

FINANCING MFI GROWTH  
IN AFRICA THROUGH  
COMMERCIAL CAPITAL:

*A Seminar Report*

Friday, 25 April 2003  
Dakar, Senegal



THE FIRST AFRICAN INVESTMENT FUND FOR COMMERCIAL MICROFINANCE  
IER FONDS AFRICAIN D'INVESTISSEMENT POUR LA MICROFINANCE DURABLE

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# Foreword

*Maria Otero*

Chairperson, AfriCap Board of Directors  
President and CEO, ACCION International



This conference is important in two ways. First, it is an opportunity to highlight the promising development of microfinance in Africa, enabling us to learn about the accomplishments and challenges faced by various microfinance institutions on the continent. Second, it enables those working in other parts of the world to share their experiences, and in particular to present the best models of microfinance institutions which can also be applicable to Africa.

Before addressing the advances of microfinance, it is worth reminding ourselves of one of the industry's earliest and most important objectives. Microfinance institutions extend financial services, including very small commercial loans, to the poor which allow them to develop their own businesses. Clients are often city dwellers housed in slums or squatter settlements, living in overcrowded settings and lacking access to basic services. Their survival toolkit excludes the education or skills necessary to enter the mainstream economy. Many are women, poorly trained and playing the dual role of provider and caregiver. They live surrounded by risk – diseases caused by bad sanitation; crime; or deeper levels of poverty when a source of income disappears or a family member dies. Their vulnerability to external shocks, whether financial (e.g. high inflation or a banking crisis), environmental (e.g. floods, drought), or economic (e.g. border closings or price fluctuations) makes their situation even more precarious.

Clients in rural areas are land poor, and their land is often unproductive and badly irrigated. Opportunities for employment are few, and these must be self-generated, with many rural homes patching together various earning activities to survive. They live in large households, their children are especially susceptible to disease, and suffer from malnutrition. Many poor depend on their children for work, and must weigh the opportunity cost of sending children to school today against present and future benefits.

Small loans can change their lives, giving them the opportunity to produce and to grow their businesses. Other financial services – savings in particular – can help them to even out their cash flows, mitigate risk, and plan for the future.

In the last twenty years we have been assembling the building blocks necessary for extending financial services to the population I have just described. The first challenge faced by microfinance institutions around the world has been to increase their outreach to as many poor clients as possible. This first challenge has come to exist hand in hand with a second, equally difficult one: covering their costs of operations, with the idea that microfinance institutions would become sustainable, and could continue providing services to the poor on a permanent basis.

We have made advances not believed possible just ten years ago. In fact, microfinance has evolved in astounding ways. Its best organizations reach tens of thousands, hundreds of thousands of poor clients – and at the same time cover all their costs. The more clients they reach, the more financially viable they become.

Financial viability of microfinance institutions is perhaps the most important accomplishment we have achieved. Important because it ensures the permanence of institutions, and because it gives them access to the capital markets of the world, the only place where they can access the funds needed to meet the great demand for capital that exists. Financial viability, once achieved, has moved

microfinance institutions throughout the world – from Kenya to Peru, from the Philippines to Mexico, from Benin to Cambodia – to take on a bold and daring challenge: to become commercial, financial institutions that are part of the banking system in their countries, complete with shareholders and with access to capital markets for funds needed to lend to thousands more.

The development of commercial financial institutions has not limited itself to one model. If we look around the world, we see a variety of approaches to formalizing microfinance, many replicable in other countries. The first and best known involves the transformation of an NGO into a commercial financial institution – started over 10 years ago in Bolivia with BancoSol, a microfinance commercial bank. We now find transformed NGOs in many countries, for example, Kenya, Peru and India, with others currently transforming in Benin, Uganda, Guatemala, and elsewhere.

A second model consists of small commercial banks, which have also evolved to focus on microfinance, either changing their market or starting this way from the beginning. In Ecuador, Uganda, Eastern Europe, Tanzania and the Philippines, for example, we find microfinance institutions that fit this model for scaling up and becoming sustainable. Large, traditional banks have also looked for ways to enter the microfinance market and they present a third model. These banks have formed subsidiaries, or created separate private service companies specialized in microfinance, as we see happening in a growing number of countries, such as Brazil, Haiti, Tanzania, Nigeria, India, and others. Credit unions have also emerged as important players in microfinance, operating as regulated institutions in their own country. This fourth model is very relevant in Africa, where the credit union has evolved more than in other regions.

The role of specialized equity funds such as AfriCap has been an essential ingredient in all these models. Equity funds provide the investment capital that allows these institutions to meet capital requirements, or to simply increase their capital to continue growing. Equity funds generally have come in as minority investors, and have focused on two goals: ensuring strong financial performance and maintaining the focus on microfinance. They are termed “social investors,” that is, providers of equity capital with an eye to a double bottom line – financial and social returns.

The organization I head, ACCION International, has been actively involved in commercial microfinance for the last twelve years and is currently working with three of the models described above in more than a dozen countries. We are not alone: many others, throughout the world, are basing their microfinance work on the commercialization approach and are also recognizing the important role of equity investment.

Our experience demonstrates that growth and strong performance cannot take place without the existence of equity investors, which play an active role in helping grow these institutions. The approach we find most useful is one in which the equity fund works hand in hand with local investors and maintains a common, unified vision for the institution. Because equity funds like AfriCap are specialized in microfinance, they can bring important lessons from other institutions in which they invest, as well as ensure that the original mission of the institution is maintained. Last year we helped create a Council of Microfinance Equity Funds which brings together equity funds around the world investing in microfinance to help them share lessons and define future objectives. AfriCap was one of the founding members of this Council.

This work to develop microfinance has not been easy. It has meant building organizations from the ground up, developing their core competence – lending to the poor, training their staff, and equipping them with the systems to manage thousands and thousands of monthly transactions. It has meant learning to interact with regulators, attracting like-minded investors, and operating as part of the financial system of the country. Each year we see new and improved models, as microfinance institutions build on the best practice around them.

We have unlocked some of the mysteries that in the past made extending financial services to the poor a losing proposition. While we are well on our way to building permanent responses to the capital needs of the poor, the challenges remain varied and hard to crack. Conferences such as the one organized by AfriCap point us in the proper direction to advance even more in our quest to alleviate poverty.

# Introduction



At its core, a commercial approach to microfinance is one that treats the provision of microfinance services as a business, as commerce. Services are bought by clients and sold by suppliers at a mutually agreed upon price. The institutions supplying the financial services have assets and owners and are designed to be a going concern. Unlike projects or programs with a limited life span, commercial microfinance institutions are designed to stick around – to generate enough income to cover their costs and to invest significantly enough in the future that their existence in the years to come is unquestioned.

A commercial approach is, therefore, an approach which demands sustainability. It is a market-driven approach that will, out of competitive necessity, focus institutions on providing the products that clients need and want. It is an approach that enables microfinance institutions to access a wide range of funding sources, the combination of which can be used to respond quickly, flexibly and efficiently to the current and future demands of its market. A commercial approach, thus, not only permits growth, it encourages growth. It drives growth. And growth, either in terms of the number of people served, the depth of the market served, or the number and quality of services provided, is vital to anyone who believes in microfinance as a development tool.

Most microfinance practitioners would agree, at least to some extent, that the adoption of a commercial approach is desirable. It is good to be sustainable, to give the community that you are working with what it needs, to be as efficient as possible, and to keep costs down. But when it comes to accessing capital markets, many practitioners become wary. They know that access to capital markets requires profitability and they are either uneasy about the idea of making a profit off the poor, uncertain about their institution's ability to make a consistent profit, or fearful that the quest for profit will compromise their institution's developmental objectives. Some worry that new injections of capital will bring new owners who will gain control of their institution and guide it in a direction other than what its original founders hoped or intended.

Certainly, access to capital markets will not make sense for every institution all of the time. But it is a powerful tool for facilitating the provision of microfinance services, and it the only tool through which the microfinance industry can grow sufficiently to meet the financial needs of the millions of Africans who currently lack access to the financial system.

Recognition of the power of this tool is what led the AfriCap Microfinance Fund to organize a one-day seminar on "Financing MFI Growth in Africa through Commercial Capital," which was held in Dakar, Senegal on April 25, 2003. AfriCap is a private equity fund that was launched in December 2001 "to help those institutions that are providing credit and other financial services to the poor to be able to capitalize themselves and to grow."<sup>1</sup> It convened the seminar in an effort to communicate the value of capital markets in the development of the microfinance industry and to give participants an opportunity to discuss how the microfinance industry can access those markets. More proactively, it challenged participants to look for innovative ways of taking advantage of capital markets and of all that the mainstream financial sector has to offer.

This document is a report of that seminar. It is designed to communicate some of the ideas, knowledge and experiences that were shared on that day by more than 130 representatives from

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<sup>1</sup> Maria Otero, Chair of the Board of Directors, AfriCap Microfinance Fund.

microfinance institutions, governments, commercial banks, NGOs and donors who traveled to Dakar from all over Africa, from Europe and from North America to participate in the event.

In its four chapters, the report addresses the four main questions that were raised during the seminar: 1) Why is access to capital markets vital to the sustainable growth of the microfinance industry in Africa; 2) What are the avenues through which microfinance can access capital markets, 3) What can be done to facilitate easier access to capital markets (i.e., how can microfinance be better integrated into the rest of the financial system); and finally 4) what are the challenges ahead for commercial investment in African microfinance?

Rather than provide a verbatim transcription of all of the comments made during the seminar, this document collects the content of the presentations given, the questions posed in response to those presentations and the discussions that were generated as a result, and it organizes all of these contributions around the main themes discussed during the course of the day. In editing the document, an effort was made to eliminate the redundancy that naturally occurs during a lengthy discussion while retaining the integrity of the contributions made. An attempt was also made to present case studies in their original form, since these concrete examples are often the richest product of any such seminar, and provide the clearest guidance as to where and how commercial capital can be used to strengthen the microfinance industry.

Today there are only a handful of commercial microfinance institutions in existence in Africa, but AfriCap, among others, is setting out to change that. It is the hope of conference organizers that this compilation of ideas and exchanges proves timely, and can provide fuel for the dynamic process of growth and development upon which the African microfinance industry is currently embarking.

# Chapter 1: Why Access to Capital Markets is Vital to the Growth of Microfinance in Africa

*“Microfinance institutions will have the opportunity to access new forms of appropriate financing which will make them sustainable and put them on the path to stability, equilibrium and growth. As a result, small and microenterprises will be able to contribute greatly to the creation of employment – the source of regular income and quality of life improvements for the target population.”*

~ Mouhamadou Lo, Ministry of Finance and Economic Development, Government of Senegal

*“The success of microfinance in Africa depends in large measure on what we call the commercial approach. This means access to the full range of financial services – the ability to take deposits, debt, and risk equity capital. We’ve seen the success of this commercial approach elsewhere and feel it is the best strategy in the long-term to follow. We believe that it forms the foundation of a sustainable industry.”*

~ Martin Connell, President, Calmeadow and AfriCap MicroVentures

*“Why do we care about finding durable sources of finance? It is because we believe that microfinance has a very important contribution to make in terms of poverty control, economic growth, and improvement of the quality of life of the people who receive the services of microfinance.”*

~ Elisabeth Rhyne, Senior Vice President, ACCION International



The importance of microfinance as an effective instrument in the fight against poverty was highlighted by many participants in the seminar. Indeed, its usefulness as an economic development strategy remained unquestioned throughout the day. What was challenged was the limited availability of microfinance services around the world given current needs and demand. As David Stanton, Chief Enterprise Development Advisor for DFID commented, “There are about 1.2 billion people worldwide who are living on less than one dollar a day, and there may be as many as half a billion who would need access to financial services to stand a chance of lifting their incomes above a dollar a day.” James Mwangi, Chief Operating Officer of Equity Building Society in Kenya, cited statistics from the World Bank’s Consultative Group to Assist the Poorest which suggested that the global market for microcredit services alone is approximately one billion people, yet only 50 million have thus far been reached worldwide. He continued, “If we take the now long accepted notion that for every borrower there are about four to five savers, then it means that the microfinance sector has about 4 to 5 billion candidates across the globe.”

To play its part in meeting this demand, and to make its contribution to the development of the continent, the African microfinance industry will need to grow. To grow, of course, the industry will need access to additional funds. Microfinance institutions (MFIs) will need funds to expand their portfolios, to open new branches, subsidiaries and delivery points, to hire new staff and to train existing staff, to invest in better management information systems, to launch new products that serve unmet or poorly met financial needs, etc. Will it matter what kind of funds MFIs use to finance these needs? Will it matter how much those funds cost or what strings are attached? Participants in the seminar argued that yes, it will.

Until recently, most microfinance activity was supported primarily through donor funding. That funding has been useful, particularly in the development of successful models and microfinance products. It has also been limited, both in terms of the quantity of funds that could be provided and the type of funding that could be provided. Because of the way it was structured, donor funding often

involved delays, bureaucratic procedures, special reporting requirements, and restrictions on how money could be spent.

What MFIs need now, in the words of Stefan Harpe, AfriCap's Investment Manager, "is to be able to access funding and deal with investors who can provide a mixture of instruments and be able to respond flexibly and quickly to their needs." MFIs do not simply need more funding; they need longer term funding. They need flexible funding. They need access to capital markets.

What exactly ARE capital markets? With reference to a standard dictionary, one can describe them as places (real or virtual) where capital (accumulated goods devoted to the production of other goods) is traded. In finance, there are three main types of capital – savings, debt, and equity. Together, they provide the flexible mix of funding sources that makes up the liability side of a commercial MFI's balance sheet.

Why is access to these markets vital to the sustainable growth of microfinance in Africa? Seminar participants offered the following six rationales:

### **Reason #1: Commercial capital can provide sufficient resources to meet the vast market potential**

As alluded to above, there is tremendous market potential in the microfinance realm, and demonstration models exist in several regions of the world which show that commercially funded microfinance institutions can be viable and achieve extraordinary outreach as they strive to meet that potential. Martin Connell, President of Calmeadow and AfriCap MicroVentures, submitted that, "In the eleven years since the first microfinance institution was capitalized and launched in Latin America, the clientele served by the microfinance sector and lenders in that region has grown from roughly 50,000 to well over 1 million and the number of dollars being deployed in terms of credit exceeds 1 billion dollars."

James Mwangi later commented, "I have no data on the market in Africa, but my guess is as good as yours, that for Africa, we have a blank page upon which we can write what we want about microfinance. A bit has been done. We know, for instance, that one reason why Africa might be the right environment and market for microfinance is that less than 10% of the African economies are in formal hands, suggesting that 90% are informal economies, which is literally the target market for microfinance. We also know that Africa is home to the lowest per capita income economies in the world, and the majority of African people live in poverty. Despite that, we know that there is no BancoSol, there is no MiBanco, there is no Prodem, there is no BRI, neither is there BRAC or Grameen in Africa.<sup>2</sup> So we are saying that Africa offers the opportunity – it's an open market – yet there are no major players. In Africa, when we talk about success stories, we talk, for instance, about KREP in Kenya. But KREP has twenty or thirty thousand borrowers in a market of about 11 million potential customers. So you find in Africa even the surface has not been scratched. Basically, my submission is that the African market is there."

As African microfinance institutions strive to meet this demand, they will look to commercial capital to fund their growth. As long as they are profitable and have a plan that will keep them viable in the future, capital markets will be able to fund that growth. Why? Because, as James Mwangi pointed out, "commercial capital has global flows. It will flow from wherever, to wherever. The question is, what will be the return, and what will be the risk." If microfinance institutions can provide investors

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<sup>2</sup> The institutions cited are examples of successful commercial microfinance institutions around the globe. BancoSol and Prodem are located in Bolivia, MiBanco in Peru, BRI in Indonesia, and BRAC and Grameen in Bangladesh.

with a sufficient return for a given level of risk, commercial capital will be available to them, no matter how much they want.

## **Reason #2: Commercial capital provides leverage**

Leverage is what happens when an MFI uses its own money – the money its owners put into the institution as well as the profit that the institution has made and retained over time – to borrow more money from outsiders. The borrowed money does not belong to the institution, but it can be used by the institution to scale up its operations and, perhaps, to make more profit for its owners. The borrowed funds act as a lever, enabling the institution to do more with whatever initial amount of capital it possessed.

Leverage is important to an MFI primarily for the two reasons suggested in the paragraph above. First, it allows the institution to scale up its operations: to expand its services, to reach more people, to serve more geographic areas than it would be able to otherwise. As Alex Silva explained using the example of ProFund, the private Latin American equity fund which he manages, “It’s the multiplier effect of the investment that a dollar invested in ProFund would have had. A shareholder like the IFC that put in three million dollars of equity could argue that that made it possible for 20 or so million dollars of ProFund to come to be, and those 20 million dollars, invested in 13 microfinance institutions, allowed the total equity for all those institutions to be assembled, and that in itself allowed those institutions to leverage themselves (since they are regulated financial intermediaries) to the point at which they now have a combined total portfolio that exceeds 400 million dollars. When you think about it, that’s 400 million dollars that are actually going to unsecured loans to microentrepreneurs.” The shareholder, in this case the IFC, was able to facilitate 400 million dollars of microlending with just a three million dollar investment of its own.

The second reason leverage is important is that it enables an MFI to generate more total revenue at a lower cost per client than would be possible otherwise. Naturally, to attract equity capital over and above what its original owners or donors may have contributed, an MFI will need to produce a return on its existing equity that is sufficiently high, given the level of risk and the existence of other investment opportunities, to make an investment in the MFI seem attractive. The MFI can produce that high return by charging a high price for the services it provides, by keeping its costs low or by increasing the volume of business that it does. Assuming that it would be difficult to decrease costs below a certain point and that increasing prices will either hurt clients or send them running to a competitor, the best way for an MFI to increase its return on equity is often to increase its volume of operations. It can do this by borrowing, by leveraging its existing equity.

As Stefan Harpe explained, “The only way that an equity investor is going to make money investing in twenty percent of the equity of a financial institution is if that equity can be leveraged, if the institution is able to borrow money and multiply the funds available for on-lending. That’s the only way in which the equity return will be sufficient to attract additional capital. What’s more, as competition puts downward pressure on interest rates and we see financial margins declining over time, more leverage is needed in order to generate sufficient return to satisfy the higher returns required for equity investors.”

## **Reason #3: Commercial capital facilitates a more holistic approach to the provision of microfinance services**

“For a long time, there has been a mistaken emphasis on microcredit as being equal to microfinance,” James Mwangi asserted in his opening remarks. “We need to go beyond microcredit to provide a broader range of services including savings, insurance, remittances, emergency loans, personal and education loans as well as microenterprise loans. We need to go beyond NGOs as the distribution

channel and consider private companies, commercial banks, state banks, credit unions and cooperatives, post offices, etc. We certainly need to go beyond the microentrepreneur and the farmer as the target of microfinance – what about factory workers, landless laborers, retired but still active individuals? What we need is diversity: diversity of the services being offered, diversity of the distribution and delivery channels, and diversity also of the clientele.”

A third reason for accessing capital markets is to facilitate the kind of diversity that Mwangi illustrated. Such diversity will come not through access to additional funds alone, but through an approach to the provision of microfinance services that is more holistic, one that focuses on the target population and on the provision of financial services that are appropriate for that population, rather than on the provision of a particular product. Mwangi continued, “I think microfinance has remained the only sector or industry in the world that is supply-driven. And one of the reasons why microfinance has not done well is simply because it is supply-driven rather than market-driven. We assume clients’ point a lot, but clients know what they want. At Equity Building Society, we adopted an approach that goes to the client and tries to seek what the client wants. That is what the whole microfinance industry needs to do. We are talking of customizing the existing banking system and distribution channel to make it appropriate for our people. We are talking of providing Africa with a banking system, through microfinance, that answers to the needs of its people the way corporate banking answers to the needs of Wall Street.”

A holistic approach to microfinance would marshal a variety of resources through a variety of mechanisms to provide the most appropriate, accessible, high quality and affordable services possible, services that would integrate microfinance – and microfinance clients – into the rest of the financial system and use those linkages to fuel economic growth and development. Donor resources, government resources, and NGO resources would all be integral to such an approach, but so would commercial capital. Without it, the microfinance industry will remain isolated from the rest of the financial system, and it will be limited in the extent to which it can meet the diverse needs of poor and low income clients around the world.

#### **Reason #4: Commercial capital demands viability**

In the words of Stefan Harpe, “Access to [capital markets] requires viability; it requires a sustainable, profitable, well-managed institution.” This fact is yet another reason for the importance of capital markets in the development of the microfinance industry.

After all, to serve a target population well, microfinance service providers must be viable. They must be able to provide their clients with quality services over time, and this is not simply a matter of covering costs with revenue generated. MFIs must make investments in their infrastructure and assets so they can operate profitably in the future, and they have to be attentive to changes and trends in their environment so that the investments they make are appropriate. They have to be aware of their competition, look for ways of providing what others in the market do not, and make sufficient gains in efficiency and productivity to be able to offer clients a competitive price.

An MFI that succeeds in obtaining access to capital markets will find its viability goals reinforced by investors. As Beth Rhyne, Senior Vice President of ACCION International, commented, “commercial investors bring a focus on financial returns, and that focus sharpens up the emphasis on efficiency, and the ability to minimize costs and to maximize output and impact.” Even the desire to access capital markets often compels MFIs to think more carefully or consistently about their profitability, to be more creative in their strategic planning or problem solving, and to pay more attention to their external environment.

The desire to gain or maintain access to commercial capital encourages institutions to be more knowledgeable about the market in which they are operating and to be more conscious of their

relative strengths and weaknesses within that market. It mobilizes them to make better use of available technology and technical support services. It also increases their transparency and operational accountability. In all of these ways, commercial capital helps institutions to achieve their sustainability objectives.

### **Reason #5: Commercial capital can bring access to investors who provide additional value**

Private investors and, in particular, private equity funds offer MFIs more than just money. Speaking from the perspective of AfriCap, Stefan Harpe explained, “There are a number of ways in which that value added can be provided. The key and the most important from the perspective of a fund, as opposed to an individual investor, is that we have shareholders who have unequalled experience in Africa, in the financial sector, and in microfinance, and we can provide the institutions we invest in with access to this network of expertise. We also provide active governance to our investees. MFIs who are in transition between the donor-funded world and the commercial world need active governance at the board level and also support to management – patient, long-term support. MFIs are here for the long-term and long-term, patient capital is what they need to sustain the institutional development of their organizations.” Beth Rhyne pointed out that long-term patient investment is particularly important for institutions that are planning rapid expansion.

Private equity investors bring an ownership stake, a level of commitment to the institutions they invest in that only owners can provide. They often provide institutional credibility, as James Mwangi noted. If they are a fund like AfriCap, they can also provide support in balancing the social and financial objectives that many microfinance institutions simultaneously embrace. Harpe admitted, “Most of the institutions that we’re looking at are maintaining a dual objective, aiming for both a commercial future and the economic development of their countries and their economies.” This dual objective is a challenging one for most MFIs, and they would benefit from being able to attract investors that not only support the balance, but are also capable of sharing strategies for achieving that balance.

