quasi-public / quasi-commercial investors, who are already familiar with microfinance, to arrive at a blended cost of funds that is feasible for profitability goals and to meet our immediate growth needs.

Post By: Gregory Chen

I understand that in Bangladesh ASA and BRAC have moved away from the local apex - PKSF - and are now financing most of their portfolios through member savings and/or deals directly with commercial banks. While some may have concerns about NGOs taking savings (I am less concerned given the track record of these two institutions), this overall appears to be a healthy development. The interesting twists are the securitizations and straight bank debt these institutions can now access; rates may be higher but other terms are more favorable. Dependency after all comes from reliance on too few sources of funding; whether these sources are domestic or international.

The Pakistani situation is quite different, but we'll save that for a subsequent submission (perhaps).

Post By: Marc de Sousa-Shields

Thanks for your thoughtful comments. Commercial banks are certainly a good option in the short term. Guarantees seem to be a good way to access them too. CGAP will be producing a paper soon on the topic. Unfortunately, guarantee schemes have a bit of a bad reputation due mostly to poorly designed programs to help small businesses. The guarantees we have seen for MFIs have generally been good however and have allowed institutions to access new sources of capital, diversify sources of capital, and increase leverage generally. The problem with international guarantees, as I understand it, they are not financially viable for funds to provide. In fact, from what I have heard, at best they may be able to break even at very modest rates of return (particularly given the limited scale).

Right now I am not sure that there is too much capital available for MFIs from donors and international funds, rather there is a shortage generally speaking. You are right about bank liquidity, pretty much in every country we work in (about 60 or so) banks are looking for good investments. There are some strong regulatory incentives in most countries from making loans to MFIs that, in addition to conservative lending habits, tend to decrease the attractiveness of MFI lending. In countries were banks have been sensitized to MFI lending, we have seen some success. For example in Uganda, banks were lending to MFIs on an unsecured basis because USAID Speed among others took the time to educate the banks about the opportunity. Of course that the MFIs were willing to pay over 15% on the loans was important to successful lending as well!!

I agree with your point however that in the end it remains piece meal. Ultimately too, bank financing is probably not a good long run solution simply for pricing reasons.

Post By: Camilla Nestor

In Grameen Foundation's experience, placing partial guarantees to spur local commercial bank financing for MFIs has indeed helped local commercial banks become more familiar with microfinance, allowing them to take on increasing amounts of risk over time.

We also have seen local currency financing rates come down closer to prime lending rates as the banks become more familiar with the microfinance sector -- in some cases a reduction of as much as 150 bps over the course of a year. Thus long term, we do see local commercial banks as a good source of financing for MFIs given the liquidity that Marc notes below as well as improving terms & conditions that are becoming available to MFIs. They are also able to provide local currency financing, which is critical -- while USD/EUR financing may carry lower interest rates, currency depreciation should be factored into pricing estimates over the course of the financing.

As with the Uganda case Marc notes, we see banks in India in some cases lending on a fully clean basis to MFIs, or with a nominal guarantee of 5-10%. Priority sector lending requirements have played a role in this, but the banks in India have been increasingly viewing the microfinance sector as an attractive market niche. Morocco is another environment where we see guarantees being reduced over time and clean lending beginning to take place.

Post By: Marc de Sousa-Shields

Discussions on guarantees so far have sounded pretty hopeful. Why is it then that effort by donors still seems to focus more on international funds and lenders?

With the exception of equity, perhaps, why support international efforts at all given transaction cost constraints, dependency on foreign capital and donors, not to mention currency exchange risk?

Where are local or regional funds?

Post By: Gert van Maanen

Why is there so little local funding for MFIs?

First of all we have to realise that in the view of regular bankers MFIs are engaged in a weird kind of business, giving very small loans to vulnerable and poorly educated people without banakble security.... In fact, one needs a very developmental mind to like that. That differs from a regular banking mind. Within regular banks one needs courage to propose to engage in such activity, because it goes against most banking reflexes. In most of the - relatively few - banks that started to play a supportive role there is a strong supporter at Board level but it is uncertain whether such activity will survive the retirement of that Boardmember.

