

How the Netherlands Government Fostered Successful Public-Private Partnerships for Financing MFIs

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This case study examines how a change in Dutch microfinance funding policy led to successful public-private partnerships that brought private financial expertise to microfinance funding and increased the amount, range and flexibility of financial instruments offered to microfinance institutions (MFIs).

Overview

In 1997, the Netherlands Directorate-General for International Cooperation and its four co-financing agencies (CFAs) instituted a major policy change in Dutch government funding for microfinance. Cognizant that the amount of microfinance funding was not producing expected results, they agreed that all financial assistance to MFIs should be managed by financial experts. With most donors, as revealed by the recent Microfinance Peer Reviews of 17 development assistance agencies, the bulk of public donor microfinance funding is managed by development specialists, without microfinance or financial sector expertise. The Dutch decision was ground-breaking and an important step toward improving the effectiveness of their microfinance operations.

Following the decision, the CFAs and several private, socially-oriented Dutch financial institutions (FIs), developed successful partnerships. These partnerships use a combination of government and private sector funds to offer flexible, quasi-commercial funding instruments, such as loans, loan guarantees, and equity investments, to MFIs dedicated to serving poor people. In parallel, the CFAs use government subsidies to provide essential technical assistance for MFI institution building. The collaboration between various Dutch actors—both private and public—was then formalized in the Dutch Microfinance Platform. The platform comprises 15 Dutch institutions involved in microfinance, and is an important catalyst for private-public partnerships.

By the end of 2003, the four CFAs and their FI partners had collectively lent or invested over €51.2 million in 145 projects worldwide. (An additional €11.7 million in government funds was allocated by the CFAs to MFI technical assistance and start-up grants). In many cases, these partnerships offer MFIs sequenced financing to match the stages of their institutional growth. When more than one CFA-FI partnership funds the same MFI, the

parties share information and, increasingly, provide syndicated (i.e., joint) loans.

Comparative advantage drives these partnerships. The CFAs have a deep knowledge of local NGOs in developing countries and a focus on poverty alleviation. Private Dutch FIs have missions rooted in social justice and expertise in international lending, governance, and a wide range of financial instruments. The Dutch government uses its own comparative advantages—money and knowledge of microfinance good practice—to encourage partnerships between these two types of institutions.

Box 1. Dutch Micro Finance Platform Improves Member Effectiveness

The objective of the Dutch Micro Finance Platform is to enhance the effectiveness of Dutch institutions that support microfinance by increasing their collaboration. Launched in early 2003, the platform has a rotating coordinator. Coen van Beuningen of Hivos, who held this position in 2003, led the organization to establish a portfolio database on all microfinance funding in the Netherlands. When the database revealed that many MFIs worldwide were receiving funding from more than one platform member (most with government financing), Mr. van Beuningen convened a member workshop on collaboration. Stijn Albregts of Novib became the platform coordinator in January 2004 and is currently focusing the organization on a comparative advantage study and greater collaboration with the MIX Market.

Setting the Stage

The Dutch government has a unique approach to overseas development assistance (ODA) that emphasizes support to civil society in both the South and in the Netherlands. In 2003, for example, the Netherlands allocated approximately 22 percent of its bilateral development assistance to non-governmental organizations in developing countries. About half of this funding was channelled through four large, multi-sectoral, non-governmental development agencies (the CFAs). Each CFA represents a pillar of Dutch socio-cultural-religious

life. These agencies are Hivos (Humanist Institute for Co-operation with Developing Countries), ICCO (Interchurch Organization for Development Co-operation), Novib (Netherlands Organization for International Development Cooperation), and Cordaid.

The Dutch government is one of the biggest bilateral contributors to microfinance. For many years, the multi-sector CFAs used Dutch government monies to provide grant funding to MFIs as part of poverty alleviation and rural development projects. After gaining a better understanding of microfinance good practice, the Directorate-General for International Cooperation (part of the ministry of foreign affairs) and the CFAs jointly evaluated their economic development programs, including microfinance, in 1996. The evaluation found that the CFAs lacked sufficient financial skills to support MFIs with the proper mix of instruments. Also, the evaluation results showed that credit components in larger development projects were most often ineffective. The CFAs then embarked on a strategy to professionalize their support for microfinance and other economic activities.

Building on the initiative of the CFAs, the ministry in 1997 announced a new policy for financial support to microfinance (this included loans and guarantees, but excluded technical support). In keeping with its strong private sector orientation and close links to the Dutch financial sector, the ministry told the CFAs to either find professional financial partners or develop in-house financial expertise. In addition, all loans and guarantees to MFIs were to be made on market-oriented terms (as opposed to low-interest loans with soft repayment discipline). Three of the four CFAs decided to partner with financial institutions dedicated to social investments. To date, only Cordaid has decided to develop its own in-house expertise. Examples of the partnerships formed between the CGAs and private financial institutions are described in the following section.