### **Reason #6: Commercial capital facilitates industry development**

“Finally,” concluded David Stanton, “I think that commercial investors can change the nature of the structure of the financial industry. For example, there is an organization called Africa Bank Holdings which is looking to buy equity stakes in several technically insolvent state banks in Africa, or struggling state banks in Africa. If this can happen, it might liberate markets, it might liberalize the environment for investment, and it might turn around loss making banks, similar to the story of Equity Building Society, and build from them sustainable microfinance services.”

“There is a question of the development of an appropriate legal and regulatory framework,” James Mwangi noted. “I think it is almost twenty or thirty years since microfinance came to Africa and started to flourish, particularly in Kenya, but within those twenty years the legal and regulatory framework has never been developed. Why? Because the drivers of microfinance have never been from a commercial aspect. In countries like Uganda, Zambia and Kenya, we have seen that when commercial capital comes in, governments are quickly putting up the legal, policy and regulatory framework, which enhances the chances of success.”

Several speakers corroborated Mwangi’s story with observations of their own from Africa and from Latin America. It seems that as long as microfinance services are being provided by a scattered collection of donor-funded NGOs, there is little incentive for governments to move microfinance policy-making up their list of priorities. However, once commercial investors express an interest in

injecting a few million dollars into the financial system but refuse to do so until a legal framework is in place for microfinance, a powerful incentive appears.

A similar phenomenon is occurring in the development of performance and reporting standards for the industry. Before getting involved with microfinance, commercial investors need to understand MFI performance and be able to compare one institution's performance with another, so they are demanding mechanisms that enable them to do so. They are demanding transparency and standardized reporting and the microfinance industry is delivering because it finds it in its best interest to do so. By providing more accurate, more reliable, and more relevant information, the industry is decreasing the risk of investing in microfinance. Consequently, MFIs are able to increase their access to capital markets and decrease the cost of that access.

The same trend can be seen in the area of technical support services. New local markets are developing to provide MFIs with technical services because the demand for private suppliers is great and cannot be met through expensive external consultants or free donor resources. Credit bureaus are being established – again, to reduce risk. The industry's infrastructure is being strengthened in a myriad of ways as a result of commercial capital involvement.

## The Case of Equity Building Society

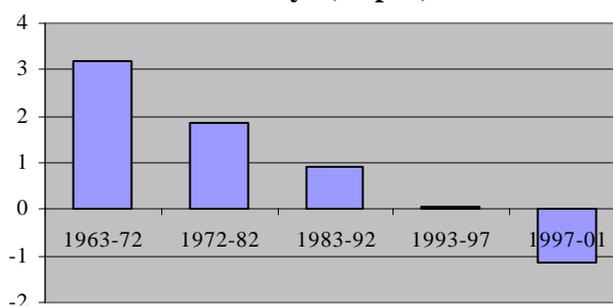


As suggested by the discussion above, participants in the seminar's morning session found numerous ways to make the case that access to capital markets is vital for the sustainable growth of the microfinance industry in Africa. No one individual made these arguments more tangible than James Mwangi in his presentation on the performance of his institution and its attitude towards commercial capital. Equity Building Society is one of the most successful microfinance institutions in Kenya. It is profitable, privately owned by Kenyans, regulated, and professionally managed. It has been operating as a microfinance institution since 1994, but until recently had received no donor support. As Stefan Harpe noted, "EBS built an equity base of four million dollars through its own sweat equity and private investment." Senior management invested in the company, as well as thousands of its own clients. Mwangi shares the story of his institution below.

"You don't naturally appreciate the performance of an institution unless you understand the environment in which it is operating. I'll begin, then, by explaining that Kenya achieved its independence in 1963. During the first three decades of its independence it saw very rapid growth, but during the most recent decade, economic performance has turned upside down, as you can see in Table 1.

Equity Building Society (EBS) was established in 1983 to reap opportunities that resulted from the economic success of the 1960s and 70s. You would have expected that, with the economy continuing to perform well, EBS would also have performed well in its early years and that, in 1993, when the economy took a turn for the worse, the company naturally would have performed poorly. But this is not what happened.

**Figure 1: Per Capita Income Growth in Kenya (% p.a.)**

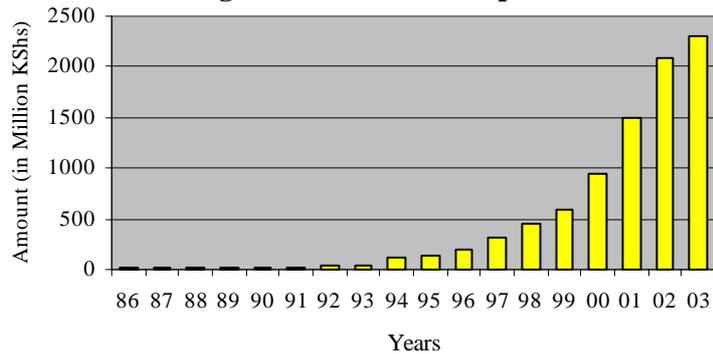


EBS was a proper formal banking institution during the first eleven years its life when the economy was booming, but surprisingly, it failed and became technically insolvent. In, 1994 it converted itself into a microfinance institution. The economy, unfortunately, turned sour just as EBS was restructuring, yet the company delivered remarkably strong performance, as shown in Tables 2, 3 and 4.<sup>3</sup>

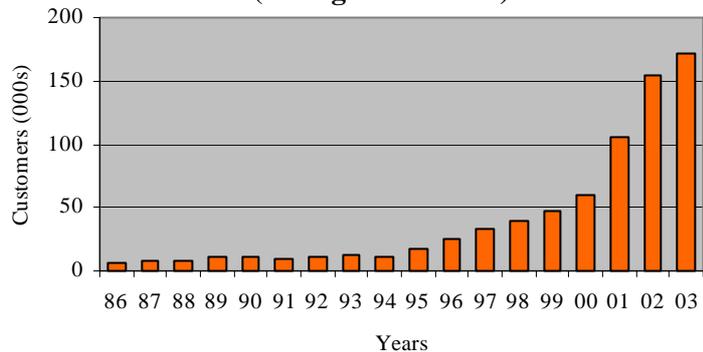
When you look at customer deposits, for instance, you see that EBS's first decade was a total failure. And when it comes to growth in customers, the result was the same. It is my submission that Equity Building Society, as a formal banking institution, was not appropriate for the clientele that it intended to serve. It could not compete with the multinational banks and the state banks for the 6% of the economy that constituted the formal sector, and it was inappropriate for the majority of Kenyans, who worked in the informal sector. That is why, when it converted to a microfinance institution in 1994, performance suddenly changed – because it became relevant to the needs of the people.

During the last ten years, the commercial banking sector in Kenya has been shrinking. The number of banks has fallen from 68 to 46, the number of building societies from 36 to 3, and the number of non-bank financial institutions from 46 to 6. EBS, however, has grown and it has demonstrated that microfinance can be profitable even in an unfavorable economic environment. Last year, according to its 2002 audited reports, EBS yielded a return of 40% on equity and a return on total assets of about 4.8%. To date, it holds the best rating that has ever been granted by PlanetFinance of France to a microfinance institution anywhere in the world. We are regulated as an institution by the Central Bank of Kenya and we are saying that microfinance institutions can survive supervision and regulation and can compare with any other institution operating in the world while meeting those requirements.

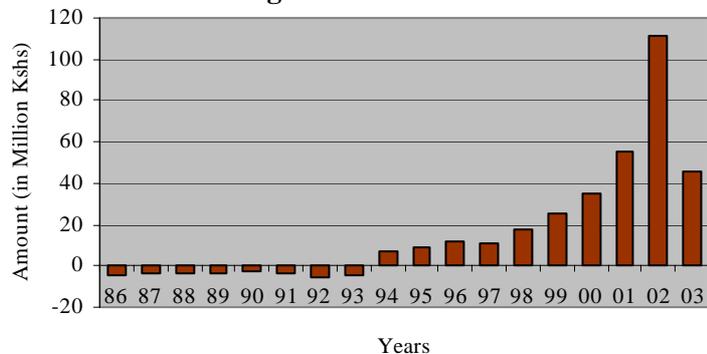
**Figure 2: Customer Deposits**



**Figure 3: Number of Customers (savings and credit)**



**Figure 4: Net Income**



<sup>3</sup> The net income chart shows pre-tax figures, with 2003 data as at March 31.

As a commercial activity, EBS has succeeded because it adopted a market-led approach. It has tried to provide a holistic banking or financial service, as opposed to a “one-size-fits-all” product. It now offers a whole ledger of microfinance services with efficiency and accountability. At EBS, our mission literally is to provide financial services to the low income and the poor, particularly in Africa. We don’t see ourselves as an institution that has restriction of boundary. We see ourselves as a bigger dream that will provide a financial infrastructure that is appropriate for Africa. We look across the continent today and we find that about 90% of us Africans have no access to banks. Obviously, there’s a need to develop an institution that would be able to reach and serve the majority of us in Africa and that is the role that Equity aims to fulfill.

Realizing that this vision of serving the majority in Africa is a bigger vision than any individual institution can fulfill, we knew it would be necessary to look for partners. We turned our heads around the African continent and we found AfriCap, which is investing 120 million Kenyan Shillings (approximately US\$1.5 million) for two million common shares, or 16% of the equity, of EBS.

There are quite a number of reasons that made us decide on AfriCap. Basically, we needed a strong partner, somebody we could rely on to help us grow and to provide us with the legally required capital for purposes of operating under the Banking Act (rather than the Building Society Act). We also saw in AfriCap a partner with a lot of competence and skills. The investors and management of the fund have more than thirty years of experience in microfinance and EBS will be able to tap into that great pool of knowledge.

In addition, we felt we needed a partner who was patient and had a long-term commitment to microfinance, not an investor who at the end of the year would be looking for a dividend to be shared out, but somebody willing to plow back the money for the sake of furthering the vision of Equity Building Society in serving a bigger outreach over the continent. We thought that going with commercial capital from a fund like AfriCap would also come with a strengthening of governance in the institution, which has been a problem for many institutions.

It is true as well that AfriCap was the only private equity fund in Africa which is focused on microfinance, so we knew we would be dealing with a fund that knows what microfinance in Africa is all about and, thus, the problems of misunderstanding that we might otherwise face should be low.

Today, having closed the deal with AfriCap, I can only see Equity moving several steps towards the realization of its larger vision of truly becoming the leading microfinance institution in Africa. Receiving this funding in Senegal, I think, is very symbolic. I think it again measures and signifies that the doors and the boundaries have been opened for Equity to become the dream African bank. The time has come for Africa to develop its own financial institutions, financial institutions that will answer to the needs and aspirations of Africans.”

## Chapter 2: Avenues for Accessing Capital Markets

*“For the type of environment that is evolving right now, where margins are being reduced and competition is taking hold, there is no way forward but to address microenterprise because that is where the bulk of the economy is in many developing countries. Banks are discovering more and more that this is an untold story, a well-kept secret. This is a very important clientele for them, much more than they used to think.”*

~ Pierre-Marie Boisson, Sogebank

*“What MFIs want is not to stop or only work at the level of microcredit, but to follow the clients even if they are growing.”*

~ Seminar Participant

*“From a standing start just a few years ago, Compartamos is now the largest microfinance institution in Mexico. It serves 150,000 clients, ninety-five percent of whom live in rural areas, and has become extremely profitable in a short period of time. It recently issued a bond to capitalize itself without going to the banking system at all.”*

~ David Stanton, DFID



Having argued that access to capital markets is critical for the sustainable growth of the microfinance industry, seminar participants turned to the second main topic of discussion for the day – **how** can the microfinance industry access those markets.

Three main avenues were identified. First, existing non-profit, non-governmental organizations (NGOs) could transform into regulated financial institutions. This change in legal status would allow such entities to directly access commercial capital through the mobilization of savings deposits, debt and/or equity. Second, regulated microfinance institutions could be built from scratch using commercial sources of capital from the very beginning. Third, commercial banks that already possess direct access to capital markets could begin providing microfinance services. They could do this by launching a subsidiary, by purchasing or merging with the operations of an existing microfinance entity, or by introducing new products through a special service window. All of these avenues would enable the microfinance industry to directly access capital markets.

There is a fourth avenue, which is to access commercial capital indirectly by establishing links between financial intermediaries that can freely access capital markets and microfinance service providers that cannot. This fourth avenue is explored briefly at the end of this chapter, but the bulk of the discussion below focuses on the first three avenues, since these are the ones that were explored in depth during the seminar and offer the microfinance industry the most potential for growth.

### **NGO Transformation**

Historically, the avenue most commonly used by the microfinance industry to obtain direct and diverse access to capital markets has been the transformation of microfinance NGOs into regulated financial institutions. Two main types of transformations have occurred. Most organizations have adopted a shareholder-based model and have converted themselves into a private company, but some NGOs have chosen to follow a membership-based approach and have converted themselves into a credit union or financial cooperative. Both experiences were discussed in the seminar.

Specific cases from Uganda and Senegal were presented and illustrate some of the similarities and differences between the two transformation models, but the main focus of the seminar discussion was the process of transformation itself. How can NGOs transform themselves into entities that can directly access capital markets? What do they need to consider? How do they decide what route to take? What are the challenges they can expect to face? And what kind of results can they anticipate? These are the issues that are explored in this section.

### **Transformation into a Private Company**

Beth Rhyne opened the discussion on transformation with some general remarks about the process, challenges and results of transformation from the perspective of NGOs that choose to convert into private companies. She began, “The most important question that we need to keep in mind as we think about transformation is, why do organizations transform?” She mentioned four main reasons, but noted that the first two were the most important.

“The first reason is access to funding to be able to grow. Access to commercial sources of funding has been the driving force for transformation, and that’s been particularly the case in the transformations that have happened in Latin America. Institutions were seeing that they needed to grow, they were poised to grow, the market was there, the need was there, but unless they transformed their sources of funding, they couldn’t grow at the rate necessary to respond to the market. And that required them to change the nature of their organization in order to be able to access commercial sources of funding.”

Microfinance NGOs that underwent transformation have, indeed, been able to grow. Many significantly increased their outreach while maintaining high asset quality and profitability. Rhyne presented outreach results from four sample institutions which are summarized in Table 1. She noted that one of the institutions, BancoSol, was rated the “Best Bank in Bolivia” four years in a row (1995-1998). In 1998, it had a return on assets of 5.2%, portfolio at risk of 0%, capital adequacy of 16.3% and a return on equity of 29%.

**Table 1: Short-term Results of Transformation**

	Active Borrowers		
	At Transformation	At the end of Year 1	At the end of Year 2
BancoSol (1992)	27,000	49,000	61,000
Caja Los Andes (1995)	5,000	16,000	24,000
Mibanco (1998)	36,000	41,000	58,000
Compartamos(2000)	64,000	79,000	100,000*

\* Projected

Rhyne continued, “In Africa, the desire to grow is one of the driving forces behind transformation, but the second major force is the desire to offer savings services. It’s not only the importance of savings that’s been recognized; it’s also the level of demand. Every time you go and talk to clients in Africa, you hear about how important savings services are to them.”

Rhyne mentioned two additional reasons for transformation: 1) to reach higher standards of operational professionalism and thus become sturdier and more resilient; and 2) to break free of the relationship of dependence on donors.

Numerous NGOs have already completed the transformation process. Some of the better known examples are listed in Box 1. In Africa, K-REP was the transformation pioneer, but as Joanna Ledgerwood explained in her presentation of the Ugandan case (included later in this chapter), other institutions are poised to follow its lead.

NGOs that have transformed into private companies have taken one of three major forms. Some have actually qualified to be a full-fledged commercial bank and must comply with all the main regulations for being a bank (e.g. BancoSol and MiBanco). Others have become deposit-taking financial institutions (e.g. Caja Los Andes, Finamerica, FINSOL – in Bolivia and Uganda a new category of financial institution was actually created to accommodate microfinance). A few organizations have transformed into non-deposit-taking financial institutions.

One participant inquired about the success of this third form, whether the non-deposit-taking institutions could actually be sustainable. Rhyne replied, “The most successful example of this type of transformation is probably Compartamos in Mexico, which is one of the top three institutions in Latin America in terms of the number of clients – it has more than 100,000 clients. I think that the institutions that become non-bank financial institutions do

so in a non-deposit-taking framework only in countries where the possibility of becoming a deposit-taking institution isn’t there. They would have preferred to become a deposit-taking institution, but in certain cases they didn’t have that choice. They can still survive, however, because becoming a formal institution that is regulated does give them more ability to leverage from commercial sources than they otherwise would have had. In the cases that we know of, these institutions do still continue to want to add deposit-taking at the time when that becomes permissible, or if doing so means stepping up to the commercial bank level then perhaps that is what is in their future.”

All of these transformed organizations, no matter what form they take, have one key characteristic in common. They are all shareholder-owned, for-profit companies. Thus, at the core of their transformation lies the question, “What does it mean to move from being an NGO to being a shareholder-owned, for-profit company?” Rhyne noted two main sets of challenges inherent in the transition.

One set has to do with internal operations and the challenges of upgrading an institution’s financial performance and reporting, internal controls, MIS, loan documentation, collateral management, portfolio supervision, loan classification, etc. to make sure the institution is capable of meeting the regulatory requirements for standards of operation. These requirements are generally laid out quite clearly by the Central Bank, but many NGOs that have come from a non-profit background have not yet developed those capabilities, so they need to do so. The financial cost of upgrading can be quite high, but it is generally not related specifically to transformation; rather, it is related to raising the standards of operation.

The other, and often larger, set of challenges revolves around the transformation of ownership. Since a key reason for transformation is to bring more equity capital into an NGO, the original owners will have to share (or perhaps cede) control of the institution to new owners. This shift of control is difficult in any institutional transformation, but it is complicated in the microfinance industry by the likelihood that the “old” owners will have been primarily focused on a social or developmental mission while the “new” owners are likely to be focused primarily on a financial mission. It is possible and, of course, desirable for both the old and new owners to possess a dual objective aimed at a commercial future with developmental impact, but even in this scenario, the task of balancing the two components of that dual objective will create governance challenges.

**Box 1: Examples of NGOs that have transformed into licensed financial intermediaries**

BancoSol, Bolivia (1992)  
Finamerica, Colombia (1994)  
Calpia, El Salvador (1995)  
Caja Los Andes, Bolivia (1995)  
CARD, Philippines (1997)  
Mibanco, Peru (1998)  
FIE, Bolivia (1998)  
FINSOL, Honduras (1999)  
K-REP, Kenya (1999)  
PRODEM, Bolivia (2000)  
Compartamos, Mexico (2000)  
EcoFuturo, Bolivia (2001)  
CONFIA, Nicaragua (2001)

As Rhyne commented, “Who are the right owners? How do you find owners that are oriented towards businesslike operations, meaning the need to show an adequate return on equity, but at the same time are totally, fundamentally committed to the mission of the organization and will make choices that balance both of those objectives? Among other things, you need to look at the group of owners that is being assembled to make sure that they can work together, that they can develop a consensus about where the institution is going and work in harmony with each other. You want to make sure you have a diversified ownership that includes a technical partner and/or a specialized equity fund, but avoids shareholders with competing businesses. You also want to establish an arms-length relationship with the original NGO, if the NGO becomes an owner in the new company.”

This last point about the role of the NGO after transformation provoked significant discussion during the seminar. Typically, the original NGO does become an owner in the transformed institution. There have been cases in which the NGO has become the sole owner of a new institution, but this was not recommended by panelists. A more typical scenario, and a healthier one for the new institution, is for the original NGO to take an ownership stake of between twenty and thirty percent. Rhyne shared data from three transformed institutions to illustrate a few examples of how ownership might initially be distributed. As shown in Tables 2, 3 and 4, the NGOs that created BancoSol, K-REP, and BASIX each retained approximately thirty percent ownership in the new institution and became the largest single shareholder in the new MFI.

Table 2: BancoSol Ownership Structure at Transformation

Investor	Type	Amount	%
PRODEM	NGO	\$1.4m	30.1
ACCION/Calmeado w/FUNDES	Technical partner, Socially responsible	\$0.9m	19.4
IIC	Multilateral	\$1.0m	21.5
Rockefeller Foundation	Socially responsible	\$0.2m	4.3
Local individuals	Local private	\$1.0m	21.5
SIDI	Socially Responsible	\$0.15m	3.2
Total		\$4.65m	100

Table 3: K-REP Ownership Structure at Transformation

Investor	Type	Amount	%
K-REP	NGO	\$2.2m	32.5
Shorebank	Technical Partner	\$0.9m	13.2
IFC	Multilateral	\$1.1m	16.7
AfDB	Multilateral	\$0.9m	14.0
Kwa	ESOP	\$0.7m	10.0
Triodos	Socially Responsible	\$0.6m	8.6
FMO	Socially Responsible	\$0.3m	5.0
Total		\$6.8m	100

Table 4: BASIX Ownership Structure at Transformation

Investor	Type	Amount	%
BASIX Holding Co.	NGO	\$1.2m	30
IFC	Multilateral	\$1.0m	25
Shorebank	Technical Partner	\$0.5m	12.5
Triodos	Socially Responsible	\$0.5m	12.5
ICICI	Local Public	\$0.2m	8
HDFC	Local Public	\$0.1m	4
Global Trust Bank	Local Private	\$0.2m	8
Total		\$4.0m	100

Whether or not the NGO becomes an owner in the new institution, there is still the question of what the NGO will do once transformation has been achieved. “It’s always a very big question, and almost always the NGO has a revenue stream, so it needs to do something with it,” Joanna Ledgerwood, Microfinance Advisor for the SPEED project in Uganda, commented. “In the Dominican Republic, there was a very successful transformation in which the NGO ADEMI transformed into BancoAdemi. The NGO now has some equity ownership in BancoAdemi and it makes a lot of money from dividends, so it needs to do something with that money and what it’s doing is community development. Another example is an institution that we’re working with in Uganda that is looking at using dividends and debt repayment that it receives from the new institution to do some food security programs in the North, so they’re trying to carry on the NGO’s original mission of poverty alleviation. What some institutions are looking at the NGO to do is to play some kind of research and development role. There’s one institution in Uganda that wants to have the NGO open new branches and then as they become profitable sell them to the new MFI.”

Neither Ledgerwood nor Rhyne was very keen on this last alternative, since that is precisely what BancoSol and Prodem tried to do in the 1990s with only short-term success. Prodem ended up becoming a financial institution in its own right and started competing directly with BancoSol. The conflicts and confusion that resulted from their complicated relationship have led most practitioners to recommend that the mission of the NGO after transformation be a non-financial one.

### ***The Case of Uganda***

Joanna Ledgerwood stimulated the discussion on shareholder-based NGO transformation in Africa by sharing some of the lessons that the Ugandan microfinance industry has been learning as it tries to facilitate the transformation of local NGOs into a new type of financial institution, the MDI. Her presentation follows.