Secondly, regular banking systems go against it. Because basically a loan to an MFI with only one major asset - a portfolio of unsecured loans - is an unsecured loan. Under the Basle rules that requires more own capital than normal loans and under National Bank rules (or auditing rules) it may require extra provisioning. Consequently, the system makes such loans more expensive, and on top of that they are perceived to be more risky. Why stick out your neck and propose such a thing ?

Thirdly, most of the regulators don't allow MFIs to take local funding in the form of savings and depositis from the general public, because in their mind it is a banking sin to turn savings into unsecured loans. For the same reasons they feel alarmed when a normal bank steps in and starts to build up a loanbook of MFI funding. Because - in spite of the performance of most MFIs - in their perception these loans are basically unsecured: in times of crisis the value of their loan portfolio can evaporate in a few weeks...

In this climate bankers gladly leave this field to others and prefer to focus on banking activities that are supported and not distrusted by their superiors. To open their eyes for microfinance is swimming against the tide.

Overseas (and local !!) guarantee schemes are nice, because they enable the proponents within a regular bank to take the first hurdle and tell their peers that this loan is not unsecured. Moreover, there is sufficient evidence within the industry to demonstrate that very few guarantees are called. So, guarantees are not conditional grants.......

Having said all that, I am afraid that there are few signs that the banking world (be it local or international) will underwrite the capital needs of the micro finance industry and enable it to double in size from 60 million to 120 million clients in - say - five years. Moreover, the few banks that support microfinance concentrate on funding of the top layer of MFIs. Ivatury (CGAP) produced an excellent paper on that for the KfW seminar in November 2004 (attached). The absurdity is that most of the international commercial funding goes to MFIs that have passed the regulatory tests and that are allowed to take savings, including the ProCredit Banks. In fact, they don't need international funding anymore and should be able to raise sufficient funds locally. I have commented on Ivatury's paper in the attached paper on the future funding of microfinance, in which I plead for special focus on enabling the non-regulated MFIs to rise to the occasion.

So the answer to the question "why support international efforts and why not put more cards on local funding" is that there is no such thing as readily available local funding as long as bankers and regulators shun microfinance and do so on the basis of generally accepted sound banking principles. The most important nut we have to crack is to convince politicians and regulators to allow well performing MFIs with a good track record to take local savings and deposits. And to create for them another regulatory environment that recognises their special nature.

In that context I am not confident at all that the urge for an integrated financial sector embracing both banks and MFIs is the solution. In such a sector 'normal banking' is likely to set the tune. I would rather prefer the regulators to make a clear distinction between banking for normal clients and for so-called unbankables, than to try to get everything and everyone under one regime. Because microfinance is not business as usual but very unusual business.

DAY TWO: DEPENDENCY COMES FROM TO FEW SOURCES OF FUNDING

Post by: Marc de Sousa-Shields

Dependency comes from too few sources of funding, be they domestic or international

In the world of financing MFIs, Greg Chen's of Shorebank words ring far too true. It seems, I and I would agree, that guarantees can leverage more funding for MFIs and the culprit it levers against are banking regulations that inhibit funding at the scale required to meet the needs of the poor.

Perhaps regulatory change allowing easier funding of MFIs, but that is not going to happen overnight.

Is it a good strategy to see those MFIs which can already access capital from local source continue to suck up donor grant and international fund capital?

Do smaller, non-regulated MFIs merit capital? And if so, where will it come from? Can funds like Blue Orchard or responsability reach down to the emerging MFI level? Can any fund for that matter?

If diversity is the key, what are the next new financing sources and tools to fuel sector massification?

Post By: Anna Bantug-Herrera

In terms of the next new funding sources, there are three major categories that I see:

1) (new-ish) Social investors - such as the Gates Foundation (with a recent $6M grant to ACCION) and the $100M Omidyar Fund in Boston

2) Large commercial banks - at the recent ACCION capital markets conference in New York, I was pleasantly surprised to meet representatives from such huge institutions as JP Morgan Chase, Capital One, Morgan Stanley, etc. What role will these institutions play in funding MFIs in the future?

3) Savings/deposits - what role will they play in providing funds for MFIs in the future?

