

February 13, 2006 Monday

## Doing good and making a profit

*"Those opting for microfinance investments are finding that rates of return on offer rival the warm feelings generated," says Deborah Brewster*

By DEBORAH BREWSTER

Everyone from Bill Clinton, Bill Gates, Citigroup and the pop star Bono have hopped on to the microfinance bandwagon. The United Nations did its bit by declaring 2005 the Year of Microcredit.

Microcredit, microfinancing or, as it is now being called, inclusive finance, means making tiny loans to impoverished individuals - mostly women - under the theory that the borrowers can lift themselves out of poverty by growing their businesses.

The 40-year-old movement began in the form of charity, providing loans through donations by governments, the UN or aid agencies.

Once carrying the whiff of obscure do-gooding, it is being discovered by a growing number of individuals, corporations and organisations, which are viewing it as a financial investment as well as a form of aid. Offering a "double bottom line" of profit and social good, it is especially appealing to capitalist philanthropists such as Bill Gates, Microsoft founder, and Pierre Omidyar, Ebay founder, both of whom gave large donations to microlending organisations in the past year.

John Tucker, the deputy director of inclusive finance at the UN's Capital Development Fund, says: "The sector has demonstrated profitability. The first country to do that was Bolivia, in the mid-1990s. An NGO (non-government organisation) doing microlending converted to a commercial bank, Banco Sol, and it became one of the most profitable banks in the country. That made people realise that poor women could provide the basis for a profitable business."

As the industry has grown, it has become more finance-driven, with investment banks, corporate lenders and advisers getting in on the act. Reliable data are hard to come by but it appears that about Dollars 500m (Pounds 287m) is currently out in the form of microloans, with an average loan size of Dollars 340.

Most investing is done by commercial entities - Citigroup and Deutsche Bank both have microlending operations on their own accounts that are sometimes open to big investors - but there is also increasing interest from individuals and institutional investors such as endowments. The idea appeals to those who would like to see their money doing good but are not keen to actually give it away.

It can be difficult to find the best way of investing, as the industry is still in its developing stage and there is no central clearinghouse aimed at investors or any standardised method of investing.

The microfinance funds open to investors do not themselves make loans but pass the money on to banks, lending co-operatives or credit unions in developing countries and these entities make the loans, often at a profit to themselves. In effect, the investor lends the money to the fund (receiving a promissory note in exchange); the fund lends it to the microfinance institution (MFI), such as a bank or co-operative; and the MFI lends it to the individual.

One of the largest micro-finance funds, Accion, offers three different ways of investing. A minimum Dollars 250,000 in Accion Investments, which makes equity investments in microlenders, expects to return 8 to 10 per cent, according to the company.

For retail investors, a minimum Dollars 2,000 investment in the Accion Global Bridge Fund, which lends to MFIs around the world, has varying returns and the USA Loan fund, which also requires a minimum of Dollars 2,000, lends within the US and offers returns of up to 2.25 per cent.

Retail investors on a budget might like the Community Investment Notes offered by the Calvert Foundation (which is associated with, but run separately from, the Calvert socially responsible investing mutual funds). The notes invest mostly in US projects (which have much higher loan amounts) but about 25 per cent of its money goes to microfinance. They are easily bought through most broker-dealers.

Shari Berenbach, the executive-director of the Calvert Foundation, says it is considering lifting the micro-finance proportion to 50 per cent, partly because of the demand from investors.

"There has definitely been a lot more interest lately, an uptick in note sales and a lot more requests for information," she says.

The minimum investment is Dollars 1,000 and gives investors the option of getting a return on their capital (of up to 3 per cent, depending on the term of the note) or of donating their returns to the fund.

The Microfinance Information Exchange ([www.mixmarket.org](http://www.mixmarket.org)), which rates microlenders, is a good place for would-be investors to start their research. It lists more than 600 microfinance institutions and 74 funds. Returns vary greatly and institutions with large amounts tend to be offered better rates.

Alan Snoddy, senior vice-president of investments at the Episcopalian Church Pension Fund, says the rate of return offered was an important reason for the Dollars 8bn fund's first investment in microlending last November.

The fund committed Dollars 15m to Deutsche Bank's Global Microfinance consortium, which raised a total of Dollars 75m from investors by offering both debt and equity tranches.

The debt component returns the London inter-bank offered rate (Libor) plus 1.25 per cent. Libor, the most widely used benchmark for short-term interest rates, is at present about 4.9 per cent for one year.

"Our investments have to be made for returns, not social reasons," says Mr Snoddy. "That said, we are a church fund and we were requested in 2000 to look at community-benefit investments. When this (consortium offer) came through, it was one of few that were attractive on a risk/return basis as well as from a social standpoint."

Returns tend to be slightly lower than for other types of investments but risk levels are not high. It turns out that poor rural women are better credit risks than many companies, meaning that default rates are low. Accion reports a historical repayment rate of 97 per cent. No Accion or Calvert investors have lost money to date.

John Tucker makes the point that there are still too few investable lenders for the weight of money coming into the industry. Many microlenders do not yet offer the transparency, consistency of policies, appropriate audits and so on that are needed for them to be seen as investable. There have also been some cases of lenders inflating possible return rates and minimising the risk of defaults.

Like others, Mr Snoddy believes that microfinancing has to go to the capital markets. "To be successful, it has to tap into institutional investment. It can't just appeal for donations any more," he says.