“There are presently over 500 MFIs in Uganda. Some say there are more than 1,000, but in terms of actual legitimate microfinancial institutions there are at least 500. There are about five to eight that are currently covering all their costs, including the cost of capital, so they are financially self-sufficient. These are really the only ones who are candidates for transformation.

It’s becoming more and more competitive in Uganda, primarily in the urban areas, but since urban markets are becoming saturated, more and more institutions are entering rural areas as well. Most MFIs use a very similar methodology. It’s a blend of Grameen and Village Banking. It’s normally group lending with weekly payments, four to six month loan terms and compulsory savings of twenty to thirty percent of the loan amount. Obviously, this product caters more to the trade sector than agriculture, which is, in fact, not appropriate. In Uganda, eighty percent of the economy is based in agriculture, so there’s a real need for product diversification. There are minimal voluntary savings services. Obviously, not being regulated, the MFIs are not allowed to take voluntary savings, but what some do is accept voluntary savings on behalf of the clients and then deposit them into commercial banks.

Given this environment, there is increasing pressure to provide savings services to the poor, specifically in the rural areas. To facilitate this, the various stakeholders in Uganda recently passed a new bill, a new law. It’s called the Micro Deposit-Taking Institutions bill, or the MDI bill. This process has gone on for maybe six years, but most actively in the last three. GTZ worked within the Bank of Uganda and provided a tremendous amount of assistance; USAID provided assistance as well. It was a very consultative process. There were many, many workshops, in part because there were a lot of stakeholders that needed to be brought on-side, or at least brought into agreement, particularly the Parliamentarians. There were a number of MPs who were unhappy with the bill, so a lot of effort was made to try to convince them that this was good for the country and good for the

industry. It was a very interesting, very successful process and if anyone wants to read more about it, you can find a detailed summary on the microfinance gateway website.

Very briefly, the MDI bill states that MDIs can accept deposits from the public and they can on-lend these deposits. That's basically what this bill says, so it's quite focused on the savings side. MDIs cannot engage in foreign exchange transactions (this is left to commercial banks), they cannot operate current accounts or checking accounts (also for the privy of the commercial banks), they cannot call themselves a bank, and they cannot on-lend the compulsory savings that they take.

To qualify for an MDI license, the NGOs or projects have to convert themselves into a company limited by shares. They have to have a proven 'track record' in microfinance. That's a bit interpretive, but it's basically three years of profitable operations. They need a minimum paid-up capital of 25,000 currency points, which is approximately \$250,000. This amount had been higher, but was reduced by Parliament when it finally passed the bill because it wanted more institutions to be able to qualify. They also need a capital adequacy ratio of fifteen percent of risk-weighted assets. For commercial banks, it's only twelve percent, so the Central Bank does see microfinance as slightly more risky.

The maximum level of ownership had been limited to 20%, but this is another change that Parliament made during the day that it passed the bill. The limit was raised from 20% to 30%, so each MDI needs to have a minimum of four owners; however, there is an exception that can be granted by the Bank of Uganda on this ownership issue. Any individual or even organization that has more than 10% of the shares must be approved by the Central Bank. The Central Bank also needs to approve all of the Board members as well as four senior management positions – the CEO, the finance director, the internal auditor and the operations manager. So, it's a very well-designed bill, well-written, and I think will become an example for other countries in East Africa.

Speaking now in terms of the benefits of regulation, obviously for the institution there are quite a few. Several panelists have already spoken about the ability to diversify sources of funding. There's also decreased reliance on donor funds and, as a result, less vulnerability to donor "whims." The institution can become more efficient and improve its service to clients. The availability of savings is a big advantage and the image of being a regulated institution is valuable as well. At least in the Ugandan market, transformation gives institutions a distinct competitive advantage over non-regulated institutions.

For clients, of course, the biggest benefit is access to savings services, and potentially, a reduction in costs. I say potentially because greater efficiencies and greater competition may result in reduced costs for clients, but that has not been shown yet. Actually, there are no MDIs yet in Uganda since the bill was just passed last November. Finally, for the industry, transformation will increase outreach to the rural areas, particularly, again, on the savings side.

Given these benefits, I want to look a few of the things that an institution or a project needs to consider if they want to transform. On the institutional side, a very big one is the ownership mix, as others have mentioned. What is the ideal mix? How much should external investors come in? How many from outside the country? What about the balance between social and commercial investors? How much should the original NGO own, if any? Do the founders take an ownership stake? And ultimately, what are the exit strategies, if any?

Second, what legal form should the transformed institution take? This is very much determined by the country that you're operating in. In Uganda, it has to be a share company, but obviously, in other countries the laws may allow institutions to become banks or finance companies.

Also, what do you do with the assets that are in the NGO? How do you transfer them to the new institution? Do you move clients as they renew their loans or do you move the entire portfolio on a

given day? What happens to the contributions that have been made by donors? Most donor contributions end up in equity, and in Uganda, we're having to spend a lot of time with donors trying to convince them to allow this equity to be transferred into a privately held company. Of course, the big issue for donors is that they don't want public money to go into the hands of private individuals. So for the most part, we're keeping the equity from donors in the NGO ownership stake of the new institution.

Another issue to consider is capitalization and leverage. This has been talked about a bit. What is the minimum capital requirement? In Uganda, it's not very high, but in other countries it might be higher. If, as in Uganda, the institutions that want to transform already meet the minimum capital requirement, then they need to think about plans for growth. When are they going to need additional capital? What kind of a hurdle rate are investors going to demand? How do they split the debt and the equity, or how do they transfer the assets into debt and equity in terms of the NGO investment?

Governance is probably the biggest issue, bar none. What happens to the original NGO and its Board? What is the role of the Board, and what is the role of NGO itself? How many Board seats will there be and who gets them? What are the voting rights? Will there be an ESOP where the employees also take a share of ownership? What are the terms of the Board, the various committees, etc. Often the Board of the NGO is not the most appropriate Board for the regulated institution. These are all very big issues that need to be considered.

On the operational side, you have to consider whether the management of the institution is capable of managing a regulated institution. There are corporate culture issues as you move from non-profit status to for-profit status. Is your staff on side with the transformation? Are they going to remain happy and committed and motivated in the new institution? Are your human resources appropriate? Are your financial management and treasury departments adequate? For many institutions this will be the first time they're managing liabilities, so capacity in this area may be poor. Risk management is also a major concern. Internal control is one of the weakest areas in Ugandan institutions, and this is an area that the Central Bank takes great interest in.

With respect to back-office operations and MIS, a lot of the institutions that we're working with aren't even computerized. So, not only are you trying to get them organized to take savings and to develop the savings module of a computer system, but you're actually working to get the original computer system in place. One must also ensure that the institution is able to comply with Central Bank reporting requirements, and this takes a great deal of time and money. It is probably the biggest budget item of the transformation process.

Once they transform, most institutions do increase or broaden their market. They may not abandon their original market, but they will have a different market, particularly on the savings side. And that will lead to a need for new products and services. Last but not least, there is the issue of money. Transforming is expensive – one million dollars seems to be the average cost. Where are you going to get this money and how do you budget for it?

In terms of technical challenges, I've already mentioned MIS, inadequate internal controls, low product innovation, and a lack of skills among managers and often on the Board as well. In Uganda, we found a lack of local appropriate technical assistance providers, which means that it's going to cost more money to bring people in from the outside. We're also finding it difficult to recruit people locally with the necessary skills for key new management positions (treasury, internal audit, CFO, etc.) and ultimately, finding equity investors – local and social/commercial investors. We need to find mechanisms for local stakeholders to participate in the initial capitalisation so as to avoid domination by external shareholders. Perhaps this will not be too difficult for the first one out of the box, but the ones that follow will have a hard time.

We also struggle with the issue of how to systematize and professionalize an institution, which is key for the Central Bank, while maintaining the flexibility and innovation that are key for customer service. Managing staff expectations and the fear that there won't be a place for them in the new institution is very important, as is having an internal communications strategy.

What have we found that has worked well? Having a very clear transformation plan, with clearly identified activities, timeline and responsibilities. The project I work for is a donor-funded project, and what we do is support the capacity building of the institution involved in the transformation. We put a full-time person in the institution to manage the transformation for anywhere from 12 to 18 months and that has worked very well. It allows the management to continue running the institution as they should.

We found that transformation is easiest with local MFIs that have a competent Board and management. Obviously, cooperation with the Central Bank, donors and the government is key. A sound regulatory environment is essential. Commitment by all Board members to the transformation process and to the introduction of external investors is very important; you really need buy-in from the top in order for transformation to work. You also need a solid communication strategy (both internal and external). Giving direct technical assistance and training (often drawing from international experience) has proven very useful. Market analysis and customer care aspects have proven critical. Certainly, the process can be long and expensive, but it can also be worth it.”

### ***Transformation into a Member-Owned Institution***

Although most transforming NGOs have chosen to convert themselves into private companies, a few have opted to convert into member-owned financial institutions. Be they credit unions, cooperatives or mutuelles, what these transformed institutions have in common is an ownership structure that is based on membership rather than shares. Voting rights are distributed democratically – not in proportion to the size of the investment made – and members become both the owners and the principal clients of the new institution.

The transformation of an NGO into a member-owned, regulated financial institution enables it to access some additional sources of capital. Most importantly, it becomes free to mobilize savings. It may also be able to obtain short-term liquidity and medium-term financing from its affiliates. However, member-owned institutions are generally unable to access large-scale commercial financing or to attract external private equity investment and this restricts both leverage and growth.

Perhaps because of these limitations, the membership-based transformation was not as widely discussed during the seminar as the shareholder-based transformation, but the experiences shared did suggest that NGOs undergoing a membership-based transformation face similar processes of change and a similar set of challenges as those undergoing a shareholder-based transformation. In all cases, transformation requires system upgrades, ownership transfer, cultural change, legal procedures, human resource development and more. To illustrate the complexity of one membership-based transformation in Africa, Anicca Jansen and Mayoro Loum presented the case of ACEP in Senegal.

### ***The Case of ACEP***

Anicca Jansen, with USAID Senegal, introduced the case by describing ACEP's origins and the environment in which it developed. She began, “The 1970s in Senegal was a period of great crisis. There was a drought, decreased agricultural production, worsening terms of trade, increased government borrowing, and severe issues with respect to food security. At that time, lending in rural areas was done through ONCAD (Office National de Cooperation et d'Assistance au Développement), a parastatal. The idea behind ONCAD was to work through local credit committees to provide access to rural credit despite the lack of traditional collateral. Anticipated profits served as

the guarantee against agricultural loans; and if loans were not repaid, dividends paid to the growers were to be reduced by the non-reimbursed amounts. However, ONCAD was dissolved in 1980 because of severe management problems at the local level and internal control issues.

The CNCAS, Caisse National de Credit Agricole du Senegal, was then created. Originally, this was supposed to be a cooperative with rural shareholders. It was to be independent from the government and have decentralized loan decisions and local credit committees with local producer groups getting direct bank credit (which they weren't getting before). Individual producers would receive loans in kind, not cash, and future credit would be dependent on repayment. CNCAS still exists today, but as a bank with the Government of Senegal as the majority shareholder.

There were certain policy changes going on in the 1980s: decentralization, privatization, increased access to capital in rural areas and a focus on increased food security, which was the particular interest of USAID at the time. So USAID launched a project, the Community and Enterprise Development Project in the regions of Kaolack and Fatick, which were seen as high potential areas for food production. The project was implemented in cooperation with the Government of Senegal through an agreement signed in January 1984. It had two components. One was to assist village organizations to provide grants, credit, technical assistance and literacy training, and the other component was to assist small scale enterprises in management, numeracy and literacy, and credit, and it is this component that eventually became ACEP.

The credit products for the villages were highly geared toward food security because of problems at the time – gardening, cattle fattening and fishing, and then again there was a small scale enterprise component that was supposed to help support off-farm activities. In 1987, the project was evaluated and the village organization component was found to be very weak. The local NGOs running it had a background in social welfare and emergency programs, but not in business and they were not accustomed to loans having to be repaid. There were other problems with the projects in terms of market constraints (faced by vegetable gardeners), technical problems with wells, pumps, etc., and credit payments being behind schedule.

But at the same time, there were some food security impacts: more consumption of eggs and vegetables, a better understanding by villagers of the formal banking system, increased transport services, and increased recognition by the government that village organizations could be used in development.

On the small scale enterprise side, there were 384 loans that had been given over a period of about two and a half years. One hundred and thirty-five part-time jobs were created; 42 full-time jobs were created; there was a 90% increase in profits to borrowers and 71% cost recovery already at that time. However, there were problems. Four of the seven agents had been dismissed for embezzlement.

As a result of the evaluation, a shift was made. Work with local NGOs was limited and there was expansion of the small scale enterprise credit component, both geographically and in terms of loan size. This is where we see the beginning of what was to become ACEP. In January 1989, after three and a half years, the project had 234 loans outstanding, a portfolio of 239 million CFA francs outstanding, an average loan size of 1.3 million CFA francs (loans ranged from 100,000 to 4,800,000 CFA francs) and 96% loan repayment. Forty-four percent of the loans were made to commercial enterprises, 26% to agriculture, 20% to the service sector, and 10% to manufacturing.

In 1989, the project was facing its final challenges: how to increase the portfolio while maintaining repayment; how to improve internal control and management (because there were problems); and how to establish a private, independent financial institution. At the time that the project was created, it was envisioned that the small scale enterprise component would eventually be folded into CNCAS or some other private bank, so the plan to create a commercial entity was nothing new. The Government of Senegal did, however, find the idea of transferring the project's public assets to the private sector

problematic. It was concerned that private operators would not be interested in what ACEP was trying to do, and would shift operations away from the project's original mission if they took over.

USAID wanted neither itself nor the Government of Senegal to be an owner in whatever entity was created out of ACEP. It thought that the best thing for the project was to become was a non-bank financial institution. However, at the time, Senegal's banking laws did not favor such a transition. There was an interest rate ceiling and there were limits on non-secured loans. There was no legislation that would make it possible to transform into a non-bank financial institution. In 1991-2 not even the PARMEC law existed.

By December 1991, all ACEP branches were profitable, but debate about what to do with the project continued. There were few bank branches in the areas where the project was operating and no bank was interested in ACEP's target client group, yet ACEP's asset base was too small for it to become a bank itself.

Eventually, it was decided that the Ministry of Finance would draft interim legislation that would allow ACEP to operate as a credit union until the PARMEC law came into force. Thus, on March 23 1993, seventy-seven founding members officially established the Alliance de Credit et d'Epargne pour la Production (ACEP) and on May 9, 1993, ACEP statutes were approved by the Ministry of Finance. Measures were included in the by-laws to ensure that new members would not be able to dissolve the institution to get their hands on its assets, which totaled one billion CFA francs. In case of an early dissolution, the assets would be retransferred to the State, and it would be up to the State to transfer them again to another institution."

Mayoro Loum of ACEP, continued, "People question whether we became a credit union because there was no other choice, and that is essentially true. But in addition, we knew we had to find other resources to finance our growth and we felt that the credit union formula could work for us. We already had clients' trust, so they wouldn't hesitate to put their savings in our coffers. Plus, there would be a feeling of ownership as a result of being involved in the decision making.

There were challenges, of course. We've been trying to meet them all along, but some are still there to be taken up. It has been difficult for people to understand what a community credit union is. Developpement International Desjardins (DID) sent someone for two years to help us with the transformation of regional branches into local funds (except in areas where there wasn't enough potential) and that's how we launched the institution. But the scale and challenge is totally different today. In 1990, we had a portfolio of 200 million CFA francs. Now we have a portfolio of 10 billion, with 18,832 clients, 30 branches, 8 regional offices and a clientele that's 30% rural.

Reflecting on the somewhat disappointing performance of major networks around Africa in recent years, we can see there are governance problems. At 200 million the stakes are not that high. But if members are not aware of their responsibilities and powers, as soon as the stakes are raised, you are faced with problems. In certain African networks, the management level has been lax, simply because the board was too powerful to allow the managers to impose their decisions. Too many privileges were accorded to members of the Board. In some places you even had catastrophes, largely due to the fact that credit was given to influential members of the Board who diverted these funds for their own purposes. So our principle challenge was to find the right balance between the power of ACEP's membership and the power of its executive. It is this clear division of responsibilities that can help safeguard the institution.

Another problem is that of training. For example, at a certain level of activity you need an oversight committee. We quickly realized that even the accounting firms that we called upon to audit our activities at the end of the year would take two to three months to issue statements because we had so much activity that the volume was more or less equivalent to that of a bank. Eventually, we realized

that our oversight committee was no longer useful because it wasn't able to keep track of all the activity.

Thus, today, the challenges are of an institutional nature. We need to have accounting and auditing norms and good management information systems; in other words, we need to put into place a structure similar to that of banks. Our second challenge has to do with viability. It is true that profitability had been achieved by 1991, but we quickly realized that there was a lot of investment that still needed to be made if we were to have a good management information system. So, on top of everything else, it was necessary to find the resources to make these investments. You could only get those resources if you had operational norms and policies in place, good management, and clear, transparent, audited financial statements. With all this in place you could go not only to donors but also to commercial sources of finance.

Another major challenge today is the regulatory framework, which is found somewhat wanting, but discussions are underway to make some revisions. We've been looking for about two years now at the possibility of transforming into a bank, although there are limitations there too related to the banking law, particularly with respect to the classification of loans and the establishment of reserve requirements, which make transformation difficult. I do think that with the kind of discussions we're having, we can find solutions."

## **Building MFIs that Access Capital Markets from the Beginning**

Instead of transforming NGOs into regulated financial institutions, the microfinance industry can access capital markets by building regulated microfinance institutions from scratch using commercial sources of capital from the very beginning. There are relatively few examples of MFIs that have been built in this manner, but the avenue is still quite new for the microfinance industry. Start-up companies in all sectors face major challenges in obtaining seed capital, but these challenges are exacerbated when the company operates in an emerging industry or sector. MFI start-ups have an even tougher time than most new companies because commercial investors are still unfamiliar with the microfinance industry and/or consider it to have a high risk profile.

Until recently, there was little incentive for commercial investors to take interest in the industry. The vast majority of microfinance institutions were donor funded and few were providing anything near what a commercial investor would consider to be an attractive return on equity. However, now that several commercial microfinance institutions have demonstrated that microfinance can provide an attractive return, investors are becoming more interested in the industry.

In the last decade, a handful of institutions have succeeded in building licensed financial intermediaries with private capital from the very beginning and, in so doing, are breaking ground for others to follow in the future. The example provided by Equity Building Society was already highlighted in Chapter 1. Another inspirational case study is that of FINADEV in Benin, which is presented below by Patrick Lelong, FINADEV's Managing Director. FINADEV owes its existence to the early support it received from a commercial bank in the West African Monetary Union. As shown below, that support was critical, but it did not result in an institution that was wholly owned by the bank. It resulted in a private, profitable microfinance company.

### ***The Case of FINADEV***

"Within the framework of West African experience and the progressive structuring of the microfinance sector in the West African Monetary Union since 1995, the President of the Financial Bank Group realized very early on that this new industry, which was essential to development, could prove its growth potential and commercial banks should invest fully in it.

Although expensive and risky at the time, such investment would support and even accelerate the development of the financial system for clients who were traditionally neglected by the commercial banks. Bankers could bring their technical skills in certain target areas (e.g. very small companies, rural credit, small processing industries, new technologies) and in certain services that MFIs and rural NGOs had difficulty with, such as medium-term lending. The banks could work in close cooperation and/or risk-sharing arrangements with these institutions in areas outside their fields of competence. It was also felt that the banking system should be able to play a significant role in the refinancing of MFIs by being familiar with their needs and by permanently monitoring their development.

In 1995, Financial Bank Bénin introduced a "social loan" product, which was designed for groups of workers who wanted to borrow for housing improvements or the purchase of small plots of land, but who could not access commercial banks on a purely individual basis. The loans were available to groups of salaried employees from both the public and private sector and were considered somewhat innovative at the time.

In addition, the bank was and still is one of the principal partners of PADME (Project of Support to the Development of Microenterprise), and remains an elected member of its executive committee. It placed part of its branch network at PADME's disposal for the purpose of loan disbursements and repayments and, in parallel, it freed up lines of credit in PADME's favor to facilitate the development of its portfolio. Financial Bank Benin also helped this institution to create its own tellers and cashiers through training activities within the bank.

As a result of these experiences and the vision of the bank, the Directorate General decided to participate actively and even more directly in the development of the microfinance industry, at first in Benin, but also, if the experience proved conclusive, in other countries of the region.

A pilot phase, launched in November 1998, allowed the creation of a FINADEV microfinance window, which was integrated into the Financial Bank network and delivered through its agencies. The idea was not for the window to become permanent, but rather for it be transformed as rapidly as possible into a separate legal entity. During this pilot phase, Financial Bank Benin prepared for the creation of the first private microfinance institution in francophone Africa, managed by professionals of the bank and placed under the supervision of the sector's regulatory authorities.

The limited company was created in July 2000, but since the operation was the first of its kind in Benin and in the UMOA zone, it had to obtain permission from the relevant authorities to be able to operate under this legal form. Thus, the microfinance window continued to function for an additional year until an agreement with the authorities was attained.

On July 4, 2001, the signing of a convention with the Ministry of Finance and Economy of Benin allowed FINADEV to begin operating as a limited company – as an entirely autonomous institution. Having fulfilled the conditional requirements of its partners, FINADEV's capital of one billion CFA francs was entirely released and subscribed before December 31, 2001, according to the following final distribution: International Finance Corporation 25%; Dutch FMO 25%; Financial Bank Benin 25%; Financial Bank Holding 15%; and Lafayette Participations (Horus Group) 10%.

Institutionalization as a limited company has many advantages, including clear governance, rapid decision-making, and a well-defined and controlled plan for growth. On the other hand, because of its legal status, FINADEV's activities proceed on the same basis as a private commercial company, that is to say, without any tax exemption, which makes the various fiscal burdens of managing the company heavier, and without any subsidies or preferential line of credit. Our NGO and cooperative colleagues do not experience such penalizing conditions.

However, we can see that the institutionalization of microfinance organizations is becoming critical for the future of the sector, with donors wanting to do everything they can to shift their interventions

and their support towards the promotion of competition within the sector, abandoning in stages their direct support, soft-loans, and the refinancing of guarantee funds. To sustain their activities in a competitive context, our microfinance colleagues will have to make an institutional choice for the future, and we think, as do our shareholders and current partners, that the limited company can respond positively to this necessary evolution. Perhaps our experience can be a small pilot for them and assist them in identifying an advantageous solution.