Post By: Regula Schegg

A few thoughts to your sources of capital:

1) Social Investors: I would even go further and distinguish between double bottom line and triple bottom line investors. The question becomes, are such social investors as you mentioned focusing on commercial investment opportunities or continue to accept a discount on their return for social causes. Looking at the triple bottom line investing focus, one could argue that investing in socially oriented organisations, whether in microfinance or any other industry, does not necessarily require accepting a discount on returns. As the triple bottom line financial market performance statistics show, companies that are socially responsible, consider environmental aspects in their decision making process, can actually achieve better long-term returns as their peers not focusing on triple bottom line.

Generally, SRI and Triple Bottom Line investors become increasingly interested in microfinance and once we are able to provide additional transparency, better understand the risk/return profile of such investment opportunities, we can start creating a more liquid primary and secondary investment market - connect the dots.

Upon speaking at a global private equity conference recently, I believe, it is just a matter of time that private capital of HNWI and institutional as well as strategic investors (sourced through private equity funds) will more prominently focus on investing in microfinance institutions and related business serving the poor. It seems there exists reluctance also because there is not sufficient awareness in this market and deal sizes are still very small in comparison to other emerging market private equity investments.

2) Commercial Bank: The question I raise here is to what extent they will go down market and what model they continue to use. Partnership model or will we see increased acquisitions to access this tremendous market potential?

3) Savings: A very large role since it allows the local markets to become less dependent on foreign capital which has a positive impact on preventing forex risk.

Post By: Elissa McCarter

Thought provoking questions. Here are a few thoughts:

Q: Is it a good strategy to see those MFIs which can already access capital from local source continue to suck up donor grant and international fund capital?

---- To the extent that local capital does not meet all financing needs, MFIs don't really have a choice and need to diversify sources; however, donor money should be targeted to "wean them" off, and perhaps complement this local capital by taking on the "riskier" ventures in new product development and expansion to harder to reach areas, leaving the "safer" portfolio expansion to local investors rather than crowding them out. I think everyone agrees that international money should not compete but complement -- the tricky issue is knowing where to draw the line.

Q: Do smaller, non-regulated MFIs merit capital? And if so, where will it come from?

---- What do you mean by non-regulated? Should all MFIs strive to have a full banking license and fall under a Central Bank regime? I don't think that is going to happen, and most countries have some sort of regulatory/monitoring framework in place for the non-bank MFIs. Until regulators keep up, perhaps the donors/investors can provide better incentives, demand transparency, and enforce greater accountability.

Q: Can funds like Blue Orchard or responsibility reach down to the emerging MFI level? Can any fund for that matter?

-- The criticism to date that only top tier MFI favorites get the foreign investments is starting to be heard. I see funds increasingly looking to the networks as a filter. Not to do self-promotion here, but I do see value in funding the 2nd and 3rd tier MFIs via a network organization that can take on some risk, assure the due diligence and help aggregate numbers (and effort it takes) for the funds. The BlueOrchard St. Honore Fund is one example of this shift from financing MFIs individually to providing network loans. However, these social investment funds are still small to finance full growth needs of MFIs.

So...that leaves your question:

Q: If diversity is the key, what are the next new financing sources and tools to fuel sector massification?

-- I agree with Ann, tapping into savings/deposits as long-term sources of capital would be great, but again, I'm not sure how realistic or desirable it is for the non-bank MFIs to transform into banks. Is it possible to work out arrangements with local banks where MFI retail outlets could originate savings accounts for banks and somehow tap into these deposits through an internal financing agreement with a bank? I am also wondering if private placements, public offerings, re-insurance schemes, securitization could really be an option long-term as the industry matures, and if there is greater scale and make it possible to aggregate portfolios. The transaction cost of such deals is huge and it looks like anything less than $100M as a very minimum is not worth considering. It seems like massification will still depend on freeing up overliquidity among local commercial banks, so to what extent can governments provide incentives to the banking sector to enter or invest in microfinance, as India has done, and Lebanon?

Post By: Julie Abrams

Your question: Is it a good strategy to see those MFIs which can already access capital from local source continue to suck up donor grant and international fund capital?

Regarding the question above, we all know that MFIs that can already access local commercial capital continue to take on donor grants and international fund capital. However, the onus for this to change must come from the international funders themselves. I can hardly blame an MFI that is looking for the lowest price debt at the best terms to turn down a concessional loan. They are merely acting as savvy shoppers, looking for the best deal they can find. Although it sounds intuitive, we did show empirically in a survey of both regulated and unregulated MFIs, that "lower interest rates" was by far the number one factor cited by MFIs in seeking foreign investment. (See CGAP Focus Note 30, page 9, http://www.cgap.org/docs/FocusNote_30.pdf).