Structuring Public-Private Partnerships

The partnerships created between the CFAs and private financial institutions allowed both sets of partners to concentrate on their area of expertise. The socially-oriented FIs conduct due diligence, manage microfinance funding operations, and monitor investments. The CFAs focus on institutional building and technical assistance. The partnerships typically target MFIs that are in the crucial growth phase when they are just ready to begin accessing funding on near-commercial terms. These public-private partnerships are succeeding because the CFAs and FIs carefully matched their respective institutional goals and then designed the partnerships to achieve specific financial and developmental outcomes.

“The partnerships bring together specialized developmental and banking knowledge to address the social and financial objectives of MFIs in a balanced manner. They offer a broad spectrum of financial instruments and technical assistance funds, as needed. Challenges of these partnerships include: efficiency, strengthening and expanding retail MFI capacity (especially ‘young’ MFIs), and stimulating sustainable local financial markets.”

Johan de Waard, policy advisor, the Netherlands Ministry of Foreign Affairs, Directorate-General for International Cooperation

Hivos-Triodos Fund (HTF). Hivos works with NGOs in the developing world to achieve poverty alleviation and sustainable development. Three years before the Dutch ministry introduced its new policy, Hivos recognized its own need for greater financial skills. Coen van Beuningen, senior economic policy officer, and Jaap Dijkstra, managing director, looked for a small bank that shared Hivos’ mission and wanted to collaborate. Triodos Bank, a world leader in social and environmental lending (€962 million in total assets in 2003), was also looking for a development finance partner.

In 1994, the two institutions established the Hivos-Triodos Fund (HTF), a microfinance lending facility that extends commercial loans to MFIs in local currency, offers loan guarantees, and makes equity investments in promising regulated MFIs (such as Findesa in Nicaragua, a finance company). The goal of the fund is to provide financing to MFIs that no longer need subsidized donor funding, but are not yet prepared to access commercial capital.

Financing for HTF lending comes from Triodos Bank’s “North-South” savings accounts; these monies are guaranteed by Hivos (90 percent) and private individuals (10 percent). HTF equity investments are financed by interest-free, subordinated loans from Hivos, which receives any dividends and all capital gains realized upon the sale of stock. As of 2003, Hivos also began to provide a 100 percent guarantee on the foreign-exchange risk of all loans made by the fund. Box 2 below gives an example of HTF lending. HTF’s cost of funds, management fees, and overhead are covered by income earned.

Triodos International Fund Management manages the fund and a senior staff member of Triodos Bank joins the board of directors of MFIs in which HTF makes equity investments. Thus Triodos also contributes its experience as a small independent bank that combines both social and economic objectives. This experience is highly valued by the MFIs. For Triodos, the HTF fund is a strategic activity; it is not a hugely profitable business. Its costs are covered by the management fee charged to HTF.

Box 2. HTF lending to Socremo in Mozambique

The Hivos-Triodos Fund (HTF) extended a €225,000 loan in local currency to Socremo, an urban-based MFI in Mozambique, in 2002. Loan terms were three years at market interest rates with a bullet principal payment. The following year, at the initiative of Triodos International Fund Management, HTF and Novib offered a syndicated loan to Socremo (syndicated means a loan advanced jointly by two or more financial institutions).

HTF lent the equivalent of €100,000 and Novib, €200,000, both in Mozambiquan Meticaïs. Loan terms were three years at market interest rates with a bullet principal payment. On behalf of HTF and Novib, Triodos International Fund Management conducts due diligence and manages the syndicated loan, visiting Socremo twice a year to review developments.

Socremo benefits by receiving one, larger loan and having to deal with only one organization instead of two. Novib benefits because Triodos International administers the loan. Hivos guarantees 90 percent of the HTF loans and, from separate funds, provides technical assistance to Socremo. To date, Dutch government monies used for the HTF guarantees have generated €325,000 in private sector funds for loans to Socremo.

By year-end 2003, HTF had a total portfolio of over €12 million spanning 33 MFIs in Africa, Latin America, Eastern Europe, and South Asia. Of the total portfolio, €3.9 million was in equity participation and €8.04 million in loans.

"Thanks to our cooperation with Hivos, it is possible to finance institutions that are still in a start-up phase and, obviously, [represent] more risk than more established MFIs. It also makes it possible to provide finance in local currency, so that HTF [bears] the risk of major currency swings instead of passing these risks on to the (more vulnerable) MFI ... however, there is still much to learn about how best to finance transitioning MFIs."

Marilou van Golstein Brouwers, managing director, Triodos International Fund Management B.V.

Novib-ASN Fund. ASN Bank is the oldest social bank in the Netherlands and was rated the number one socially responsible bank by the Netherlands Consumer's Organization in 2003. Novib is one of the oldest development NGOs in the country and raises a good part of its operating funds directly from Dutch citizens.

In 1996, ASN and Novib created the ASN-Novib Fund to provide loans to MFIs in developing countries. ASN Bank wanted to develop a product that put its Dutch banking clients in contact with developing-country entrepreneurs and Novib believed microfinance offered a good opportunity to attract private capital from individuals. Both contributed €0.7 million to the fund, which was opened to private investors in 2000. The portfolio consists primarily of hard-currency loans on commercial terms to 16 MFIs in Eastern Europe and Latin America. A targeted dividend of 2 percent per annum is paid to fund investors (1.8 percent was paid in 2003). As of December 2003, the

total asset value of the ASN-Novib Fund was €9.1 million, of which €5.5 million was outstanding loans and the remainder, equity, and guarantees.