During our first eighteen months of operation, FINADEV served more than 25,000 borrowers and disbursed more than 8.3 billion CFA francs. The provisional result, as of December 31, 2002, showed a profit of 56 million CFA francs before taxes. This result is very encouraging and shows that a structure like FINADEV can rather quickly reach the break-even point. Current loans outstanding, which grew strongly during the year 2002, put us in fourth place, behind FECECAM (Federation of Agricultural Savings and Loan Cooperatives), PADME (Projet d'Appui de Developpement des Micro-Entreprise) and PAPME (Projet d'Appui de Petite et Moyennes Entreprise), two powerful institutions which are in the research phase of their institutionalization.

After these statistics, there is another element that one must take into account in microfinance and that is the human element – the aspect of personnel. As strong as portfolio growth was during this period, there was a similarly strong growth in personnel. From the launch of FINADEV's operations until the end of 2002, we grew from 13 to 46 employees. In eighteen months, we effectively tripled in size. This strong growth in numbers was accompanied by skill development and internal promotion. The two French volunteers who took initial responsibility for the northern and south-eastern programs were eventually replaced by personnel who had been with FINADEV from the beginning and had been promoted to middle management with either programming, accounting or legal responsibilities. To date, we have not had to resort to any external human resources.

With respect to our coverage in Benin, we are currently more focused on urban and peri-urban areas, but our desire is to also have coverage in rural areas. There are openings planned in the next two or three years together with the Office of Posts and Telecommunications, which we have been in partnership with since January 2002.

We also have many new departments to create or to develop since, initially, our relationship with Financial Bank enabled us to develop with assistance from its personnel department, for example, and a bit from its legal department. Significant financial investments need to be made in information servers as well as in specialized personnel to create a Personnel Department and an Internal Audit Department.

We are continuing to develop partnerships with our donors and shareholders, but we also have a strong relationship with the European Investment Bank in Luxembourg, which has given us a one million Euro line of credit. In fact, we would like to expand this partnership for the types of loan products under development, especially medium-term credit. We have a lot of requests for social loans and housing loans, in particular, that must be medium- to long-term. The resources that are available at our level are primarily short-term resources.

In the context of strategic alliances, FINADEV continues to collaborate with other microfinance organizations in Benin, namely FECECAM, PADME, PAPME and VITAL. Since September 2001, it has also participated actively as a member of the ALAFIA consortium, the National Association of Microfinance Practitioners in Benin.

The concept of FINADEV does not stop, however, in Benin. It was created with the intention that it would also be able to operate in the region, either in the UEMOA zone or the UDEOAC zone. Toward this end, a FINADEV window was created in August 2001 at Financial Bank Chad in N'Djamena, and that window transformed into a limited company as of January 1<sup>st</sup> of this year. The institutionalization process was shortened as a result of our experience in Benin and the support of our

shareholder and technical partner, the Horus Bank and Financial Group. Its participation, together with that of the Financial Bank Group and the International Finance Corporation, is especially innovative since it incorporates the Villegrain Group, thus demonstrating the possibility of engaging private, non-financial international groups in the development of African microfinance.

In expanding FINADEV's activities, we have been working in liaison with our partners to create a FINADEV holding company, with the aim of creating subsidiary companies within the region. Country studies have been carried out or are in the process of being carried out for future operations in Guinea, Guinea Bissau, Gabon and Togo. A partnership is envisaged in Burkina Faso as well, but it is not yet finalized.

The intention of our shareholders and close partners is that the FINADEV concept – in legal form, in spirit and in the framework of activities that it developed – be duplicated in other countries of the region, first in those countries where the Financial Bank Group is already operating or where it wishes to operate in the long-term.

However, it would be illusory to believe that such openings can take place without additional support being provided during the initial start-up and development phases, before the break-even point is reached, just like with our experience in Benin. The Financial Bank Group knows the cost of such expansion and cannot support this growth alone without external assistance. The successful experience in Benin, currently being duplicated in Chad, should make it possible to facilitate the provision of the necessary financing.

To conclude with reference to our current experience with the market and its constraints, we would like to underline the need for modifying the PARMEC legislation, which governs microfinance activities in the UMEOA zone. This desire is shared by all the members of the sector with which we work locally. Two principle themes seem to us to be priorities for future negotiations with the authorities: 1) the authorization of financing between MFIs, introducing if necessary and after consultation, rigorous financial and non-financial ratios on the matter; and 2) the strengthening of legal measures with respect to the seizure of collateral, particularly in the context of debt recovery. In Benin, various proposals are currently being studied in these areas through the ALAFIA consortium.”

## **Commercial Bank Downscaling**

Although the FINADEV case study was introduced as an example of an institution that was built by accessing capital markets from the very beginning, it is also one example of how commercial banks can get involved in microfinance and, in so doing, can link the microfinance industry to capital markets.

There are other ways, however, for a commercial bank to get involved in the microfinance industry. It could buy the operations of an existing microfinance entity; it could develop and deliver microfinance products itself; or it could create a subsidiary through which to deliver such services. Any one of these strategies would bring microfinance into the mainstream financial system and give it access to a variety of capital sources including savings, institutional deposits, interbank liquidity, commercial borrowing, and private equity investment. The potential for growth, both in terms of scale and the types of services offered to clients, makes it an avenue with tremendous potential and one that the microfinance industry is getting very excited about.

What would be the incentive, however, for commercial banks to downscale? Why would they want to do it? Hany Assad, Program Manager for the International Finance Corporation, explored some of the incentives and disincentives that commercial banks face with respect to downscaling. He also commented on some of the things that banks need to consider if and when they decide that they do, indeed, want to downscale. A summary of his remarks is provided below, together with a case study

from Sogebank, a commercial bank in Haiti that actually took the plunge and entered the microfinance market by establishing a subsidiary, Sogesol.

### **Commercial Banks and Microfinance**

The typical commercial banker is negatively pre-disposed towards microentrepreneurs, who often work in the informal sector, in semi-legal, low-productivity, mostly family-based activities that are difficult to quantify or assess. They have minimal assets and therefore minimal collateral. In rural areas, businesses are often dispersed over large a geographical area, which makes them difficult to reach. They invariably operate in cash-based markets with informal structures. Business is conducted through hand-shake contracts and verbal agreements that are not recorded and not legally enforceable. Many microentrepreneurs keep a low profile in order to avoid the high cost of formalization (registrations, taxes, labor regulations, payroll charges) and the enforcement of regulations by authorities, which means that banks don't know what to do with them.

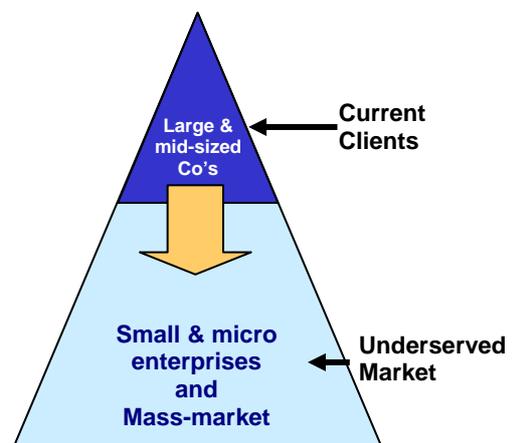
For commercial banks, microenterprise means small transaction size, high cost, and high risk. Bankers lack knowledge and understanding of the markets in which microentrepreneurs operate and, in many cases, they have no experience or tools with which to transact with microentrepreneurs or poor individuals. There's very little information available on this potential market and that makes it hard to assess risk, yet collecting additional information is very high cost. Most bankers simply don't trust microentrepreneurs. And most microentrepreneurs have as little trust in banks as the banks have in them.

Clearly, there are major problems that need to be dealt with, but let me put them in perspective. You see all these negative things and you say, 'why are banks interested if we are so far apart?' There are reasons and the reasons, you have to be aware, are market reasons.

Banks have a tendency to function only at the top of the economic pyramid. You hear that somewhere between three and, let's say, a maximum of thirty percent of the enterprises in a developing country have any banking relationship. Yet today, as a result of globalization, technology advances and the development of securities markets, many new competitors have entered the financial services market and clients at the top of the pyramid are being fought over like never before. Large companies don't even need the banks to borrow; they can go straight to the capital markets to access funds. Thus, commercial bank margins are narrowing and fees are dropping.

As the financial services industry becomes increasingly competitive, banks feel the pressure to move down market. That is true wherever we go. If you don't hear this, then they're not telling you the truth. Let me put this in context because it's an important point. This is the only industry in the world where there is a huge untapped market. If you take any productive industry and you talk about market share, you're talking about a marginal increase in production to reach a marginally larger size of the market. But this is a market where there is a huge un-served population, which means by definition that there is huge potential to grow. There is a huge opportunity to go for markets where, as we have heard, the margins are not bad. As Pierre-

**Figure 5: Financial Services Market**



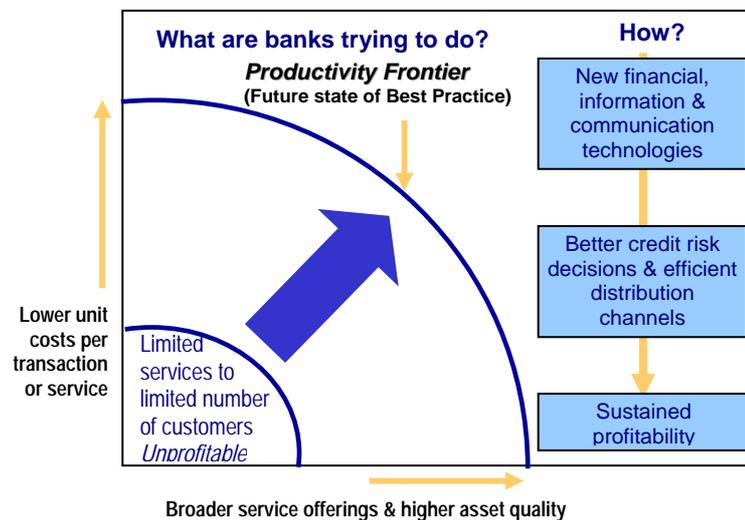
Marie Boisson noted, “If you have the right productivity, you can have a much better margin in microfinance than in any other banking business.”

Banks are starting to realize, I think, that microfinance is something to consider. And then they wonder, ‘how do we do it? This is not the business we’re in; we don’t understand how to move down market.’ So, what would it take for commercial banks to enter the microfinance market? What are the prerequisites, so to speak?

They need sound macroeconomic policies and an appropriate regulatory and prudential framework. That’s very important because it helps in managing risk, and in understanding the rules of the game. They also need reliable credit information on micro-entrepreneurs, i.e. information on past payment history, level of indebtedness, and default information. The only way for banks to assess risks and know how to make a loan or provide a financial service is to get that credit information. A third prerequisite is better understanding of the markets in which microentrepreneurs operate. Commercial banks need, for example, primary & secondary market research on the types and size of businesses run by microentrepreneurs and the characteristics of the industries they operate in. They’re no longer dealing with the cement industry or the paper industry, sectors that they already know and understand.

Once banks decide that they want to move down market, how do they actually do so? What do they need to do? I’d like to answer this question by looking at the theoretical framework shown in Figure 2. This may look complicated at first, but it’s actually very simple. There are two things that banks – or any financial intermediary for that matter, microfinance institutions and leasing companies included – are trying to do with respect to the microfinance market. They’re trying to lower their costs per unit of transaction and, at the same time, they’re trying to broaden their service offering and increase the quality of their assets. You see these two objectives on the X and Y axes of the chart.

**Figure 6: Shifting the Productivity Frontier**



If you plot existing financial institutions on this graph – this is very theoretical, but if we try to do that – you find that most banks or financial intermediaries fall within the lower left hand corner. They have limited services for small clients, and it costs them a lot to provide those services. You hear it all the time. ‘Microentrepreneurs are high cost and too much risk; I’m not going to transact with them.’ This is a typical response from a bank.

How do we change this? If we look first at the X axis, we look at the market in which the institutions are operating. The question here is how to increase demand for the products and services of the bank or the financial intermediary, in other words, how to grow. Let me just say that in the banking world, bankers say that if there’s no growth, there’s no bank. So when a bank cannot grow any more, what does it do? It acquires another bank. The banking business has to continue growing; that’s part of the way banks are structured. But growth on its own is not enough. Growth needs to come with asset quality, which means risk management. And here we are talking about small and mid-sized banks,

but also microfinance institutions. It is very important to remember that microfinance institutions are financial intermediaries. They are not dealing with anything different from what the banks should be doing.

The most important thing we found in talking to many bankers is that very few know their markets, know their clients – who are they and what do they need. We heard today from James Mwangi that it's important to meet client needs, but how many banks actually know their small business clients? I'll give you an example, in the United States, which is the most advanced country in small business finance in the world – I think there are two hundred billion dollars per year that are being targeted to small business in the U.S.; the rest of the world is not even a tenth of that – only five banks out of the top fifty have done market assessments of their clients. And they feel they need to go a lot further. I'm talking about small business finance, not mortgage or retail or anything else.

James said it this morning, but I would like to emphasize the point that if banks knew their clients, then they would be able to provide them with the right product and service. You have to start with the client. You also have to think about how you reach your client. If your client is in a rural area and the bank is in Dakar, if you only have ten branches, how can you get there? One has to think of the product and service and distribution channel together in order to solve the question of how to reach the client.

A lot of work has been in the area of efficient distribution channels and there are quite a few new risk management technologies that have been applied and adopted as well. The most significant is what we call credit scoring. Using the U.S. example again since it is the largest small business market, credit scoring accounts for ninety-four percent of the decision making process for all small business loans and there are at least a million loan decisions made each year on small business loans.

Financial and information technologies such as credit scoring can be leveraged not only to improve portfolio risk, but also to reduce transaction costs, which brings us back to the Y axis in Figure 1. The second thing financial institutions need to do is improve their operating efficiency, and that challenge is not restricted to microfinance. We've heard a lot in the era of the internet about the importance of information technology, internet banking, etc. That's because banks are trying to figure out how to bring down the cost of a transaction. For example, processing a check in the U.S. may cost a bank fifty cents per transaction. But if the same payment is transacted electronically, it could cost the bank a mere five cents. That's a ten-fold difference in the cost, so just take that and multiply it out to anything you do. Banks are now the largest consumers of information technology in the world. They pay more for information technology than any other industry and they do so because it is driving down transaction costs.

With respect to technology, it is important to mention that not all technologies can be transferred just the way they are. Assuming that if a technology works in Bolivia or the United States, it will automatically work somewhere in Africa, is one of the biggest mistakes that we make. To take a technology that has worked in one place, understand it, and adapt it for your country is a learning process that one has to go through.

We have examples of commercial banks that are successfully providing microfinance services. Many of them were created through the transformation of MFIs or NGOs, such as BancoSol in Bolivia, MiBanco in Peru and Banco Solidario in Ecuador. In Guatemala, BancaSol entered microfinance by merging with the NGO Genesis. In Haiti, Sogebank created a microfinance subsidiary – Sogesol. Hatton National Bank in Sri Lanka developed microfinance products and is offering them through its main branch infrastructure. These banks provide examples of best practice that one can look at, learn from, and specially adapt. They are at the forefront of what we were talking about in terms of pushing the productivity frontier – improving the quality of assets and reducing costs. Today in Bolivia, we're not talking about fifty percent operating efficiency (defined as operating costs as a percent of

portfolio). We're talking about ten to twelve percent. If you're at fifteen, fifteen percent of your costs, then you're out of the game; you're bankrupt.

To conclude, then, banks will move down market. They'll move first into the SME market and then into microfinance. How? By establishing a separate subsidiary, by acquiring existing MFIs and keeping them as separate businesses, or by integrating microfinance services into the regular operations of the bank.

When? Obviously the macroeconomic context will be a determining factor, as is the risk profile. But more importantly is when banks start seeing, or let's say, financial intermediaries start seeing that microentrepreneurs are actually good business. There is a huge role for existing MFIs, whether they be cooperatives or NGOs, to demonstrate that this is a profitable business.

As competition increases, the speed of change will also increase. That means that if you just sit there and say, 'okay I'm happy in my country, and I have an MFI that does very well,' that's not going to be the case in a few years. Somebody's going to make a move in that market and competition is going to increase. Banks will find ways to effectively leverage financial, communication and information technologies (and by technologies we also mean methodologies – how to do things, processes, organizing people, training, etc.) to reduce operating costs and improve credit risk assessment. When they do, the microfinance industry will change dramatically.

### ***The Case of Sogesol***

*Presented by Pierre-Marie Boisson, Chief Economist, SOGEBANK; Chairman of the Board, SOGESOL*

My aim today is to present the case of my own institution, SOGESOL, a 35% affiliate of SOGEBANK, Haiti's largest commercial bank, as a model for successful entry of a large retail bank into microfinance. Today, after only 2.5 years in existence, SOGESOL has already served some 9,000 micro-borrowers, with 6,500 active clients in six branches and close to US\$3 millions portfolio of loans averaging US\$420, with only 3.2% are in arrears of more than 30 days. SOGESOL has been profitable since August 2002 and projects to exceed 30% return on shareholders' equity for its third year, making it one of SOGEBANK's most successful endeavors.

There are five main questions that I would like to focus on today, i.e. : (i) why did SOGEBANK chose to enter the field, in line with market conditions and the bank's business strategy; (ii) how did we choose to deliver and reach our long-term goals of efficiency, sustainability and market outreach, be it in terms of organizational model, mission statement, client segments, product-mix, methodology and human resources; (iii) how did we use external assistance and partnerships; (iv) what results did we obtain and expect in the future; and (v) what are our main challenges in going forward.

### **The Haitian Economy and Informal Sector**

SOGEBANK's move to microfinance cannot really be understood without considering the environment in which it operates. Haiti is the western hemisphere's poorest country, with per capita income of US\$405, life expectancy of 54 years, infant mortality of 71 per thousand, 51% adult illiteracy and 80% rural poverty. Its population of 8 million, growing at 2.3% per year, is very young (20 years median age) and rapidly urbanizing (35% vs. 20% in 1982), resulting in a high demand for jobs.

Formal sector employment has, however, been deeply constrained by years of a deteriorating business environment, forcing the population toward migration, unemployment or self-employment. Migration has boomed in the last 40 years, resulting in one of the region's largest diasporas, accounting for one fifth of our total population. More than half of our migrants live in the United States, sending

remittances to their relatives that constitute Haiti's largest source of foreign exchange, amounting to 15% of GDP.

Self-employment, however, remains the main option for people unable to obtain formal jobs and concerns 75% of working-age Haitians. Most of the self-employed take advantage of the demand for retail urban services (food, cloth, jewelry, tailoring, barbering, car repairs, etc.) – which is partly fueled by remittances – to create their own informal microenterprise. The relative size of Haiti's service sector is reflected by the fact that it accounts for half of the country's GDP compared to 27% for agriculture. We estimate the current number of bankable micro and small enterprises to be around 300,000, of which about 60,000 are currently receiving formal credit.

### The Banking System

Haiti's banking system is made of twelve banks, including eight private Haitian banks holding 80% of total assets, with 63% going to the three largest ones. Deposits include some 750,000 accounts, amounting to about US\$900 million (25% of GDP), 89% of which belong to small passbook holders with balances averaging \$500. The credit portfolio amounts \$390 million (11% of GDP), loaned in majority to well-established businesses including large importers and a few industrial companies in the beverage, construction and food processing industries.

The large presence of micro and small enterprises in our economic landscape has been, until lately, largely ignored by the system, which has long been plagued by credit concentration and risk aversion, owing to a combination of commercial bank culture and financial repression in the form of an interest rate ceiling, a very high reserve requirement and overall weakness in the legal and judicial systems favoring debtors over creditors. This undoubtedly contributed to the deepening of Haiti's unequal income distribution, one of the main obstacles to a better social and business climate in Haiti.

Starting in 1993 however, Haiti's monetary authorities adopted aggressive liberalization measures, licensing five new banks, eliminating the 22% interest rate ceiling in 1995, lowering the reserve requirement from 48 to 26% in 1996, and introducing a series of reforms designed to encourage competition. Among the expected outcomes of this new posture was an accelerated provision of financial services to the population, helped by branch expansion and product innovations, and a more favorable distribution of credit, including an opening to micro and small businesses and individuals.

### The Microfinance Industry

Haiti's microfinance industry has traditionally been, as in all developing countries, dominated by credit unions and NGOs. Stimulated by international advances and development of the domestic informal economy, the industry rapidly grew during the 1990s to reach, by September 2002, sixty thousand borrowers, served by 79 providers, among which were 58 credit unions, 17 NGOs, associations and religious groups, and 4 commercial banks.<sup>4</sup> Although they were late entrants to the industry, commercial banks have been the fastest growing segment, now representing 20% of the number of active clients and 30% of the total credit portfolio (in value) after five years of presence.

In spite of the industry's fast growth, most of the players, with the exception of banks, suffer from limited access to financial resources and weak capacity to handle large transaction volumes, which gives large retail banks significant competitive advantages. The current industry fragmentation is thus bound to give way to consolidation and even the disappearance of smaller players although some credit unions, religious entities and NGOs will surely survive, but under growing competitive

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<sup>4</sup> Based on DAI-FINNET database, which excludes an unspecified number of very small informal cooperatives, rotating credit associations, money lenders and other informal credit schemes.

pressure, which will induce, among other consequences, better efficiency, reduced lending costs and improved services to micro and small enterprises.

### About SOGEBANK

Created in April 1986 through the acquisition of the Royal Bank of Canada's Haitian operation by a group of Haitian businessmen, SOGEBANK quickly grew to become Haiti's largest commercial bank with 30 branches, US\$310 millions in total assets and 29% market share of the banking system, compared with the two branches, US\$60 millions assets and 17% market share that were bought from RBC. Besides the commercial bank, SOGEBANK created six for-profit affiliates involved in mortgage banking, the credit card business, consumer credit, real estate development, microcredit and remittances, and its philanthropic entity, *Fondation SOGEBANK*.

SOGEBANK introduced many technological innovations into Haiti's banking system, including credit cards and ATM services. It enjoys a strong image as market leader in terms of competence, service, technology and financial performance, with 17 years of uninterrupted growth and profits (20% average ROE). SOGEBANK's corporate culture is a mixture of dynamism and commercial bankers' traditional prudence. Its clientele is very diversified with a dominant presence of small, individual passbook holders, representing 40% of our deposits in value. We estimate that 40% of those are self-employed individuals running microenterprises, which created our first motivation to enter the microfinance market as a way to boost client satisfaction and loyalty.

### Why SOGESOL?

As Haiti's largest commercial bank with about a thirty percent share of the country's small savers, a national, modern, inter-connected branch network, capacity to handle high transaction volume on-line, proven management capacity and solid internal controls, SOGEBANK was a logical candidate to take advantage of banking liberalization and the opening of the microfinance market. The elimination of the interest rate ceiling in 1995 offered the first and most important incentive to that effect, since small and micro credits impose high transaction costs requiring a high interest rate to be viable. The 1996 reduction in legal reserves, freeing the equivalent of US\$70 million for lending in the banking system, constituted a second powerful incentive to enter the field.