Your question: Do smaller, non-regulated MFIs merit capital? And if so, where will it come from? Can funds like Blue Orchard or responsibility reach down to the emerging MFI level? Can any fund for that matter?

I think that the higher risk capital that is funded by public institutions would be best invested in the smaller non-regulated MFIs, i.e. higher risk MFIs. Thus, multilaterals and foreign governments should be funding the riskier so-called (but never well-defined) second or third tier MFIs. I would expect the funds you cite, such as BlueOrchard and responsAbility, to go as risky as they can, given their investment mandate and the returns required by their investors. That said, I would expect their capital is far less risk-taking than that of the international financial institutions. Private commercial funds are not the best candidates for reaching down to the emerging MFI level, unless they structure this as a unique higher-risk product. Of course the best answers to this will need to come from the private investment funds themselves.

The good news is that there are clearly some highly successful profitable "top tier" MFIs that are fully capable of attracting both local and international commercial capital. For example, in research for the above-mentioned CGAP Focus Note, we found that 148 MFIs held more than USD 1 million in foreign investment, and gave examples of ten MFIs that had between 8-20 foreign investors each. These types of MFIs do not need donor and international fund capital.

I think there is a very compelling need to develop and fund the next generation of MFIs to be the next success stories. This is where the higher risk capital can have the biggest and most long-lasting impact to succeed in the ambitious scaling up of microfinance that everyone advocates. This is a great role for donor grants and international fund capital.

Lastly, the basic principles of finance always advocate diversification as a way to reduce risk. I am sure many of us know of horror stories of MFIs that did not adequately diversify funding liabilities and also investment assets (or both) and the type of things that happened. So the development of new products and diversification of funding sources is one of the keys to an MFIs success.

Post By: Gregory Chen

An important issue that we find in South Asia is SCALE. For all of the well thought through new funding instruments nothing gets the attention of the markets like scale. When an MFI can go to Commercial Banks with a portfolio of $100 million or more this can command attention, better pricing and leverage on terms.

Experience in South Asia would suggest that the effective use of guarantees, grants or other sources of subsidy can be most effective when deployed to get an MFI to the scale where it can negotiate funding from a position of strength.

I would argue that donor funds are often best placed with MFIs that havepotential to go to mass scale (in South Asia this means millions of clients) and be profitable. Once in this position of strength, funding sources will be easier to diversify.

Post By: Anita Campion

I agree that some guarantees can encourage donor dependence, but I have seen other positive examples as well. For example, USAID's Development Credit Authority (DCA) guarantee was used to build client trust and willingness to place long-term savings (certificates of deposits) in two MFIs in Mexico, FinComun and Union de Credito Progreso. In addition, the DCA can help facilitate bank lending to the MFI, but requires the lender to retain at least 50% of the risk. The real question is not whether these mechanisms should be used, but when, where and for how long are they appropriate? To be successful, the formal sector finance should continue after the initial demonstration of the MFI's credit worthiness. But I'm not sure we are always following up to check on that and documenting when that does not happen and why.

Post By: Marc de Sousa-Shields

Some thoughts...

Does it make any sense funding the small MFIs when we see the tremendous growth of Compartamos for example.... With somewhere near 500,000 clients and growing, what is the point of funding ten small ones with fewer than100,000 clients?

The question is: is it worth it to invest in the small MFIs at all?

Perhaps the real strategy is to invest in the big MFIs and attract banks into the game.....

If this is a strategy, equity becomes an issue... few MFIs are positioning themselves to be sold... rather the reverse.... odd for startup industry....

As Gert van Maanen from Oiko Credit mentioned, the demand is huge.... Are start up and greenfield MFIs the way to meet this demand? In any other industry start ups are bought by major players, in this case Banks.

Should we be encouraging equity investments with such an end in mind?

Post By: Lauren Burnhill

Regarding local access vs. international funding, we are finding that local lenders are generally charging higher rates than the international lenders.