ICCO-Oikocredit Partnership. ICCO is an inter-church organization that gives grants to partner networks in the developing world. Oikocredit is an international co-operative society that uses its members' investments (mostly church-based organizations) to lend to international partners, of which approximately 50 percent are MFIs. One third of its €67 million portfolio is held in local currencies. The two organizations share a common mission of poverty reduction and global justice.

According to Eric Heinen, Oikocredit director of credit operations, ICCO and Oikocredit have complementary networks and staff competencies. From 1997 to 2001, the two parties carefully analyzed how to best structure their financial relationship to benefit their developing country partners.

In May 2001, ICCO and Oikocredit reached an agreement whereby ICCO guarantees 50 percent of Oikocredit loans to MFIs considered relatively risky institutions (e.g., MFIs in the start-up or expansion phase, or with a rural or women's empowerment focus). ICCO uses funding from the ministry to furnish the guarantees. Oikocredit pays ICCO a 2 percent guarantee fee to cover costs and risk. The two institutions work on a case-by-case basis, with Oikocredit assigned responsibility for financial issues and ICCO, responsibility for optimum outreach and capacity building.

"We do not wish the ICCO Loan & Guarantee fund to become a big fund. To the contrary, we wish the focus of the fund to be 'leveraging' private capital (Oikocredit and others, like banks), and, of course, on the developmental relevance."

Cor Wattel, policy adviser, Credit Desk, ICCO

By year-end 2003, Oikocredit had approved a total of €8.4 million in loans guaranteed by ICCO, which were extended to 16 partners in 8 countries. Total ICCO guarantees for the 16 loans were €2.7 million, meaning the loans represent a multiplier of greater than three. To date, no ICCO guarantees have been called.

Improving the Effectiveness of the Public-Private Partnerships

In 2003, new initiatives began that built on the partnerships' solid foundations:

Syndicated lending. The CFA-FI partners started syndicated lending (see Box 2 for a specific example) in 2003, and by the end of the year, seven syndicated loans had been extended to MFIs in Africa and Latin America.

All seven were initiated by Triodos International Fund Management because the MFIs it was lending to needed bigger loans than Triodos could provide. The solution was to bring in other financiers.

Focus on niches. The CFAs and other platform members have started to identify their respective niches in microfinance, encouraged by the 2003 Microfinance Donor Peer Review coordinated by CGAP. ICCO, for example, has tentatively identified its niche to be the support of small and rural microfinance institutions in both post-conflict economies and countries where the microfinance industry is emerging.

Increased coordination at all levels. To improve the effectiveness of these partnerships, the Dutch ministry is: expanding its coordinating role (based on its 2004 vision for microfinance); upgrading how it tracks the microfinance portfolio financed by Dutch funds; monitoring how these monies leverage private funds; and improving CFA accountability for achieving impact. For the Dutch Microfinance Platform, improving CFA-FI effectiveness currently involves: enhancing information sharing and coordination among members prior to funding approval, thus avoiding duplication of effort; further identifying the comparative advantage of members, thus achieving greater impact; designing financial instruments for MFIs reaching poorer and more rural clients and; providing TA for MFIs that want to provide savings and insurance services.

Conclusion

By facilitating the development of public-private partnerships which are based on comparative advantage, the Dutch government has greatly improved the effectiveness of its microfinance financing. The result is a focus on sustainable MFIs that alleviate poverty. The CFAs have concentrated their resources on the institutional development of MFIs, leaving financial decision making to their lending partners. Socially-oriented FIs have lent on a greater scale to MFIs because the risk of such lending is lowered by the CFA guarantees. The FIs have also succeeded in sharing their management and governance expertise with young, pro-poor financial institutions. MFIs can access a greater range of financial instruments in local currencies and now benefit from larger syndicated loans that require reporting to only one entity. In addition, they continue to receive CFA technical assistance for institutional development (i.e., for projects that cannot be readily funded by commercial sources).

Box 3. Public Private Partnership Lessons for Donors

The Dutch government relied on good-practice microfinance principles and an analysis of its own comparative advantage to choose the most efficient strategy to support microfinance. It recognized that the development of successful microfinance organizations follows a sequence in which subsidized capital for on-lending is followed by near commercial funding, when donor grants are best devoted to institution building. Some lessons from the Dutch experience include:

- Donors that do not have a wide range of financial instruments for microfinance or the technical expertise to effectively build MFIs should fund institutions that do.
- Governments should refrain from intervening directly in the private sector and, instead, allow private institutions to implement financial projects.
- Grant making in microfinance should be separated from loans and equity investments. Donor grants in particular should be limited to non-commercial purposes (e.g., initial capital for on-lending, institutional development) so that subsidies do not disturb the development of the market for financial services.
- All actors active in microfinance - donors, implementing organizations, technical specialists, commercial financial institutions - benefit from regular dialogue, which allow them to enhance collaboration, efficiency, and effectiveness.

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Contacts and Websites

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