Third, the demonstration effect from successful commercial institutions, such as Bancosol and Caja Los Andes in Bolivia or Bank Rakyat Indonesia, created the sense that, with good technical assistance, microfinance could be highly profitable, especially considering the large size of Haiti's informal economy.

Fourth, the failure to offer credit to its microenterprise clients could pose a serious risk to SOGEBANK of losing some to more agile competitors, threatening our main customer base. As a final side benefit, a large microcredit operation was bound to strengthen SOGEBANK's well-established reputation as a community leader and socially responsible actor, a precious part of our banking franchise.

### How did we choose to deliver microfinance services?

#### *The Organization Model*

At the start, SOGEBANK chose to create an independent subsidiary with its own Board and Management, for the following reasons:

- Staff motivation was likely to be stimulated by the commercial drive, sense of purpose and accountability that a separate affiliate provides, as demonstrated by the performance of SOGEBANK's other subsidiaries.
- The strong cultural differences between traditional commercial banking and microfinance could be better managed if an independent subsidiary were created; distinct management tools could be developed, such as aggressive incentive schemes.
- There was a need to attract separate shareholders, including technical and financial partners.

SOGESOL is thus owned by SOGEBANK (35%), ACCION (19.5%), PROFUND (20.5%), and a group of local shareholders (25%). Its main originality resides in its organizational model, designed to capitalize both on the above-mentioned strengths of a subsidiary and on the obvious synergies with the commercial bank, its mother company. The main features of this organizational model are as follows:

- SOGESOL is a service company, in charge of originating and managing a loan portfolio booked by SOGEBANK, for which SOGESOL uses its own staff, operating in separate rented branches located near those of SOGEBANK, and a loan management software that is more adapted to microfinance's high reliance on management information, but electronically connected with SOGEBANK's own bank software.
- SOGEBANK provides disbursement and repayment services through its own branches, and these are automatically transmitted every day to SOGESOL's software.
- SOGEBANK also provides support services in infrastructure, technology, personnel administration, legal, marketing, treasury and audit, allowing SOGESOL to focus on its own business.
- As a service company, SOGESOL does not need its own bank license, avoiding the heavy workload associated with regulatory reporting, which remains SOGEBANK's duty, as well as the official responsibility for loan risk.
- However, under the SOGEBANK-SOGESOL service agreement, SOGESOL is paid a variable fee fully reflecting all benefits, costs and risks accruing to the managed portfolio, including loan loss expense, market cost of funds, support service contractual commission and an ad valorem transaction fee. Accordingly, SOGESOL is compensated exactly as a regulated financial institution without the associated hurdles.
- Under similar arrangements, SOGESOL will also be able to offer a great variety of savings, lending and payment products to its clients, under its own label but using SOGEBANK's various capacities as well as those of its affiliates, including credit and debit cards, ATM and remittance-related services; indeed, SOGESOL recently started opening saving accounts for its clients;
- Loan approval and management is fully decentralized, under uniform guidelines, at the branch level.

This model clearly provides for commercial agility and fast growth, as already demonstrated by SOGESOL's performance during its first two years, as shown later.

#### *Mission and Market Positioning*

In line with the above business rationale, organizational model, and institutional capacities, SOGESOL gave itself the mission to “promote Haitian entrepreneurship by adapting the traditional ways of banking to respond to the need of microentrepreneurs and focus on client satisfaction while always aiming to achieve the levels of efficiency and profitability required to ensure the continuity of its services.”

The market we target is existing micro and very small enterprises with credit needs ranging from the equivalent of US\$100 to US\$10,000, engaged mostly in retail trade and other urban services, both in Haiti’s capital and its major provincial cities. SOGESOL is also considering extension to rural areas in the future, initially using wholesale lending to existing providers.

SOGESOL’s basic product is a short-term working capital loan. Fixed asset loans have recently been introduced on a pilot basis in two branches. The long-term goal is to cover a full range of business and personal needs, including fixed asset and housing improvements, lines of credit, credit and debit cards, life and health insurance, all tailored to client’s debt repayment capacity.

### *Methodology*

Based on client needs and market trends, SOGESOL chose to initially provide direct individual loans to established enterprises. The credit is extended to the microenterprise owner who must be at least 21 years old, have been in its current location for at least a year, be absent from a delinquent list communicated by “FINNET,” a DAI-managed independent network of credit providers, and have a stable business with good repayment capacity. Although business cash flow is the primary source of repayment, credit officers base their analysis on family surplus. Loans are character-based but usually backed by personal items and business assets, including inventory, co-signors and/or guarantors. SOGESOL uses the step lending method, designed to reduce risks by getting acquainted with clients and imposing repayment discipline before eventually reaching full debt capacity.

The loan process includes regular information sessions to which prospective clients attend and eventually register for a loan or drop-out, either voluntarily or because of ineligibility. Clients are soon after visited by the area loan officer, both at their business and residence to evaluate their cash flow, family surplus and guarantees. Loan evaluations are discussed at daily loan committee meetings headed by branch managers or senior credit officers and are usually approved within 5 working days for new credits and 1-2 days for renewals, assuming that all requests are fulfilled by prospective clients.

### *Board, Management and Staff*

SOGESOL is governed by a five member Board, including representatives from SOGEBANK, ACCION, Profund and local shareholders. Board membership has been profiled to provide complementarity of competencies and experiences, including hands-on business, economics and technology knowledge. The Board formally meets every month to discuss commercial and financial performance as well as major policy decisions. The Chairman, however, heads weekly management meetings to get a close view of progress in all areas, to support management and to provide for quick decision-making when appropriate.

Day-to-day management is assumed by a team of three experienced professionals (two of them coming from SOGEBANK) including the General Manager, the Commercial Manager in charge of supervising branch and collection management, and the Operation and Finance Manager who also oversees monitoring and internal control. Management receives fixed salaries as well as quarterly and annual performance bonuses. Internal audit services are provided by SOGEBANK’s Audit Department and reported directly to SOGESOL’s Board. SOGESOL’s accounts are also externally audited (last year by KPMG’s local partner).

Credit and operation officers are young professionals with minimal post-secondary education, specially trained by SOGESOL, which is usually their first employer. Most officers and support personnel are paid a combination of fixed salaries and performance incentives linked with a set of indicators, which include, for loan officers, number of clients, growth and portfolio size and quality. Officers start by being closely supervised and move to autonomous status and senior officer level, each associated with improved compensation and status.

Branch Managers are either experienced loan officers or directly hired, and judged able to handle people management challenges as they are mostly asked to provide leadership and guidance to their team. Their compensation is also heavily performance-based and will soon include a percentage of branch profit on direct controllable costs.

#### *Expected Productivity and Efficiency level*

With its decentralized and fully motivated organization enjoying full access to loanable resources and support services, SOGESOL expects fast growth in productivity from its staff, with 250 loans per officer with three years experience and 300 loans after five years. Combining this with its rather lean structure and low branching costs, SOGESOL should bring operating efficiency to about 35% by the end of its third year and 20% the year after.

#### Technical Assistance and Partnerships

The need for proper expertise and transfer of know-how was clearly perceived from the outset as a key success factor in such a complex and specialized business. The first organization to be approached to that effect was the Inter-American Development Bank (IDB), in March 1998. IDB was extremely useful in guiding our efforts and first introduced us to Profund International – AfriCap’s Latin American ancestor – as a source of seed capital and knowledge of the sector. Alex Silva, Profund’s General Manager, was one of the key supports in guiding our search for technical assistance and project development. Profund became one of SOGESOL’s founding shareholders and holds a seat on the Board. Under our shareholders’ agreement, Profund also holds an option to sell its shares to SOGEBANK at a price based on a specified multiple of book value after five years.

In March 1999, IDB signed a technical assistance agreement associated with a US\$300,000 grant to help SOGEBANK cover its business planning and early technical assistance needs. Following this agreement, a business planning contract was awarded to BANNOCK-DAI and a final product was submitted to SOGEBANK in January 2000. A second technical assistance contract was signed in February 2000 with ACCION International to assist SOGEBANK in launching its new affiliate for an eighteen-month period ending on June 30, 2001. It covered the elaboration of procedural manuals, initial staff hiring and training, and assistance in implementing and monitoring the first two branches. ACCION also chose to invest in SOGESOL through its “Gateway Fund,” which also signed the initial shareholders agreement and is entitled to the same privileges as Profund, including a seat on the Board and the option to sell its shares to SOGEBANK.

ACCION’s technical assistance has been extended twice, through grants obtained from private donors and matched by SOGESOL, and currently expires in July 2003. Under these extensions, ACCION is helping SOGESOL consolidate its internal organization to face the challenges of fast growth and competition, and introduce several new products including fixed asset and housing improvement loans, as well as lines of credit. ACCION will also help SOGESOL conduct a client satisfaction survey during the course of next year.

Our partnership with ACCION and PROFUND, together with IDB’s early involvement, constituted crucial ingredients for SOGESOL’s success, both as a source of permanent knowledge transfer and as a contributor to professional governance at the Board level, further boosting investors’ confidence.

### Performance to Date and Future Goals

SOGESOL started its commercial operation by mid-July 2000 and disbursed its first loan on August 9<sup>th</sup> of the same year. Two years later, SOGESOL has already served more than 9,000 clients, disbursed 25,000 loans totaling some US\$10 million and has 6,500 active clients served in six branches with a portfolio of US\$3 million, only 3.2% of which is at risk more than 30 days. Arrears of one day or more are at a very reasonable 6% and overall productivity of the oldest branch is at 215 clients per credit officer.

As already mentioned, SOGESOL reached breakeven on a full cost basis in August 2002 and is expected to generate over 30% return on shareholders' equity for its third fiscal year in 2002-03, and to be then present in four provincial cities. As of now, five of our six existing branches are generating revenues higher than their variable and direct fixed costs and three are comfortably covering their allocated headquarters costs.

Within its first five years of existence, SOGESOL expects to serve 20-25,000 clients through 13 branches nationwide, with an active portfolio of US\$20 million and a return on assets of 5%.

### SOGESOL's Future Challenges

Based on its organizational model and market trends, SOGESOL has to prepare itself to face four main challenges:

- Dependency on SOGEBANK, enhanced by the risk of internal rivalry and competition for common services;
- Risk of staff turnover or work disputes, which would lower productivity, efficiency, portfolio quality and profitability;
- Growing competition, likely to result in more demanding clients, possible client desertion and overindebtedness, resulting in reduced margins and lower portfolio quality;
- Risk of adverse regulations.

On the first point, the bank's current leadership of the subsidiary's Board of Directors through a member of its executive committee is a crucial condition. It is also vital to document all relations between the two entities in clear contractual arrangements.

On the second challenge, SOGESOL heavily relies on staff motivation and stability to reach its commercial and financial goals. Departures or work disputes can be very detrimental to portfolio quality and productivity. Measures are being taken to mitigate these risks, such as better independent knowledge of clients by a control department and fast-track training to allow for quick staff replacement. Nevertheless, the negative impact of staff turnover cannot be entirely eliminated and the main solutions for minimizing it are to offer positive reinforcement, good leadership, and proper incentives and compensation packages.

On the third challenge, SOGESOL is already preparing for enhanced competition by capitalizing on its competitive strengths and providing clients with a truly unique product offering that encourages their loyalty and proper behavior. This will not, however, prevent good clients from shopping around and overindebting themselves. One of the best ways to face this is to build solid a credit bureau and regulatory framework. SOGESOL plans to closely cooperate with authorities, with help from international actors such as the IDB, ACCION or USAID to help this happen in the near future.

Such cooperation could also prevent or mitigate the fourth risk, i.e. adverse regulations such as unrealistic credit rules or a return to financial repression. On this point, however, SOGESOL and its competitors' very success in reaching out to hundreds of thousands of Haitian microenterprises and helping them significantly improve their lives may be the best recipe for encouraging authorities to build proper a regulatory framework and credit information systems, helping the industry to consolidate and continue to succeed in its endeavor.

## **Indirect Avenues**

Thus far, this chapter has explored the institutional avenues through which microfinance service providers can directly access capital markets. Seminar discussions focused on these avenues because they are the only routes through which institutions can freely access both debt and equity instruments without having to work through a third party. They are not, however, the only ways for the microfinance industry to access commercial capital.

A large number of microfinance service providers are not in a position to directly access capital markets, perhaps because of their legal status or their stage of development, though it is possible for many of them to access capital markets indirectly or partially. Such retailing institutions can hook up with wholesale financial institutions and form strong and productive relationships that, in the words of David Stanton, "can be of long-term benefit to the banks as well as to the non-bank financial institutions."

As seen earlier, commercial banks can get involved in the microfinance market by directly providing microfinance services or by creating a subsidiary to provide those services, but they can also invest – through commercial lending or equity participation – in other institutions that provide microfinance services. We've already heard about the Financial Bank Group's investment in FINADEV, but additional examples of commercial bank involvement were cited throughout the course of the seminar. Triodos Bank, for instance, has invested in twelve institutions in seven different countries. Frank Streppel explained how his bank got involved in the industry:

"Triodos Bank is a commercial bank in Holland created in 1982, basically with the vision that finance is a very powerful tool for development. The needs in Holland are different, of course, from the needs of most developing countries; our focus is different. Whereas microfinance worldwide came more from poverty alleviation ideas, Triodos focuses on environmentally friendly investments. We only want to finance companies that somehow contribute to society. It can be environmental, like renewable energies – solar energy, wind energy – but also social and cultural related activities. It's the developmental approach and developmental power that money has. At the same time, it's also a way of positioning yourself as a financial institution. And doing that, trying to balance the developmental aspects and the commercial aspects of an institution, you find yourself constantly balancing the two. This is the same type of tension that we also see in microfinance. As a sort of natural result, we got involved in the microfinance industry and, well, that resulted in the creation of an international fund management department where we are managing three investment funds at the moment that are created to invest both commercial loan facilities and equity participation in the microfinance industry."

According to James Mwangi, a number of banks are lending directly to microfinance institutions in Kenya, even foreign banks such as Standard Chartered and Barclays. Pierre-Marie Boisson noted that Sogebank targeted the microfinance market in Haiti not only by creating a microfinance institution, but also through wholesale lending. It has been providing direct funding to cooperatives "for a simple reason, which is not charity, which is simply that our model cannot be implemented where we have no banking network. Our banking network is mainly in town, and to touch or to reach clients in areas

where the bank does not have a presence, we need to have an operator. We are ready to fund institutions that can [play that role for us].”

Mwangi referred to the Cooperative Bank of Kenya as a particularly interesting case, “which has decided to work with all of the credit unions in the country and literally make them agents of the bank. They are even able to issue banker’s checks. That has been visible in Kenya and I think it’s just a question of time before we see the linkage fully developed.”

Given the success of some cooperative institutions, Henri Oketch of INAFI, Kenya, questioned why institutions like the Cooperative Bank of Kenya and the FCPB of Burkina Faso (a credit union network in Burkina Faso with nearly 300,000 clients) were not being looked at by equity funds such as AfriCap. Stefan Harpe, speaking on behalf of AfriCap, responded that the problem was one of ownership structure. “We are open to a diversity of institutional models, not just banks and non-banks. We would like to work with cooperatives, but of course, it’s very hard to buy twenty percent of a cooperative. In reality we can only invest in a company which has share capital.” Alex Silva, moderator for the discussion in process, challenged the audience, “what kind of mechanisms could be established, if not it’s actually impossible, for an equity fund to take an equity participation in institutions that by definition have no equity, for example, in NGOs?”

Some seminar participants cited difficulties in being able to establish a wholesale-retail relationship of any kind. They raised the possibility of development partners introducing guarantees to help markets initially develop. Mamadou Lamine Sylla, from the CBAO in Senegal, mentioned the example of a USAID financed guarantee fund that is stimulating the first contact between non-bank financial institutions and the commercial banking system in Senegal. He suggested that funds such as this one improve the relationship between commercial banks and microfinance institutions and provide a good opportunity for particular banks to move down market.

Panelists did not disagree with Sylla, but they observed that the examples of successful guarantee funds are few. David Stanton summarized one exchange by explaining, “Too often they give too much and don’t provide the right incentives for banks to take risk. The banks very often take no risks. They take the guarantees and therefore don’t have the incentives to commit themselves to the market and to remain in the market after the guarantees are withdrawn.”

Pierre-Marie Boisson added, “The sector of non-banking microfinance has been used to being subsidized, so institutions are a bit reluctant to receive funding from banks. The lending rates are considered to be very high by populations and by NGOs themselves. We have to understand that in this situation the traditional donors play an interesting role because they really prevent the banks from working for the microenterprises.”

Hany Assad acknowledged, “There are examples in Latin America where there has been a guarantee fund that was put together for microfinance institutions. The fundamental issue is that MFIs are not used to paying commercial terms for those guarantees and banks are not willing to provide financing below their funding costs. Ultimately, as I think Patrick Lelong and Frank Streppel have mentioned, it’s an issue of the differences between the culture of an MFI and the culture of a bank. We need to think through this. This is not something we’re going to be able to answer to today, but it is a major divide.”

Stanton concluded, “My understanding from some of the comments is that we are at a relatively low level of exposure between banks and microfinance institutions [in Africa] and that maybe in five or ten years time that will quickly change. I think a typical characteristic of this phase of early market development is an assumption that a guarantee fund is what is needed in the long-term to develop a relationship between banks and MFIs. Indeed, it may be a mechanism to build the beginning of a relationship, but if you look at the most successful MFIs, they do not depend on a guarantee because a commercial and profitable relationship develops between themselves and the banks and the guarantee

is no longer necessary. I think that as the banking sector becomes more interested in going down-market, and there is a recognition that microfinance can be profitable if it is brokered through NGOs or cooperative institutions and if costs can be reduced, then in the long term, this is good banking and it's profitable banking without the recourse to a guarantee. I think, generally speaking, that guarantees rarely work in terms of building long-term relationships between MFIs and capital markets."

Guarantees may, then, have their place in the forging of linkages between different kinds of financial service providers, but like most indirect avenues for accessing capital markets, they are limited in the degree to which they can facilitate access. Even the direct avenues that were explored at the beginning of this chapter can be challenging for microfinance institutions because of both the real and perceived risks of investing in the microfinance industry, the scarcity of technical expertise in certain areas, cultural differences between different kinds of financial institutions, etc. There is still a great deal that can be done to facilitate the microfinance industry's access to capital markets, regardless of the avenue that individual institutions choose to take. This theme will be the focus of the next two chapters.

## Chapter 3: Developing Access to Capital Markets

“Banks have the incentive to tap new markets, but they lack strategies and skills to tackle the impediments associated with small and microenterprises.

~ Hany Assad, IFC

“We have to be extremely careful how donor money is used in order to encourage markets and to build markets but not to distort them.”

~ David Stanton, DFID

“New regulations will not automatically generate profitable well-managed financial institutions, but evidence from countries which have developed an appropriate regulatory regime for microfinance activities, such as Uganda and Cameroon, and further afield Bolivia, demonstrates that this effort invariably attracts private investment capital and an expansion of the commercial microfinance sector.”

~ AfriCap 2002 AnnualReport, page 8



Although various avenues exist through which the microfinance industry can access capital markets, there are still significant constraints that prevent microfinance service providers from operating freely within those markets. Indeed, the process of integrating microfinance into the rest of the financial system has only just begun in most countries.

The microfinance sector is in transition, from a group of primarily donor funded microcredit projects to a very diverse array of microfinance institutions with differing levels of organizational and financial maturity. The evolution of these institutions into a viable industry is an important precondition for the development of microfinance capital markets, yet it is also somewhat dependent on the development of those markets. While this may appear to be a dilemma, many of the same factors and forces that support industry development also support capital market development, so actions can be taken to move both processes forward simultaneously. The challenge is to identify how this can be done as quickly and responsibly as possible.

Chapter two provided some thoughts on this issue from the perspective of microfinance institutions, but what about the role of other stakeholders in the microfinance industry? What can governments, donors and specialized equity funds do to help legitimize the microfinance industry and to increase its access to commercial capital? What can they do to increase not only the number of institutions that can obtain access to capital markets, but also the quality and depth of the access obtained?

Seminar participants approached these questions from a variety of different angles, but they arrived at many of the same conclusions. Clearly, strong industry collaboration is needed to educate investors, donors, governments and regulators about the current needs and growth potential of the microfinance sector. Once these stakeholders gain a better understanding of existing limitations and opportunities, there is much they can do to improve the sector's credibility and to strengthen its ability to attract commercial capital.

One of the most important initiatives these stakeholders can take is to collaborate in the creation of appropriate regulatory frameworks. Each framework must be capable of evolving together with the microfinance sector that it regulates and will need to offer some mechanism for allowing commercial investors to enter the microfinance market. Without these two attributes in particular, no framework will be able to support a microfinance sector's access to capital markets.

Stakeholders can also collaborate (or work independently) to facilitate the creation of credit bureaus, help negotiate MFI access to a wider range of financing mechanisms, provide training to MFI staff and operators, or facilitate information exchange among MFIs in a particular region or in Africa generally. They can encourage transparency on the part of microfinance institutions, and the setting of and adherence to performance and reporting standards. They can also encourage, and possibly fund, MFI access to rating facilities, both to ensure healthy management and to demonstrate the value of external capacity evaluations. Governments can take action to ensure that the microfinance sector in their country or region is overseen by a relevant ministry, such as the Ministry of Finance; and donors can take steps to better coordinate their activities so that they support the development of the industry as a whole, and avoid the market distortion and unfair competition that has been known to discourage private investment in the past.

These are only some of the more common conclusions and suggestions generated during the seminar. Undoubtedly, there is much that these stakeholders can do and many opinions about how to do it and who should play what role. Such issues are explored in this chapter, first from the perspective of public sector, then from the perspective of donors, and finally, from the perspective of private investors.

## **The Role of the Public Sector**

With all the emphasis on private capital, private markets and the linking of banks to private institutions, the role of the public sector in facilitating the microfinance industry's access to capital markets may seem inconsequential. On the contrary, it is critical.

Microfinance institutions operate in an environment that is heavily influenced by public policy, particularly at the national and regional levels. A country's microfinance industry is affected by the legal and regulatory policies that govern the financial sector, by fiscal policies that influence the investment climate, and by economic policies that affect interest rates, inflation and commerce, among other things. An industry can be hampered, for example, by interest rate ceilings or a lack of macroeconomic stability, but it can be supported by clear Central Bank regulations and by a legal framework that allows a variety of different financial structures to emerge. This last point was mentioned by seminar participants as particularly relevant for Africa. As Beth Rhyne commented:

“The systems in some places are really focused on building a framework that is suitable for cooperatives, while other systems are building a framework that is suitable for shareholder-owned structures. East Africa tends to focus more on the shareholder-owned structures while francophone West Africa focuses more on the cooperative structures. What has happened is that one or the other of the structures has come to dominate the thinking and the regulations that govern the sector. But in fact, I think what we are seeing is that both models, both shareholder-owned and cooperatively-owned models are very important for the development of microfinance. So, the ideal regulatory structure is a structure that allows both of them to develop. It's quite unfortunate that a lot of the discussion in Africa has assumed that you have to be in favor of one and not in favor of the other. But in fact, in places where you see them operating side by side, and where each side is supported by a good regulatory structure, each type of institution finds its own market niche and both models flourish.”

