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## **THE WALL STREET JOURNAL**

**A New Way to Do Well**

**By Doing Good**

**Microfinance Funds Earn**

**Returns on Tiny Loans**

**To Poor Entrepreneurs Abroad**

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**January 5, 2006; Page D1**

Making tiny loans to poor entrepreneurs in developing countries has long been a popular charitable cause, but it is now gaining traction as an investment.

Microfinance, as these loans are known, is aimed at lifting some of the world's most destitute people out of poverty by providing seed money for small businesses. Funding for the loans traditionally has come from charities and government-aid organizations. Now, an increasing number of private funds are steering capital to microfinance -- and demanding a return, albeit a modest one in single digits, on their investments. By doing so, the funds hope to boost microfinance's reach and efficiency, while also drawing more capital from investors.

Most microfinance funds are aimed at well-heeled investors, often with at least \$100,000 to invest, although opportunities for smaller investors also have sprung up that have minimums as low as \$1,000. Investors can choose among a variety of new investment vehicles, including equity and debt investment funds; bond-like securities that are ultimately backed by thousands of tiny loans and so-called loan-guarantee funds where, in some cases, participants lend their creditworthiness rather than cash. Unlike charitable donations, microfinance investments don't bring an upfront tax break.

These funds -- with money from private individuals, institutional investors and government investment arms world-wide -- invested some \$600 million in microfinance projects by the end of 2004, the latest numbers available, according to the Consultative Group to Assist the Poor, a group affiliated with the World Bank that researches the microfinance industry.

Many of the new investment instruments have been launched by nonprofit organizations long involved in the industry, including Grameen Foundation USA, the Foundation for International Community Assistance, both in Washington, and Opportunity International in Oak Brook, Ill. The trend also is drawing big commercial players: Deutsche Bank this fall spearheaded the launch of a \$75 million investment fund. Microfinance investing got a boost this fall when eBay Inc. founder Pierre Omidyar and his wife, Pamela, gave \$100 million to Tufts University to create a fund that invests in microfinance vehicles.

Microfinance fund expenses vary, but typically the funds pay managers about 2% to 3% of assets under management for operating costs. Like hedge funds, some microfinance funds might also keep a percentage of profits -- up to 20%.

Microfinance investment funds generally don't make loans directly to needy individuals themselves. Instead the funds provide capital to microfinance institutions, which are typically small, informal banks or cooperatives that lend money for small-scale businesses, such as vending fruit, weaving shawls or operating small farms in poor countries around the world.

Overall, microfinance borrowers have proved to be good lending risks, according to Microfinance Information Exchange, known as MIX, which is funded mainly by foundations to keep track of the industry. The group says the average percentage of loan portfolios that have payments in arrears for more than 30 days has been well under 5% in recent years. Still, MIX acknowledges that data on default and repayment rates can be tough to verify. Several firms, including MicroRate Inc. in Washington and Planet Rating in Paris, rate microfinance lending institutions. MicroRate also expects to launch evaluations of microfinance investment funds later this year.



María Teresa Ramírez, with her grandson, Derek. A loan boosted her charcoal business in Honduras.

There are other risks, too, including the possibility of currency devaluations in politically unstable countries. Many of the new funds raise capital through private placements, which means they are more lightly regulated than, say, mutual funds, and many can tie up your money for between five and 10 years. Also, because many of the funds are new, there isn't much of an earnings track record. Due to the risks, many microfinance investments are geared toward sophisticated and wealthy investors.

James Torrey, a hedge-fund manager in New York, says he first encountered microfinance several years ago while traveling in Ecuador, where he came across a group of women sewing shirts in a village market. The loans for the sewing machines came from a microfinance lender. Mr. Torrey says he started donating to microfinance charities and has now "gone from being a small donor to being a significant investor." His investments include

MicroVest I Fund, based in Bethesda, Md.

Most microfinance funds are debt instruments, which make loans to microfinance institutions and generate interest income for investors. Among these are Dignity Fund, based in Oakland, Calif., and Global Partnerships' Microfinance Fund 2005, in Seattle. There are also a handful of equity investments, which give investors shares in the microfinance institutions. These include MicroVest I, which invests in both debt and equity, and Accion International's Accion Investments in Microfinance. Debt funds expect annual returns to investors of anywhere from 1% to 5%, while equity funds, which usually have more risk and longer investment terms, expect annualized net returns of about 5% to 10%.

Some investment firms are marketing securities that are similar to bonds and are backed by microfinance loans. These instruments, aimed at raising capital for several microfinance lending institutions, were developed by BlueOrchard Finance SA, a Geneva investment company, and Developing World Markets, Darien, Conn. Two offerings of the securities, in 2004 and 2005, raised \$87 million. Returns on the seven-year notes are expected to be about 5% to 8% annually. BlueOrchard plans another offering this year.

A few opportunities in microfinance investing also exist for smaller investors. Calvert Foundation offers Community Investment Notes, which require a minimum \$1,000 investment, and can be

earmarked to invest in developing countries or other initiatives, including post-Katrina recovery on the Gulf Coast. Investors can choose among notes with terms of one to three years, which yield as much as 2%, while notes that last for five, seven or 10 years return up to 3%. Other microfinance offerings with relatively small minimum investments are offered by nonprofits Oikocredit USA and Accion.

Smaller investors can also make loans of as little as \$25 to specific individual entrepreneurs through a service launched last fall by Kiva, a Palo Alto, Calif., nonprofit organization, whose first loans have gone to individuals in Uganda. The loans are administered by local microfinance institutions. Individual lenders can expect to receive their principal back, but no interest income, within six to 12 months.

The average micro-loan size is about \$345 and about 80% of borrowers are women, according to MIX. The loans generally come due within three to nine months and can carry high interest rates and fees, typically ranging from about 24% to 45% annually, MIX says. Industry officials say that is because it is expensive to administer such small loans, and the rates are still much lower than what local moneylenders charge. A rising number of microfinance institutions, which number in the thousands world-wide, are expanding beyond business loans, by offering savings accounts and insurance, products sorely lacking in many impoverished areas.

Microfinance has been around since at least the 1970s, when experimental lending programs started in Brazil, Bangladesh and a handful of other countries. By the end of 2004, more than 3,100 microfinance institutions reported reaching more than 92 million clients, according to the Microcredit Summit Campaign, a Washington nonprofit organization. Still, microfinance hasn't escaped controversy. Lenders have long touted very high loan-recovery rates that occasionally have been shown to be exaggerated. And loans at times have been used for other than their intended business purposes.

Robert Pattillo, of Atlanta, started a \$50 million fund to invest in microfinance projects. Mr. Pattillo, who recently sold his real-estate development company, says that demanding a return on investments should help to make the microfinance industry more accountable and sustainable. "If you just donate it [to charity], you write that check one time and it's gone," he says.