The local lenders don't seem to have (or want) an understanding of the "big picture", so an MFI that is tops in the world is not perceived that way within its local financial sector.

While I would like to see MFIs having better access to local markets, there is a lot of educational effort that will need to happen. We need to somehow help local markets develop appropriate products, while channeling the international funding in ways that will deepen the pool of global investors interested in microfinance.

The next new financing sources? Check back with me in six months, but I think we will see networks like ACCION, Opportunity, Shorebank etc., increasingly being pressured to act as second tier intermediaries for their networks, partners and beyond. Banks like BIG, as in at least $100mm transaction size. That means finding new ways to aggregrate debt, as Blue Orchard can't be the only player in the market or it will end up with excess risk concentration.

Post By: Marc de Sousa-Shields

Interesting you mention network organizations.... are they really suited to such lending and investing?

Post By: Lauren Burnhill

I don't know if networks ARE an appropriate vehicle to act as second tier lenders. If the alternative is to create new 2nd tier structures, then it would definitely make more sense to tap into networks. In our own case, I know that the monthly, quarterly and annual monitoring that ACCION does of/with its affiliates would enable effective loan supervision. Going beyond network, we have experience training institutions to make use of the monitoring system, which provides both social and financial indicators. as to investing, we've been doing it for a decade (Gateway Fund) with strongly positive results in both strategic and financial terms. Actually, I'm convinced that we are precisely the type of patient investor that is needed in many cases, since we have the luxury of being able to give strategic returns as much priority as financial ones! But enough about equity...

The key issue for me is what does it take to attract new sources of financing. Major institutional investors (banks, pension funds, mutual funds), want to look at asset classes with significant volume, liquidity and comparability (e.g., ratings and benchmarks). Most MFIs can't hit the volume needed on their own, nor will they have the size to do so for the next 3-5 years. In the meanwhile, I think aggregators like Blue Orchard are playing a crucial role in opening international capital markets, but again, they can't do it alone, and if the top MFIs wait until they're big enough but do nothing until then, the investor base will not be ready. The rest of us must design instruments, programs and facilities that are attractive to global capital.

In local markets, the required deal size may be lower, but the same issues of liquidity and comparability are a factor. In addition, many local markets are distorted by things like high rates paid on government paper that discourage banks and investors from looking at alternatives (and that raise the cost to potential MFI borrowers). I think the fact that almost anyone in the MF industry can name all the significant local bond deals (counting on the fingers of one hand) is really a shocking indication of how much work needs to be done at the local level. We're planning on using our Bridge Fund (guarantees) to support local paper in the future, not just credit lines, but our resources are rather limited so the impact we can have may be small.

Post By: Marc de Sousa-Shields

An interesting thought came from a group of senoir US social investors at a recent conference I host here in Mexico... they believe that if a MFI fund of funds did get big enough it would be a target for hedge fund investment, $50 million would be a minimum. Hedge funds can invest in anything really and have nt the kinds of regulatory restrictions or transaction cost structures that prohibit other types of investors....

Post by: Ann Miles

I have had an opportunity to help finance MFIs in three different capacities:

1) Citibank- At the time I worked there with MFI networks (1996-2000) Citi was active in the guarantee market only and had not yet developed a strategy for working in local capital markets. This followed soon with their engagement with Mibanco in Peru and Compartamos in Mexico. Developments continue to support local financing. We had varied success with guarantees depending on the risk appetites of the local banks.

2) WWB- We saw that over time (2000 to present) that the stronger MFIs increasingly improved their terms of financing, local and international. These same MFIs had solid financial planning and transparency. The smaller MFIs

did have trouble accessing both sources of capital due to size and capacity to manage debt. They needed concessional funding to help them get to the next level.

3) BlueOrchard- Since its inception, 2001, BlueOrchard has experienced increasing interest in microfinance from a range of investors- pension funds, commercial and socially responsible investors and high net worth individuals. Only recently has there been an interest in going below the top tier MFIs and a willingness to take on more risk. We should complement and compete with local capital.

Ten years may be a long time to witness these developments but they do happen and I think the pace is now accelerating. We have to continue working at all levels- local and international- to educate regulators, market players and investors about microfinance. We must also continue to work with MFIs to prepare them for increasing complex capital structures that appropriately support their growth and product development.

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