For the public sector in Africa, the challenge is not simply to create an environment that allows microfinance institutions to function. Rather, the challenge is to create an environment in which MFIs and their clients can succeed, because it is this success that will fuel economic growth in the years to come.

To meet the diverse financial needs of their populations, can governments make it possible for a variety of financial service providers to emerge, to grow, and to operate prudently at the same time? Can they create the policies and institutions that are needed to enhance the viability of small and

microenterprises, for example, property registries, contract and collateral enforcement, and simplified processes for licenses, customs and taxation that eliminate corruption? Can they incorporate financial system development, including microfinance, into their larger development strategies?

David Stanton notes, “There is evidence that governments are in fact responding quite well to this challenge. If one looks at the series of poverty reduction strategy papers developed by many sub-Saharan African governments over the last few years, one can see that financial systems and microfinance are fairly well represented in those plans.”

Still, there is a long way to go. This document is not an appropriate forum for discussing the details of what an enabling environment should look like or what specific governments need to do. A great deal has already been written on the theme and much is still being done to address challenges in this area. However, to illustrate some of the issues that governments at various levels are trying to deal with, as well as some of the actions they have already taken to facilitate the integration of microfinance into their financial systems, three case studies are presented in this section. The first is from the Government of Senegal, the second is from the Central African Economic and Monetary Community (CEMAC), and the third is from the West African Monetary Union (UMOA).

### ***The Case of Senegal***

*Presented by Marie Seck Seye, Technical Adviser, Ministry of Female Entrepreneurship and Microcredit, Government of Senegal*

The 1980s in Senegal were marked by restructurings in the public and private sectors – notably in the banking sector; by considerable unemployment; and by the development of the informal sector or subsistence economy. Indeed, given the massive decrease in hiring in both the public and private sectors, people resorted to activities of survival and the creation of small and microenterprises. This new economic reality naturally generated new financial needs. However, the level of poverty of these economic actors excluded them from the financing offered by traditional banks.

Since the liberalization of banking conditions, which occurred at the same time as the financial sector restructuring, two types of financial institutions have coexisted in Senegal and in the majority of countries in Sub-Saharan Africa: 1) traditional banks (commercial banks and development banks); and 2) cooperative financial institutions. These cooperative structures are recognized by the regulatory and monetary authorities of the West African Economic and Monetary Union (UEMOA), and are governed in Senegal by Law 95-03, which was signed on January 5, 1995. Among these organizations, there are 260 savings and credit associations, 384 recognized savings and loan groups, and 8 signatories of the convention framework.

The integration of cooperative structures into the system of financial intermediation is essential in the context of the fight against poverty, which is based on the generation of income by disadvantaged populations. Some of the institutional characteristics that make Senegalese MFIs suited to this task include:

- The ability to develop financial services that are adapted to the needs of those excluded from the traditional banking system (flexible credit terms with respect to collateral and solidarity group guarantees);
- The strong involvement of clients, in the majority of cases, in the management of the institutions of which they are simultaneously owners and users;
- The proximity of the institutions among their target population;
- The ability to mobilize savings among the disadvantaged classes: deposits rose from 9.85 billion CFA francs in 1998 to 18.46 billion CFA francs in 2000, which represents an increase of approximately 98% over the period;

- The positive evolution of the institutions in terms of their outreach. The number of service outlets rose from 233 in 1998 to 324 in 2000, an increase of approximately 39%, and had risen further, to 652, by the end of 2002. The rate of penetration has grown from 14.4% in 1998 to 18.6% in 2000. This reflects the dynamism of the sector and its impact on the population in terms of the local supply of financial services.
- A positive trend in terms of the volume of loans disbursed: from 11.4 billion FCFA in 1998 to 20.3 billion in 2000, that is to say a rise of 78%.
- A contribution of 774 new jobs created in 1999 and 793 in 2000.
- The willingness of the government to advance the sector through its linkage to the modern economy, in particular to the financial market.

Originally, these institutions were charged with promoting the development of disadvantaged groups, particularly in rural areas. The sector benefited from public sector support through financing from development partners and from certain Ministries, such as agriculture and rural development. Social funds are still available through integration and anti-poverty programs, which can support the sector through the provision of lines of credit.

It is important to point out, however, that after several years of operation, the sector is starting to show signs of dysfunction that must be taken into account if one wants to make the sector a lever of sustainable development. A certain number of constraints have been identified:

- The ban against lending more than two times the savings collected;
- The strong concentration of activities in zones where there are problems of competition and adversity;
- The absence of qualified personnel;
- Insufficient mechanisms of internal control and audit;
- Ineffective savings mobilization policies;
- A lack of professionalism within the sector;
- The predominance of short-term loans;
- The lack of resources given client needs;
- The declining trend in the availability of external resources (i.e. credit lines, subsidies, grants); their contribution to total resources was 14% in 1998 and 11% in 2000;
- Problems with refinancing.

This is why, at a forum organized by the Ministry of Female Entrepreneurship and Micro Credit in March of this year, the Head of State recalled that the creation of this ministry, unique in Africa and the world, is based on the importance of a local and decentralized government; and the need to support the growth in decentralized financial mechanisms so that microfinance can become a financing instrument for the entrepreneur. Such a vision must be implemented through the development of the private sector, particularly, in a developing country like Senegal, small and microenterprises (SMEs).

One of the objectives of our private sector development strategy is the strengthening of decentralized financial structures through the introduction of incentives by the authorities. Indeed, SMEs are often confronted with problems of access to the traditional banking system, while decentralized financial structures, since they have only short-term resources, find it difficult to finance investments that require long-term loans.

Faced with this dilemma, the State set the objective of developing a National Development Strategy for the Microfinance Sector. This process, which will include the development of sectoral policies, will provide the foundation for the development of a microfinance sector that can contribute significantly to growth and the reduction of poverty.

The creation of a Ministry with responsibility for microcredit is a strong signal. It marks, on the one hand, willingness by authorities to promote the development of the sector and, on the other hand, recognition of the sector's maturity and its passage to the financing of income generating and value added activities. This means that in the future microfinance should take a more commercial approach.

Within the area of microcredit, the Ministry of Female Entrepreneurship and Microcredit has as its mission:

- the training of target populations;
- the promotion and development of microcredit;
- the introduction and the management of funds for refinancing which benefit the decentralized financial structures and female entrepreneurship;
- the implementation and the management of lines of credit intended for the decentralized financial system and for women;
- the signing of partnership agreements with the institutions involved in the monitoring of microfinance;
- the preparation of project reports in pursuit of lines of credit from development partners for microcredit;
- the creation of conditions that support the participation of banking institutions in a policy of microcredit development.

Through a strategy and associated plan of action, the Ministry of Female Entrepreneurship and Microcredit will develop policies and programs aimed at making the sector more professional and more attractive to private capital. In implementing its objectives, the Ministry has a clear vision that it wants to share with everyone involved, namely: "to make microfinance an effective tool for mobilizing internal resources in order to contribute services and products that are appropriate for the financing of the economy."

Since a good understanding of the problem is essential for the definition of clear and well-targeted strategies, the State must lay out the stakes and the challenges which need to be faced and identify the actions to be carried out.

The stakes are of two types. First, for decentralized financial structures, there is the viability and the sustainability of their units, and the innovation and adoption of new financial products and services. Second, there is the linking of microfinance to regional and African financial markets. On the basis of these stakes, the challenges have been identified as follows: 1) the professionalization of the sector; 2) the creation of synergies among decentralized financial institutions and between them and the capital markets; and 3) the strengthening of monitoring and evaluation in the sector.

The choice of topic for the March seminar, "Female Entrepreneurship and Microfinance: Stakes and Prospects within NEPAD," indicates authorities' awareness with respect to the role that microfinance plays in the achievement of the objectives of the New Partnership for African Development (NEPAD). Since one of its guiding principles is the development of the private sector, NEPAD focuses among other objectives on:

- promoting the role of women in socioeconomic development by facilitating gainful employment through easier access to credit;

- supporting microenterprises of the informal sector and the small and medium enterprises of the formal sector;
- compelling the authorities to remove obstacles which hinder the entrepreneurial spirit of African economic actors;
- improving the mechanisms of credit and financing;
- improving small and microentrepreneurs' access to capital by consolidating the microfinance programs;
- supporting the implementation of appropriate regulations for the promotion of small and medium enterprises, microenterprises and microfinance institutions.

In achieving these objectives, it is assumed that questions related to professionalization and refinancing will be taken into account, since these are critical problems for the sector today. Some actions that have been identified include:

- Facilitating the modification of regulations currently in force to better satisfy the expectations of various actors in the sector, and to allow an easing of operating conditions, which should generate more involvement by private operators in search of profits, thus increasing the financial possibilities of the decentralized financial structures.
- Encouraging decentralized financial structures to organize themselves as a network, perhaps inducing them to set themselves up as a bank to facilitate their access to capital markets;
- Strengthening the technical and professional capabilities of MFIs:
  - By creating a training/information center that will facilitate human resource development and increase access to financial information relating to capital markets. In this way, decentralized financial structures can acquire a strong culture of entrepreneurship, experienced management teams and effective management systems.
  - By supporting the implementation of a rating system to evaluate the capacity of decentralized financial structures and to ensure their healthy management, which is a requirement for commercial viability.
  - By creating a credit bureau for the purposes of preventing the overindebtedness of clients and the growth of delinquency rates that could call into question the financial sustainability of microfinance institutions.
- Facilitating capital market access for decentralized financial structures by reinforcing their financial capacities through:
  - the introduction of refinancing funds
  - support in their search for additional resources that can finance medium and long term needs,
  - support in accessing information about the national and international capital markets
- Ensuring a better regional integration of microfinance structures
- Motivating the development of applied research that favors impact studies, notably, the impact of linkages between SFD and traditional banks.
- Supporting the process of reinvigorating the framework of dialogue among decentralized financial structures;
- Coordinating and rationalizing the interventions of donors, decentralized financial structures, and beneficiaries.

The support of the government and donors remains insufficient and even very limited to meet the needs of decentralized financial institutions. Since financial self-sufficiency requires sustained and lasting growth, MFIs will have to seek new capital, which means they will have to access commercial resources.

Towards this end, several options can be explored:

- Debt financing, in the form of guarantee funds, loans and the mobilization of the deposits;
- Shares (capital offerings by MFIs);
- Investment funds (equity and quasi-equity participation in the MFIs);
- Social investment funds;
- Securitizations (debt issues); and
- The mobilization of resources by collecting, through the MFIs, the cash surplus in the region and the continent more generally.

However, considering the financial risk that comes with each one of these modes of financing, the credibility of MFIs constitutes, in the eyes of investors, a determining factor for their access to the capital market. This compels MFIs to meet the following preconditions:

- To have a clear statute and a regulation adapted to this activity type;
- to conform to prudential standards followed by the capital enterprises companies to the capital held by shareholders;
- To take care of the prevalence of financial return over non-financial considerations;
- To found an effective control/oversight guaranteed by a Board of Directors;
- To establish clear evaluation criteria.

### ***The Case of the West African Monetary Union (UMOA)***

Presented by Eric Amah Ekue, Director, Decentralized Financial Systems, BCEAO, Senegal

What is microfinance in West Africa? Our definition is a group of institutions that are trying to respond to a demand for credit that is not being satisfied by the banks. It is a group of operators that is trying to offer their financial service to populations that are generally excluded from the classical banking systems. Microfinance is not for us a passing fashion. Within our West African sub-region, the oldest institutions have been in operation for more than 36 years. They got started at the beginning of the sixties, notably in countries like the Ivory Coast, Togo, Burkina Faso and also Benin, and then, about fifteen years later, in countries like Mali and Senegal.

The sector encompasses a wide variety of actors, the most common of which are savings and loan institutions, mostly in the form of cooperatives or credit unions. The other categories of institution are credit-only facilities and projects with a loan component. As Mr. Lelong described earlier, we have also very recently seen the appearance of new private structures in the form of a limited company.

Overall, the sector is expanding, but the performance of the actors varies. At the end of December 2002:

- more than 500 institutions were providing more than 3,000 points of service in both urban and rural areas;
- approximately 5 million of the 75 million people that make up UMOA had access to the services offered by these institutions;

- deposits totaled 173 billion CFA francs, compared to 12 billion in 1993;
- there were 159 billion CFA francs in loans outstanding, compared to 17 billion in 1993 (when specific microfinance legislation was put into place);
- there was a high level of savings (the sector provides surplus resources to the banking system; the amount of those deposits rose to 49.4 billion CFA francs in the year 2000 and is estimated at 14 billion for 2002);
- the level of capitalization at the end of December 2000 was 23.1 billion CFA francs;
- 6,290 jobs were directly created in the year 2000; more than 7,800 were created in 2001.

The sharp expansion of the sector was accompanied by dysfunctions that are likely to weaken the recorded results. These include, in particular, the misappropriation of funds and the deterioration of portfolio quality within the main institutions working in the region, which resulted from the failure of internal audit mechanisms and insufficient management information systems. All this brought us to the current phase of thinking about consolidating the growth because although it is very strong and responds seriously to the needs of the population, it cannot survive if a certain number of adjustments are not made.

These adjustments are the focus a new program of support to the sector that is being considered at the regional level. I won't go into detail here, but among its principle objectives are the improvement of the legal and regulatory framework, the operational strengthening of institutions working in the sector, and better information about the sector, both in terms of the data collected and in terms of the utilization of that data. One of the sector's major problems is the absence of studies – to be able to know what it is that is really happening, to be able to take good decisions, and to take measures in anticipation of risk. This particular aspect is not often taken up.

As far as the response of the monetary authorities is concerned, the West African Monetary Union (UMOA) has been around since 1962 and brings together eight West African countries: Benin, Burkina, Ivory Coast, Mali, Niger, Senegal, Togo and Guinea Bissau. Together, they constitute a monetary region that encompasses an area of 3.5 million square kilometers and a population of nearly 75 million inhabitants. UMOA is characterized in particular by the existence of a Central Bank that is common to all member states – the Banque Centrale des Etats de l'Afrique de l'Ouest (BCEAO). The BCEAO emits a convertible common currency, the CFA franc, which is legal tender in all states of the union. The convertibility of the currency is assured by the complete centralization of foreign exchange reserves through a cooperation agreement signed with an external partner, the French Treasury.

UMOA was coupled in 1994 with an economic union through the creation of UEMOA (the Economic and Monetary Union of West Africa). UEMOA concentrates, among other objectives, on reinforcing the integration of the economies of the Member States through the establishment of an economic and customs union within which raw materials and labor can circulate freely. The zone is characterized by a convergence of economic policies and performance as well as by the management of common development policies.

There are several advantages of regional integration for the microfinance industry. First, there is exchange rate stability, which is a result of the fixed parity set with the French franc from 1948 to 1999, and with the Euro since that date. Preservation of this fixed parity requires the implementation of monetary and credit policies that are oriented towards inflation control.

As a result of these policies, people have confidence in the value of the common currency and this induces savings. Take, for example, the case of Guinea Bissau. Before entering the union, it had an exchange rate that changed every day so there was currency depreciation and very high interest rates.

The public did not have confidence in the currency, so they kept their savings essentially in the form of physical goods. It was only very recently, with the entry of Guinea Bissau into the union, that one has noticed a development of savings in monetary form.

UMOA's microfinance sector is characterized by a significant mobilization of deposits. In fact, there is a surplus of savings over credit operations in comparison with our colleagues on other continents. The importance of this savings is great – there are other elements that are linked to it – but we must ask ourselves why we have not been able to transform all the savings into credit.

With respect to the other elements of economic integration, one can also cite the convertibility of the common currency, the opening of markets, and the free circulation of labor as advantages of the union. As a result of integration, small traders and breeders who are involved in trans-border commerce can obtain financing. Entities from two different Member States can create an organization that offers common services to its members. UMOA nationals can work in institutions throughout the region, and have an estate in more than one member country. The freedom of transfers also facilitates commercial operations with economic actors outside UMOA.

However, the factors cited as advantages can also prove to be elements of weakness. The interpenetration of markets within the UMOA zone induces rapid repercussions from internal crises as well as from external crises or shocks. When there is a problem in one country, it is transmitted very rapidly to neighboring countries. For example, events in the Ivory Coast at the end of 1999 greatly impacted the activities of Malian merchandise transporters, who lost significant markets, and producers, whose raw materials were blocked at the port of Abidjan. Cattle traders in Burkina Faso who sold to Ivory Coast markets were unable to repay their loans when they fell due, thus causing a deterioration of portfolio quality for a large network of MFIs in Burkina Faso. This resulted in the decreased availability of credit for certain types of commercial activities in that country.

Stability can, in certain cases, lead to management stagnation or inactivity (for example, a lack of analysis concerning the costs of operation and the factors determining the viability of the institution) which can cause problems for the institution and, in so doing, compromise the resources of the depositors. As a result, the monetary authorities, in particular the BCEAO, need to pay attention to safeguarding the operations of the financial and banking system in general, and of microfinance in particular.

The actions taken by the BCEAO thus far consist principally of putting in place a specific legal framework, based on the provisions of Article 22 of UMOA's founding Treaty, which gives the Central Bank the power to propose uniform legislation for the group of member countries, particularly where foreign exchange laws and rules governing the control and distribution of credit are concerned. Participating States must adopt these rules through national legislation. It is because of this that there exists within UMOA a uniform regulation for banks.

At the beginning of the 1990s, the monetary authorities undertook a reform of the regulatory legislation governing the microfinance sector in an effort to diversify the financial landscape and thus facilitate a better financing of the economy. Before 1993, the legal system relied primarily on the cooperative law, and the law dealing with bank regulations which reserved a monopoly on savings and credit operations for banks and financial establishments (entities with a legal identity that met minimum capital requirements).

Between 1994 and 1998, specific legislation was elaborated by the Central Bank for microfinance institutions. It dealt, in particular, with:

- The law governing cooperatives or savings and loan associations and its decree of application which is intended for microfinance institutions organized according to cooperative principles;

- A framework agreement to take into account institutions that come under a legal status other than that of cooperatives or savings and loan associations;
- The directives of the Central Bank, which are application texts that permit the standardization of information collection.

The various regulations provide links between different areas of the financial sector. Thus, the savings and credit associations or cooperatives that are societies of variable capital can reach the status of banks and financial establishments by means of a financial instrument. The institutions falling within the framework agreement and those that were constituted in the form of a limited company can evolve to become banks or financial establishments governed by the banking law. It happens as soon as the various parts of the UMOA banking and financial system are not cut off from one another.

In addition, complementary measures were taken, including:

- information and sensitization about the contents of the legal framework;
- support to the Ministries of Finance for implementing the regulation (making equipment available, training agents and subsidizing the operating budgets of the ministerial monitoring structures);
- training courses for MFI representatives in the region;
- public awareness campaign and popularization of the legislation in collaboration with professional associations.

These actions undertaken around the legal framework facilitated the standardization of information collection mechanisms, making it possible to have an overview of the sector, to compare institutional performance, and to communicate statistics at the regional level.

In terms of lessons and perspective, what is now being reflected upon is how to strengthen the legal framework. A legal framework is never closed in the sense of the ongoing dialogue that we have with various stakeholders. Areas in need of improvement have been identified and will be considered in the course of the years to come. For example, there are issues related to the behavior of institutions in cases where some have an excess of resources while others do not. You can look at ways to bring these institutions together through the regulatory framework. There is an excess of resources in the short term, but there is also a need for investment funds.

In relation to this, there is also a range of concerns with respect to the strengthening of institutional operations. One cannot have growth in microfinance institutions if they do not have a solid base. The diagnostic made in the sub-region makes it possible to note that the institutions are not prepared for growth in terms of internal organization, in terms of tools. The next challenge will be to help them prepare for growth and to insist on systems of management information that permit them to have good information in advance. This will be the objective of the next phase and one of the bases of strengthening information systems, that is to say the implementation of an accounting system specific to microfinance. The banks of the sub-region have adopted a unique system. Companies have also done so. The next step is to do the same for microfinance in order to establish its role in the service of the sector.

### ***The Case of the Central African Economic and Monetary Community (CEMAC)***

*Presented by Jean Claude Ebe-Evina, Coordinator, Support Project for the National Microfinance Program, Cameroon*

Is the regulatory framework in the CEMAC zone today favorable and sufficiently attractive to receive direct private investment? This question is significant because it is often a prerequisite for the creation and the promotion of microfinance in our countries. The regulatory framework truly remains the most important pedestal.

I am going to make a presentation in two parts: an initial section that follows the historical evolution of the microfinance sector, especially the regulatory context in Cameroon and within the CEMAC zone in general; and a second section, which will look at the current situation, that is from the year 2000 to 2002. I will conclude with a response to the question that was posed to us, i.e. is there an appropriate or favorable regulatory context for private direct investment?

I will begin by describing three periods of historical development. The first period can be characterized, if one wishes to characterize it, by the economic and financial crisis of the early 1990s. The microfinance sector or movement was considered to be a relatively recent phenomenon, particularly in the countries of sub-Saharan Africa, even though certain experiments had already taken place in Cameroon, where the first experiences in microfinance date from the 1960s. The network there is the largest in the union today, comprised of nearly 250 organizations. But for the first thirty years, from 1960 to 1990, nothing much happened, and the sector was never the focus of attention by the Government or the public authorities.

So, everything begins in the 1990s with this economic and financial crisis in which the principal results became consequences and causes at the same time: the restructuring of the banking system, which caused the closing of numerous bank agencies, notably in the semi-urban and rural areas although sometimes also in urban districts; and the exclusion of certain categories of socio-professionals who would have qualified as small clients for the traditional commercial banks.

The second contextual element to note with respect to the first period is that throughout the 1990s we found ourselves at the advent of liberty, the advent of liberalization with the arrival of democracy which, as you know, would initially have repercussions at the social level – in Cameroon, through the liberalization of associations in 1990, which I have not mentioned here, but which will be continuing through the law of 1992 that deals with cooperative societies and groups of common initiative.

When one examines the text of that law, which was focused on – I would say rural – if not the agricultural sector, one notes seven articles which are essentially about the character of a financial cooperative. Although the drafter of the legislation was primarily interested in rural agricultural cooperatives, this is where some small regulation of the microfinance sector began. It is the first official recognition of the structure and the activity of microfinance.

So, having recognized that the microfinance structure can exist and that, furthermore, this activity can function for the moment exclusively under the cooperative form, what are the constraints?

First, microfinance, which is a financial activity, was placed under the responsibility of the Ministry of Agriculture. This happened simply because, at the beginning, the primary text or the primary activity that was considered was a rural activity, an agricultural activity, in which case the financial activity only came to accompany it. It is because of this that, during the first phase, the savings and credit cooperative was found under the responsibility of the Ministry of Agriculture.

The second limitation is that the conditions of access were scarcely constraining. What does this refer to? It is a matter perhaps of a savings and credit cooperative, of a simple declaration by way of inscription in the COOP/GIC registry as a group with a common bond.

The third limitation was the absence of measures aimed at safeguarding investors who are members, and depositors who are savers. Fourth was the fact that the condition of investment or equity participation was limited to twenty percent – this is to say that no investor could take more than

twenty percent of the capital and that this was the basis of the principle of the cooperative and the phenomenon of “one man one vote” regardless of the amount of your participation.

The final constraint was that users who were considered to be non-member clients could deposit funds but could not benefit from loans.

So, even though the first legislation had little to say about savings and credit cooperatives, it already imposed certain constraints upon them. In conclusion, one can say that the savings and credit association was a closed association in the financial sense of the term, in that it did not permit the easy entry of shareholders.

The second historical period takes place much later, nearly at the end of the 1990s. It is within this context that we witness the reestablishment of significant macroeconomic equilibrium and the return, in principle, of economic growth.

At the level of the financial sector, one notices a recovery of the banking sector in which we see the liquidity and profitability of credit establishments restored. At the level of the microfinance sub-sector, one finds that microfinance ceases to be merely a complement to agricultural activity and becomes an activity in its own right. This begins to be recognized by the government, which decides in 1998 through Decree 98/300/PM, to establish the first modes of operation and activities for savings and loan cooperatives.

What is the significance of this in relation to the first period? First, one proceeds or one witnesses the transfer of oversight to the Ministry of Finance. Thus, one will not speak any more of the Ministry of Agriculture, but rather of the Ministry of Finance. We consider that microfinance is effectively a matter of financial activity and no longer a supporting element of agricultural activity. This leads to the inspection and supervision of savings and credit cooperatives.

The second significant point is the recognition of the cooperative as a real financial institution and, thus, the start of its integration into the financial system just like any other institution. The third item of importance is the implementation of a basic regulatory framework. Although basic, it is already quite sophisticated, especially in terms of the conditions of access, which spell out, in addition to the registration with COOP/GIC, the composition of an economic and financial document that includes a development plan, a list of associates, the attestation of controllers, etc.

The banking commission of Central Africa became increasingly involved, and this is what truly marks the recognition of this activity as a financial one, since the commission was involved in issuing the approval to operate. Furthermore, inspection and supervision were assured by the Ministry of Finance, specifically by the decentralized financial systems unit that was created specifically for that purpose. The 1998 decree was then complemented by a financial law in 1998-99 which provided some significant modifications, in particular allowing savings and credit cooperatives to take equity positions in other savings and credit cooperatives and in similar organizations.

Thus, one begins to see an institution that is going to open up, in contrast to the closed institutions that I described earlier, and subsequently obtain approval to grant loans to non-member users. You will recall that non-members could invest or deposit money in the cooperatives but could not borrow. Obviously, this was a disincentive to deposit money in a savings and credit cooperative.

In the third period of development, we are now at the end of the 1990s and the beginning of the new millennium. At the macro level, the national economic program is being completed. There are three points I want to note about this period. First, a national microfinance policy was elaborated and became, in my opinion, the new development policy of the country. This was not only the case in Cameroon but also in certain other members of the CEMAC zone, particularly in Chad and the Congo

and to some degree in the Central African Republic. The national microfinance policy, in fact, became an element of the anti-poverty strategy.

My second point is that, as I said earlier, the Government had not been particularly interested in microfinance. Their interest in the sector really began in 1998. By this time, the microfinance sector was experiencing a real boom, especially after 1996. Statistics from a study of the sector show that of the 300 existing cooperatives, or microfinance institutions, fifty percent were created between 1996 and 2000. These were four years of explosive growth and of course growth at this pace has consequences. Sometimes these consequences are simply related to lack of experience, training, tools and such things. But other times the consequences were because some people created institutions simply to extort funds.

This led the Government to become more rigorous and resulted in the signing of the 2001 Decree which made some modifications to existing legislation. This in turn resulted in strengthening of the supervisory and control activities of the Ministry of Finance. As a consequence, there was a clean-up of the sector through the introduction of mandatory registration. This clean up work took about six months and resulted in the closure of between two hundred and two hundred and fifty institutions.

What is limiting in our case is that what we have talked about until now are the cooperatives. But they only represent fifteen percent of all microfinance operations; eighty-five percent of the operators remain unregulated, or informal. This is despite efforts to formalize the sector. So the legislation is still insufficient.

A second constraint is that this form of microfinance does not always offer an attractive environment for potential investors because of an inappropriate legal framework.

This brings us to the second part of the presentation which is the current situation. It can be seen as a fourth period because of the changes in the law of 2001. What is the context in this period?

First, there was an increase in the development of microfinance in all its forms: independent networks, projects supported by bilateral and multilateral organizations, at the national level and sometimes at the regional level, in both urban and rural areas.

Second, there was consolidation as a consequence of political will and government support. This support came as a result of the strong need expressed by the population, and by a growing recognition of the essential role of microfinance as a tool in the fight against poverty. This happened not just in Cameroon, but in all the countries of the zone because of the participation of the Central African Banking Commission and its role in establishing norms and conditions for monitoring the sector and then in establishing financial standards for the industry.

It is interesting to note that this time the growth of the sector is not limited to the cooperative model but also includes other forms, to the point where we talk about microfinance and not just about cooperatives. There are three principal models.

In the first category are institutions which collect savings and redistribute them in the form of credit exclusively for their members. This is the kind of grassroots institution found in villages. The legal structure is that of an association, cooperative or credit union, and there is no minimum capital requirement.

In the second category, the institutions collect savings and grant loans to both members and non-members. The legal form is that of a limited company and the minimum capital required is 50 million. The third category of institution provides credit but does not mobilize savings. It requires a minimum capital of 25 million.

Another advantage with respect to the legislation is that it permits institutions the possibility of operating as a bank (except for international transactions). It also establishes regulatory and prudential standards; a very important advantage for the industry. The remaining constraint is principally the development of an accounting system, which I believe Mr. Ekue mentioned in reference to the UEMOA zone as well.

In conclusion, and in response to the second part of the question we were asked, we can say that the new regulatory framework serves as an incentive factor for investing in the microfinance sector. That is to say, one can take a risk in an environment which is sufficiently regulated, particularly in those institutions in categories 2 and 3: the cooperatives and the commercial financial institutions.

## **The Role of Donors**

Donors have played a prominent role in the development of the microfinance industry to date. Even today, the vast majority of microfinance institutions are funded primarily by donors. Their support has been critical in helping institutions get started, in developing initial success stories, and in facilitating the growth of the industry to date. But many seminar participants commented on the way donor support is also distorting the market and, in fact, is discouraging private investment. Institutions, governments and clients have gotten used to subsidies and have little incentive to operate on market terms as long as subsidized funds remain available. MFIs that cannot survive on market terms are not attractive to investors, and private companies that want to get involved in the microfinance industry cannot survive as long as other entities operate in the same market with subsidies and are able to charge below-market rates for their services. Furthermore, as James Mwangi noted, donor interventions are too often driven by political priorities or expediencies which hamper the development of the overall industry.

This begs the question, should donors still be involved in microfinance? Are they doing more to discourage the integration of microfinance into the financial sector than to encourage it?

Seminar participants argued that donors do need to be involved in microfinance, but the nature of their involvement needs to change. Indeed, it is changing. Donors have no desire to distort financial markets, and many are making a conscious effort to move away from direct funding initiatives and toward the facilitation of industry development. As David Stanton commented, “The Consultative Group to Assist the Poorest (CGAP), and individual donors like DFID, USAID, CIDA, and many others are very much aligned to the mainstreaming of financial services and the linking up of microfinance with the formal financial system.”

The main idea behind this linkage, as has been mentioned several times now, is growth. Stanton continued, “There are many strong microfinance institutions that reach a certain level of development, but then get stuck. They may serve ten or fifteen thousand clients, but cannot get above that glass ceiling for managerial capacity or market-related issues. So somehow we have to work to break through the glass ceiling in order to get the level of scale needed to make a significant impact on national and regional poverty.”

According to Stanton, the donor community’s role in facilitating the microfinance industry’s access to commercial capital is essentially two-fold. It can help to correct market failures; and it can encourage the development of market-based relationships between microfinance institutions and the rest of the financial system. This role was not heavily discussed during the seminar, but seminar participants did raise what they thought were six valuable contributions that the donor community could make and these are noted below.

First, donors can mitigate the risk to a commercial investor. They can do this by helping to identify and develop technologies that improve risk management by microfinance institutions. They can

encourage transparent, standardized reporting and ratings. They can also invest in mechanisms like AfriCap, through which subordinated debt can be provided to MFIs. As Stanton explained, “Through subordinated debt, donors can carry the biggest risk and therefore take the first hit in the event of difficulty allowing commercial investors to enter the market with a lower level of perceived risk. So really, what we’re trying to do is to act as a temporary stimulus to encourage market entry by commercial investors. In time, we would wish to withdraw and to allow market forces to continue without donor assistance. There are many cases, however, where donor investment is important to get the market going, to start this type of investment.”

Second, donors can provide technical assistance in terms of grants for capacity building, management strengthening, the development of systems and information technology. Such assistance will be needed by banks as well as non-bank financial institutions, by regulators, and by supervisors, so donors will need to take an industry-wide approach to support this area. They could also fund study tours, institutional exchanges, seminars or research, which facilitate cross-fertilization, knowledge sharing and relationship building.

Third, donors can provide an introduction or brokerage service, by using their regional and sector knowledge to help good microfinance institutions hook up with interested investors.

The fourth contribution is also related to the flow of information. Donors can help to publicize the best success stories in the microfinance arena. As Stanton commented, “We know about the Asian models – we know about BRAC and we know about BRI Indonesia; we know about the Latin American models and BancoSol. What we need to do is get hold of a microfinance institution in Africa that makes a similar successful transition and to trumpet it in the international community, so people start to recognize Africa as the emerging market for microfinance.”

Fifth, donors can use best practice and institutional success stories to influence government regulation of financial markets, so that public policy responds to the needs of the microfinance industry in terms of the legal and regulatory environment, minimum capitalization requirements, the speedy issuing of bank licenses and sensible supervision.

Finally, although it is likely to be the most difficult contribution that donors can make, Stanton argued, “it is possibly the most important of all. Donors really need to get their act together and to think only about sustainable microfinance, or at least to distinguish between the type of microfinance that would not require commercial investment and is inherently to do only with poverty alleviation, as against the type of microfinance which is looking to build financial systems and markets. There are some extremely bad microfinance programs around the world, programs that are operated with good intentions but which are unsustainable, very often supported by donor finance, and which are indeed distorting rather than building markets. We refer to these programs as oil tankers and we need to turn them around in order to make a significant impact on markets and to encourage private investment.”

Stefan Harpe also commented on this theme, “Ultimately, there will be a spectrum of MFIs, ranging from those approaching commercial viability to those operating in conditions or providing services at a level which will never become viable. The key challenge for donors will be to develop a range of interventions depending on where an MFI is on the spectrum, and to ensure that strategies applied at one end of the spectrum support those at another, or at least, support the development of the microfinance industry as a whole.”

## **The Role of Specialized Equity Funds**

In many respects, specialized equity funds pick up where the other actors in this chapter leave off. Governments and donors create an environment that enables specialized equity funds to make a market for investment in microfinance. They demonstrate that microfinance institutions can be viable

on commercial terms and can provide an attractive return on investment. Of course, it is not so clear cut as this. The funds will work together with policy makers to improve the environment in which they operate, and they'll collaborate with donors to ensure that the institutions they invest in get the non-financial support they need to be successful. But in general, their role is to carry the microfinance industry to the next level, to provide a bridge between donor-funded microfinance and privately-funded microfinance.

From one perspective, specialized equity funds are wholesale institutions, and as such, they were mentioned briefly at the end of chapter two. They provide funds and credibility; they can raise the stature of the industry, provide comfort to regulators and fuel for growth. Yet specialized equity funds are much more than just wholesale financial institutions. They provide additional value of an entirely different character. In their role as venture capitalists, they provide risk capital and networks of expertise; in their role as development capitalists, they work with central banks and other industry stakeholders in an education and negotiation process to bridge the gap between the mainstream financial sector and microfinance.

As Stefan Harpe explained in response to a question raised by Nana Asante Bediatuo of Citi Savings and Loans in Ghana, "The regulatory challenges and the constraints that you face are, in some respects, very common in the development of new markets because they evolve over time as various parties – investors, investees, regulators and so on – figure out what is the best way to provide stability and ensure the safety of deposits and so forth. [Specialized equity funds like AfriCap are] going to be able to play a significant role in contributing to greater awareness of the needs of commercial microfinance institutions. We would hope that, were we to invest in Ghana, we would have meetings with the Ministry of Finance, meetings with the Central Bank of Ghana, etc. and this would be part of the legitimization of the industry. When they see us coming in, they look at who we are, we're going to put a million dollars on the table, we're serious, our investors are serious, it changes the context. So, this is what we're trying to achieve – a changed mindset. And it's definitely part of our mandate to engage in that sort of activity because it's intimately linked to our ability to invest and divest."

There are an increasing number of equity funds worldwide that are investing in microfinance – AfriCap, ProFund, IML, ACCION Gateway Fund, Shorebank International Fund, Saron Global Investment Fund, Hivos-Triodos Fund, and the CARE Capital Markets Fund, to name a few. These funds vary greatly in their degree of specialization and their focus on Africa. The two discussed in most detail during the seminar were ProFund, which was the first equity fund designed specifically to invest in microfinance, and AfriCap, which is the only specialized equity fund focusing exclusively on African microfinance today. To conclude this chapter, case studies from these two institutions are summarized below.

### ***The Case of ProFund***

*Presented by Alex Silva, General Manager, ProFund*

ProFund Internacional (ProFund), was incorporated in 1995 as a for-profit investment fund in the city of Panama. Managed by a professional team from its headquarters in San Jose, Costa Rica, the fund seeks a high return on investment for its shareholders while promoting the growth of regulated and efficient financial intermediaries whose main target market is the small and microenterprises (SMEs) of Latin America and the Caribbean.

ProFund provides equity and quasi-equity resources to eligible financial institutions so that they can expand and improve their operations on a sustainable and large-scale basis. It takes minority positions in these institutions, generally ranging between 15 and 30 percent of their net worth. A summary of the fund's active investments is provided in Table 5.

**Table 5: ProFund's Active Investments**

<b>Institution</b>	<b>Type</b>	<b>Country</b>	<b>Instrument</b>
BancoSol	Transformed NGO	Bolivia	Equity (Common)
Banco Solidario	New financial entity	Ecuador	Equity (Common) & Syndicated Loan
BanGente	New financial entity	Venezuela	Equity (Common)
Caja Los Andes	Transformed NGO	Bolivia	Subordinated & Term Loan
Compartamos	Transformed NGO	Mexico	Equity (Common) & Term Loan
Finamérica	Transformed NGO	Colombia	Equity (Common) & Convertible Loan
Génesis / Bancasol	Transformed NGO	Guatemala	Convertible Loan
Mibanco	Transformed NGO	Peru	Equity (Common)
SOGESOL	Established financial institution	Haiti	Equity (Common) & Subordinated Loan
Visión	Established financial institution	Paraguay	Preferred Shares

As shown, ProFund invests in three types of institutions:

- non-governmental organizations (NGOs) that provide financial services to SMEs and have decided to become formal commercial financial institutions;
- new banks or regulated finance companies dedicated to financing SMEs; and
- established financial institutions that are interested in entering the SME market or in strengthening their activities in this market.

ProFund's original sponsors were ACCION International, FUNDES, SIDI and Calmeadow. However, in the last seven years, CDC, IFC, MIF/IADB, SECO, CAF, CABEI and the Calvert Foundation have also made major investments. To date, ProFund has committed more than US\$22 million in twelve institutions operating in ten different countries. It is estimated that these investments have indirectly benefited over 400,000 micro and small entrepreneurs.

With that brief introduction to ProFund, I'd like to try to answer the more general question, "What is the role of a private equity fund?" Initially, ProFund was conceived as a source of capital, and I guess that's the main role that it should play. The institutions we invest in, whether they're transforming from NGOs or are newly created institutions, are trying to raise a given amount of capital (normally there is a minimum required by the authorities). In so much as there is a neutral source of funding (neutral meaning that the private shareholders are not going to be diluted in terms of their control of the institution by a fund like Profund or AfriCap), it reduces the amount of capital that the sponsors, or the original shareholders, need to raise. Thus, I would say that an equity fund's primary role would be as a source of equity capital – difficult to find equity capital.

Beyond that, a fund like Profund or AfriCap would like to think that it's going to have a demonstration effect. The idea is that by generating positive returns, both in terms of monetary returns and also in terms of social returns, they would be able to demonstrate that commercial microfinance is not only viable, but actually could be and should be very profitable. By the way, in terms of being very profitable or profitable, while the internal rate of return for Profund is right now being estimated at seven percent, and that may not seem like a very high number, one has to be reminded that right now Latin America is going through a very deep recession. Having any kind of positive number – seven percent, for example – is considered to be very good. Most equity investors are actually losing money in Latin America these days.

The third role that a fund like ProFund can play is that of a cultural bridge. Since we do understand NGOs, we understand their objectives, and we have a body of shareholders that have very clear missions and visions which are normally shared with those of the NGOs, we can relate very well to these institutions. Yet on the other hand, we are very much a for-profit institution, very much staffed with individuals whose extraction is really more from the investment banking world. Thus, we are

able to understand the language that bankers and regulators and other participants in the mainstream financial sector speak. This allows the fund and its staff to play a role that facilitates understanding between the two worlds – the NGO world and the banking world. Consequently, I would like to think that we're very good partners to have around.

Finally, although ProFund was not originally designed to play this role, it ended up providing quite a lot of support to the institutions in which it invested. ProFund was supposed to be a source of capital and maybe have a demonstration effect, but it was not supposed to provide much more beyond that. However, we ended up playing a major role in terms of disseminating experiences. Since we invested in several institutions in several different countries simultaneously, we could immediately bring best practices from one place to the other. We also ended up playing a very active role in terms of the governance of these institutions. It was a key contribution that ProFund ended up making as a minority investor. And something that was completely not thought of, but ProFund ended up providing emergency liquidity to institutions when, because of external events – maybe an earthquake or some other natural disaster – liquidity became tight in the system. ProFund was a partner with deep pockets and was able to provide the kind of emergency liquidity that the financial intermediaries needed.

### ***The Case of AfriCap***

Presented by Stefan Harpe and Wagane Diouf, AfriCap

The successful experience of ProFund led Calmeadow, one of its original sponsors, to pursue the creation of a similar fund for Africa. That pursuit resulted in the October 2001 launch of the AfriCap Microfinance Fund, the first equity investment fund focused specifically on microfinance institutions in Africa.

AfriCap is designed to provide patient venture capital and active governance to emerging commercial MFIs in Africa. It is African-based, incorporated in Mauritius and operating out of Dakar, Senegal. The Fund itself is now capitalized at \$13.3 million; it will invest in about ten MFIs over five years – and divest and liquidate within ten years. In addition, the AfriCap Technical Services Facility (TSF) has been grant-funded with \$3 million over the first five years; it will support capacity building of the MFIs in the portfolio and pursue broader industry development goals in areas where a lack of information and/or seed capital might constrain the growth of the microfinance sector more generally.

AfriCap, thus, has a dual mission – to generate both a commercial return to shareholders and a social return in the form of a viable microfinance industry. It is designed to support the commercialization of the microfinance industry, by bridging the transition from a sector traditionally funded by donors to a scenario where the leading microfinance institutions are raising most of their funds from commercial sources, be that voluntary savings, wholesale deposits, interbank liquidity or private investment capital.

AfriCap intends to fulfill its mission through a five-prong strategy, which can be described as follows:

***Selective.*** The Fund's Investment Strategy is to invest over five years in a small number of leading MFIs across Africa which have the potential to become demonstration models of successful microfinance. These investments will not only be attractive on their own merits, but will also support a broader objective, that of helping to legitimize the emerging microfinance industry. Divestment will occur as soon as practicable, but most probably towards the end of the Fund's ten-year life.

***Focused.*** AfriCap invests exclusively in institutions dedicated to microfinance or small business lending, and as such, brings a specialist expertise and focus to the management of each investment and to the development of the portfolio as a whole.

**Capital Markets Access.** The Fund always strives to co-invest with local investors, or leverage our investment with access to local bank financing. The objective is to strengthen the access by viable MFIs to local capital markets, thereby ensuring their long-term growth and ultimate integration into the financial system.

**Networks of Expertise.** To enhance the quality of information available to the Fund Manager from different parts of Africa, access to a network of microfinance professionals as well as broader financial sector contacts is central to both maximizing the efficiency of the Fund Management team, and also to ensuring that AfriCap investees have access to the best practices, expertise, and leading edge methodologies in our sector.

**Industry Development.** One of the Fund's dual objectives is to promote the legitimization and professionalization of the microfinance industry. The Investment Strategy incorporates an emphasis on the development of the industry, and greater linkages between MFIs and local capital markets. This is intended to support the Fund's exit options, since the cultivation of possible institutional buyers of our ownership stakes will be greatly facilitated by the broader understanding of the growth and profit potential of this emerging industry.

There has already been significant discussion about the role of equity funds in facilitating the microfinance industry's access to commercial capital, and the value that AfriCap can bring to that process is largely explained in our strategy description. However, by way of conclusion, it is worth mentioning a few other contributions that AfriCap, in particular, intends to make.

First, AfriCap will provide flexibility. The Fund can act quickly, invest in a variety of instruments, and tailor a package to suit the particular capital needs of each situation. Through the TSF, AfriCap can also provide targeted technical assistance and management support to our investees. This capacity to provide a combination of resources is part of our strategy to ensure that each institution gets the resources it needs to build a successful profitable organization.

Second, AfriCap will take a long-term approach to building value and will develop an active governance role with each institution as part of its investment. Collectively, the AfriCap team has a long history of experience striking the tricky balance between increasing profits and maintaining the mission at commercial MFIs. We believe quite strongly that these two objectives can be reconciled, and in fact, their juxtaposition and ensuing debates often contribute to a very constructive tension within the institution.

Finally, in addition to providing access to the network of expertise mentioned above, AfriCap will also provide access to a network of African microfinance leaders. As the Fund develops its investment program, investees will have the opportunity to link up with other companies in the portfolio, institutions that will be the leading innovators in their field and will therefore represent a network of significant value to each other. AfriCap will support the exchange of experiences by organizing regular communications, annual meetings and other vehicles. In this area, we see our role as that of facilitator. We aim to invest across Africa – in the East and the South and the West – because we believe that this African exchange will prove in time to be a very rich source of best practice microfinance experience.

## Chapter 4: Challenges Ahead

“I think probably the most important difficulty for banks to address in microfinance is cultural.”

~ *Pierre-Marie Boisson, Sogebank*

“Given the historical origins of donor-funded microfinance NGOs, the whole concept of commercial microfinance at market interest rates with private investors making returns serving poor people is difficult for most people to swallow unless it’s well-presented, unless it’s well-communicated, and unless there are concrete examples behind those concepts to convince people of its worth and of its value.”

~ *Stefan Harpe, AfriCap*

“Once Profund has come to an end, who will come in and become the owner?”

~ *Koenrad Verhagen, Argidius Foundation*



Challenges faced by the African microfinance industry as it endeavors to access capital markets have been mentioned throughout this document. Performance challenges, capacity building challenges, technology challenges, cultural challenges and regulatory challenges are just a few of the broad categories that have been noted thus far.

These challenges have not been examined in any organized manner because the seminar was not particularly focused on the topic of challenges. Rather, it set out to explore why access to commercial capital is important to the growth of the African microfinance industry and to discuss real examples and strategies for facilitating that access. The focus was on *how* various stakeholders can help make access happen. Of course, any discussion of “how” is naturally going to look at specific obstacles, problems or complications that might arise for different stakeholders, and it is within this context that challenges were mentioned.

There were moments during the seminar, however, when participants took a step back and considered a challenge or a set of challenges that confronts the microfinance industry as a whole, challenges that would need to be dealt with by all stakeholders if the industry is to access capital markets in any significant way in the future. Three such challenges were raised during the course of the seminar and they are described in this chapter: 1) the challenge of providing a social return; 2) the challenge of reducing risk; and 3) the challenge of making markets.

At no point in the seminar did anyone pose the question, “What do you think are the biggest challenges facing the microfinance industry’s access to capital markets today?” Thus, it would be incorrect to assume that the three challenges presented below are the only challenges facing the industry or even, that they are the most critical. The fact that they are the ones that sparked discussion, however, suggests that they are particularly relevant for stakeholders in the African microfinance industry today.

### **Providing a Social Return**

Without a doubt, the challenge that most occupied the minds, and seemingly, the hearts of seminar participants was the challenge of ensuring that microfinance would continue to provide a social return even after accessing commercial capital. No one questioned whether commercial microfinance would be capable of delivering attractive financial returns over time, but many were anxious that in order to

get those financial returns, they would have to compromise the social returns that had attracted them to microfinance in the first place.

“What impact will commercialization have on clients who are the most poor?” “What will happen to the quality of the services provided to clients?” “When commercial players start actively participating in the microfinance industry, will the social considerations be lost? Will there be a strong mission drift? Will the very poor be ignored by these institutions?” “Can microfinance serve as an effective economic development tool if MFIs become focused on profit rather than development?” These are some of the questions that were raised.

As Beth Rhyne noted near the end of the seminar, “The underlying issue that sometimes came to the surface, but was clearly bubbling under the surface, is the concern about the compatibility of commercialization with a concern for poor clients. I think that we need to recognize the depth of the concern that people have over that issue and the fact that the concern over that issue is probably the single biggest factor that causes people to not be interested in seeing commercialization happen.”

Fear within the microfinance industry itself about the effect that commercial capital will have on the industry’s ability to meaningfully contribute to economic development is preventing it from integrating with the rest of the financial system and is hindering its ability to grow. For the industry to move forward, it will have to confront this fear, and do so in a way that pulls the industry together rather than apart.

The challenge of ensuring that microfinance will continue to provide a social return even after accessing commercial capital is a multi-faceted task. First, a handful of microfinance institutions will have to demonstrate that they can generate a social return even after accessing capital markets. Ideally, they would be able to show that this return can be at least as great as the return that is being generated without commercial capital. Second, the microfinance industry will need to provide reasonable assurance that a typical MFI can generate such a return. Proving that it is theoretically possible, or may be possible for one or two institutions under exactly the right set of circumstances, will not be enough to allay people’s fears. Finally, after it is demonstrated that MFIs can generate a social return, someone will have to persuasively argue (or MFIs will have to start proving) that they will actually choose to provide these social returns, rather than reap greater financial rewards.

Certain stakeholders within the microfinance industry have already begun addressing this challenge. Those who were present at the seminar and had specific experiences to share argued strongly that access to commercial capital does not inevitably lead to a shift away from the poor. It *can* lead to this kind of shift, but it does not have to. As Rhyne commented, “There is a real pressure to move up market, but many institutions – in fact, most institutions – are able to resist that.” She cited the example of the twelve MFIs in which ProFund has invested, “Overall, ProFund institutions have maintained their target population focus, as measured by average loan size.”

James Mwangi joined in, “Our experience in Equity Building Society is that commercialization does not necessarily work against the client because of economies of scale. We have been able to continuously lower the cost of funding to the customer because of increased volume and increased efficiency, as imposed by commercial capital. We started off with an effective interest rate of about 35%; we are now at an effective interest rate of about 24% on a declining balance method.”

Rhyne continued, “The key question is, ‘what is the nature of the quality of the services that are being offered to clients?’ And one of the things that does seem to be coming along with commercialization is a blossoming of product development. When BancoSol started, when it first became a bank, it had one product – a solidarity group, working capital loan. Today it has twelve products – 4 savings and 6 credit products. It’s basically serving the same client group as before, but now clients have a wider range of products that they can choose from. When K-REP transformed, it had two products, and both were group lending products. Today it has a much larger number. I don’t have the exact figure,

but KREP has at least six or seven additional products which include the payment of bills on behalf of clients, money transfers, school fees, savings accounts, agricultural loans, car loans, and loans to SACCOs.”

Alex Silva commented, “The biggest impact of commercial participation is more to be derived from the number of poor individuals that have and will have access to financial services compared to those who today may not have access to those services. Most commercial MFIs, at least the ones that we have been involved with, are not really measuring the social impact of what they are doing. They are basically seeing a market; they’re seeing an un-served need for financial services, and that is what they’re going after. They don’t do what they do thinking that they are providing a social good, but indeed they are providing a very valuable social good. For example, there are 400,000 clients of microfinance services in Bolivia today and ten years ago those individuals had no access to such services. A micro-loan in Bolivia now costs less than a consumer loan. That has to have a very significant social impact.”

“I would like go back to the example of Plan International,” Anicca Jansen interjected. “Plan started a number of revolving loan funds that were targeted toward the mothers of the children that they sponsored, and it found these revolving loan funds basically could not grow; there was a limit to how much these funds could really do. So, Plan chose to work with PAMECAS to group these revolving loan funds together and use the capital that had accumulated to capitalize a credit union. Then, that credit union – that money and that place to save – became available to everyone in the village, not just those mothers. So they moved into areas where there was no formal financial institution and they created a credit union that’s available to everybody. Certainly, that won’t by itself reduce poverty, but I think it certainly increases the chances that incomes will increase for a greater number of people.”

Silva continued, “I think that nowadays we have gone beyond the point at which we were thinking only about micro-loans. I think we are now looking at microfinance as a whole and we are realizing that when we can reduce the cost of a financial or economic transaction – for example, the cost of transferring money from one place to another – we’re really having a very profound impact on the livelihood of that person.” Martin Connell commented, “Analysis has been done by independent surveys which suggests that there are many benefits that accrue to individuals and their families who have access to financial services. As has been mentioned here earlier, there is a sense of financial stability and flexibility that comes from knowing you have access to financial services. There has also been demonstrated in some of these surveys a modest but a real increase in the quality of income in the home. There is a sense of satisfaction in knowing that you have this degree of flexibility in your income situation, and this has enhanced empowerment of the individuals and their families and created a greater sense of self-reliance.”

Thus, the general argument goes, commercial capital gives more people access to more financial services at a lower cost, which enables them to improve their quality of life and their overall well-being. This is a clear increase in social return over the status quo.

Skeptics pushed further, however, and questioned who would actually receive this increased, improved service. Would it be the poor, the very poor, the poorest of the poor, or the not-so-poor? Who is it that benefits from commercial microfinance, and aren’t there sectors of the society that get squeezed out, that lose their access, or that never get access in the first place because they are too difficult or too expensive to reach?

Participants had a more difficult time addressing this angle of the original question. After all, how do you define poor, very poor and poorest of the poor? How do you assess how many clients a MFI is serving in each category, and what the impact of the financial services provided might be? Is it even possible to do this? If it is possible, is the information gathered worth the cost? “Just imagine,” Emile Groot remarked, “with thirty, forty, fifty, sixty thousand microentrepreneurs, how are you

going to measure this? How are you going to find out? Moreover, with the microentrepreneur, there's hardly a distinction between what he's doing professionally and what he's doing in his household. A loan can be used for buying a uniform or for paying school fees. In the end, does it really matter, as long as he gets money and he can do something productive with it?"

Alex Silva admitted, "Banks and commercial players are, at least initially and preferably, going to go for the larger clientele within the microfinance target market. This, indeed, may not be the ideal occurrence from a social perspective, so an open question might be, what can you actually do about it? Perhaps, and this is showing my bias, the fact that commercial players are able to reach a large number of those individuals who previously were not being reached should in itself be something that we should all be happy about and not look so much at the fact that they may not be reaching everybody that we wish they would. Then we should be concerned with finding alternative ways of reaching the very poor and maybe accept the fact that commercial players are probably not going to be reaching those individuals. They are commercial institutions and they will not service clients that are not profitable, at least, today they are not profitable."

Silva continued, "That doesn't mean that we cannot look for, and eventually find, schemes that work. I might remind you that one of ProFund's best investees is Compartamos in Mexico and they are basically serving the very poor in Mexico in the rural areas. It's an example that this can be done commercially. But you're right, most commercial players that I know of are tending to serve the urban areas only, and for that matter, among the poor, only the top half of the poor. I guess it's an issue we could debate for awhile, but I do not think that one should criticize somebody who's doing something good just because he's not doing everything that one wished that he was doing."

Silva's comments sparked an interesting discussion about the role of NGOs that are oriented towards serving the very poor and would not be able to transform into viable commercial entities even if they wanted to. Beth Rhyne noted, "There's a large sector of the microfinance world whose driving force is to reach the very poor. Those people's *raison d'être* is being challenged by commercialization if they feel that they are not potential candidates to become commercialized. They feel that their legitimacy is threatened by pressure coming from donors, pressure coming from wherever. And I think that it's very important for those people who are involved in the process of commercialization to create a space in which those institutions that are working at the bottom end of the scale can feel legitimate and can have a real working space to do what they do best and to move their mission forward."

Anicca Janssen added, "I think it's clear that NGOs have an important role to play, even as NGOs without having to feel that they need to transform. If they are able to show that they are really moving down market, reaching people that otherwise would not be able to be reached, if they are able to be innovative and experimental, they have a role to play. One of the big contributions of NGOs historically has been to go where no one else would go and figure out how to serve the people that no one else could serve."

Thus, there will be a role for non-commercial microfinance institutions to continue providing social returns even if they cannot provide financial returns. However, that role will need to be carefully delimited by industry stakeholders in order to avoid a situation in which public subsidies crowd out or discourage private investment and the integration of disadvantaged communities into the larger financial system. It is a challenging line to walk.

In the end, seminar participants seemed to agree that up to some not-very-well-defined point, commercial microfinance can have a significant social impact. It cannot do everything, but potentially, it can do a lot. The next question to consider was the likelihood of African MFIs actually fulfilling that potential. What are the chances that "a typical" MFI will choose to deliver social returns over increased financial returns even after accessing commercial capital?

“I was on a panel at the World Bank about six months ago that brought up this issue,” Joanna Ledgerwood began, “and it was very interesting because one person on the panel showed statistical or numerical data to prove that in fact once an institution transformed they abandoned the poor and moved up market. And he was sitting literally on the left of the panel and on the far right of the panel was someone else who said this is absolutely not the case and in fact I have numbers to show that transformed institutions go down market. So, I don’t know actually. I think you can argue either way. I think what’s going to happen in Uganda and I think what has potentially happened in other countries that I’ve worked in, is that the market expands. It doesn’t necessarily mean that the institution abandons its original target market, but I think that the market grows. I think when you start offering savings products, particularly in rural areas or areas where people have not had access to financial services before, you attract poor savers but you also attract a higher level of developed client. There’s a huge missing middle in terms of services provided. MFIs serve the bottom 5% and commercial banks serve the top 5%. So you have 90% of the country that doesn’t have access, and I think there’s room for a lot of institutions to target a lot of different areas of the market. So, I think you sometimes just expand it as opposed to abandon it.”

Other participants agreed with Ledgerwood’s idea of market enlargement. For example, Stefan Harpe commented, “After institutions become sustainable in a core business, they start to look at providing a broader range of services – money transfer services, salary deduction loans, etc. This is where the concern often arises about mission drift, i.e. that the institution is no longer worried about its original aim to serve the un-banked or the poor or however you want to describe it. We’re not too concerned about that because in order to create a viable business, you do need to diversify. In order to be able to provide services to regions and markets which may be further away, have a lower population density, or be tougher to reach, you need to have a profitable, viable organization and that sometimes requires diversification.” Mayoro Loum argued that if a MFI is truly providing a social return and its clients are developing, it will see some natural movement up market. “The average loan I had in the 1980s, I cannot have in 2003. You have to take the clients’ evolution into account.”

Experience thus far seems to suggest that a major factor of success in the microfinance industry is the simultaneous pursuit of both financial and social objectives. As Beth Rhyne noted, “Among the most responsible and successful microfinance institutions there is a strong emphasis on patient capital and on plowing money back into institutions. They are looking at a balance between the good of the institution and its ability to serve clients on the one hand and their needs for a return on their investment on the other hand.”

Even if the primary motivator is profit, a commercial microfinance institution needs to satisfy its customers if it wants to stay in business. It needs to serve them even better than its competitors if it wants to grow. Commercial MFIs will find their clients at the lower end of the economic spectrum and they will have to respond to the needs and desires of this type of client if they are to succeed. Of course, they can try to capture additional markets that are higher up the economic scale, and as their clients grow it will be increasingly possible (and one might argue, desirable) for them to do so. But the higher up-market they go, the more competition they will face from traditional financial institutions and the more inappropriate their products and business model will become.

Will microfinance institutions abandon lower-end markets, or will at least some carve themselves a market niche at the lower end of the spectrum and thrive? Will the MFIs who serve slightly higher-end but still currently un-served clients not contribute to the economic development of a country or community? Will commercial MFIs that choose to follow an entirely profit-driven approach fail? The microfinance industry does not yet have the data or the decades of experience to answer these questions in any convincing manner.

Particularly in Africa, the number of MFIs that have successfully accessed capital markets is still small, and their experience is relatively young. The data that do exist have yet to be effectively

organized and distributed. An ongoing campaign of research, analysis and dissemination is needed to determine the real impact of capital markets on social return, and appropriate tools and indicators will have to be developed before this assessment can be undertaken.

Although it will take some time for the desired information to become available, this should not deter the industry from disseminating the results that it has gathered to date, and from sharing the strategies that commercial MFIs have used thus far to help ensure that their institutions deliver a social return. It has been shown, for example, that specialized equity funds and socially responsible investors can be particularly useful in helping the institutions they invest in to stay on track. Having clear by-laws and a mission statement that embrace both social and financial objectives can help, as can balancing the representation of socially and financially motivated members on the Board of Directors. Providing a social return is a multi-faceted challenge, so if research eventually shows that commercial MFIs are abandoning lower end markets, the industry will need to explore why and identify strategies for counteracting the trend.

## **Reducing Risk**

The second major challenge facing the microfinance industry in its efforts to access commercial capital is the challenge of risk reduction. After all, for commercial investors to be interested in entering the microfinance industry, they have to believe that they will make a return on their investment that is attractive given: 1) other investment opportunities; and 2) the level of risk involved. Microfinance institutions have already taken great strides in demonstrating an ability to fulfill the first part of this equation. BancoSol's ability to generate the highest return on equity of any regulated financial institution in Bolivia is one notable example, but there are many others, including EBS, Sogesol and FINADEV. In general, informed investors do not doubt that MFIs are capable of delivering attractive returns.

What investors doubt is the ability of MFIs to deliver attractive returns over a period of time. They doubt the industry's ability to perform well as a whole. They doubt their own ability to predict the performance of a specific institution within the industry, and they have particular doubts about Africa, where there are still few commercial microfinance success stories. Overall, there is still a great deal of uncertainty about the future performance of MFIs and that uncertainty keeps investors from getting involved in the industry. Microfinance is perceived to be risky.

If, therefore, the microfinance industry wants greater access to capital markets, it must take actions to reduce uncertainty about its performance – to decrease both the real and perceived risks of investing in the industry. How does it do this? Obviously, there will be different strategies for different kinds of risk. Seminar participants mentioned several different types of risk, although they barely scratched the surface of what would be considered a comprehensive list. Regulatory, macroeconomic, political and operational risks of various kinds were noted.

There were arguments about some. For example, Hany Assaad at one point stated that, "Microenterprises are more vulnerable to the vagaries of economic cycles; they feel the effects of a downward economy much more than a bigger company because they don't have a cushion of protection." Pierre-Marie Boisson disagreed, "It you take the example of Indonesia after the Asian crisis in 1998, Indonesia's banking system collapsed and the microfinance organizations were actually cross-subsidizing the banks because the good microfinance institutions proved more resilient to macroeconomic crisis than the other way around. When you have an environment of exchange rate and interest rate volatility, you tend to have more problems with corporate clients than with microfinance clients."

In general, however, examples of risk were put on the table and they stayed there, uncontested. Yes, microfinance is perceived to be a relatively risky industry, and the principal reason for that seems to be a lack of information. Investors simply do not have the information they need to understand the sector, to feel comfortable in it, and to reliably predict its performance.

Assaad referred to the problem as an “information gap” because data often exists that could be used to help investors feel more comfortable, but it has yet to be organized, packaged, or communicated in a way that investors find useful. “As much as a MFI needs to know about its clients, so must investors know more about the MFIs themselves. There must be some mechanism that allows them to transfer this large amount of information into something that they can use to compare different microfinance institutions. It’s not just a matter of providing numbers or financial statements. There’s a lot of what I call infrastructure work to be done, building the financial infrastructure to make this happen – credit bureaus, credit ratings between banks and MFIs, etc.”

The African microfinance industry needs to publicize and widely disseminate its success stories. It needs to share the experiences of those institutions that have proven viability. Doing so will raise confidence in the industry and help investors to become more familiar with how commercial microfinance works and why. The industry will need also to introduce investors to its various stakeholders, and be transparent about the role and intentions of each, particularly with respect to donors and public sector players, since they have crowded out private investment in the past.

MFIs themselves must continue working hard at achieving and maintaining viability, so that a track record can begin to be established over a significant period of time. They also have to be transparent about their performance results. They will need to agree on standard, quality reporting and support industry mechanisms that assist in the dissemination of that information. MFIs will have to work at establishing relationships with private sector partners, such as commercial banks, so that there is an exchange of information and a permanent dialogue that can improve communication between the two cultures. They will also have to explore and invest in technologies that help them manage risk and improve efficiency.

Risk management is a hot topic in the microfinance industry today and is currently being explored through a variety of channels, but most often from the perspective of MFIs. More will need to be done from the perspective of a commercial investor – what do investors need or want to know and how can the microfinance industry provide it?

## **Making Markets**

A third major challenge facing the microfinance industry is the challenge of market making. If the industry is to have massive, long-term and flexible access to commercial capital, a market needs to be created through which debt and equity participation in microfinance institutions can be freely traded. As Stefan Harpe noted, “AfriCap is a ten-year fund. Ultimately, we want to sell our ownership positions, but the only way we’re going to be able to sell is if we, at the same time, create a market of institutional investors interested in expanding and investing in this industry.”

When institutions like AfriCap are ready to exit their investments, others must be ready to enter. Ideally, the interest would not come from developmental investors only, but also from what some have termed “pure private investors,” or investors who have no vested interest in seeing the microfinance industry succeed, but rather, are investing in it because they find it attractive for their own institutional or personal reasons. It is the most ambitious and long-term challenge that was raised during the seminar, but if it can be met, then the goal of integrating microfinance into the rest of the financial system will have been achieved.

ProFund's experience in Latin America suggests that the challenge of market making is not unsurmountable. As Alex Silva explained, "Initially, we were not very successful in attracting local co-investors. Most of the institutions, at least in the early stages of ProFund's development, were basically transforming with the NGO as local investor, with Profund, and then other international investors. I think that the industry at that point still needed to prove itself. Today, however, I think it's a whole different ball game because some of these institutions now are very profitable and some have demonstrated that they can be very attractive to the private sector. As a matter of fact, we are seeing quite an intense competition already from some commercial banks. The most recent investments we have made have actually been with purely local investors. And you heard one of those examples today with Pierre-Marie Boisson of Sogebank. It's a purely commercial bank, and I would like to think that it's more the model of the future."

"In terms of who we see taking our place once we exit, we basically see local investors and that can take the form of commercial banks that now want to really go seriously into this business. In some instances, we even see management buy-outs. We are discussing this in a couple of cases – to have local investors in the form of management buy-outs or even directors who want to increase their participation – but basically, the way the last deals have been structured, we already know who is going to take us out – the banks we have co-invested with. For example, we know that Sogebank is going to buy our participation in Sogesol."

Silva continued, "Furthermore, when you talk of investment you normally refer to equity investments. However, if you would just broaden that definition and think of taking deposits from the public, these institutions have had no problem whatsoever attracting depositors. I mean, the local public has actually trusted these institutions to a very large extent, and one could repeat a lot of stories about how well these institutions survived several crises in Latin America – much better than the norm within the financial system. To date, there is tremendous interest in providing leverage to these institutions in terms of depositing savings through passbooks or certificates of deposits or by buying bonds of the institutions. It is very well accepted by the private local sector in Latin America."

Several participants commented on the paradoxical reality that, in many African countries today, traditional commercial banks are sitting on excess liquidity while microfinance institutions are simultaneously experiencing a funding gap. They asked, "Cannot commercial banks invest in the MFIs? Wouldn't it be beneficial for everyone?"

In more general terms, what would it take to create a market for commercial microfinance investment? Participant observations revolved around two main themes – education and incentives.

First, current and potential market actors need to be informed about basic concepts and functions of the market being built. As mentioned earlier in this section, potential investors need to know what microfinance is, how they can evaluate it, what standards of performance are used, etc. At the same time, microfinance service providers need to learn what the different types of commercial capital are, how they can be useful, what a required rate of return is and how it is set, etc.

Stefan Harpe explained, "I would say that we are looking at two new markets. One is a private equity market, in other words, the whole concept of private equity investment. Having an external shareholder take 20 to 30 percent of your company, become a partner in the company, sit on the Board and look for a capital return, is something that is quite new in most of Africa. This is something that we're finding more and more, even with fairly commercial institutions, as a challenge to overcome – communicating what an external private equity investor looks for, what they can bring in terms of a new partnership, and how that can benefit the organization and the industry as a whole. Clearly this is a process of deepening the understanding of what private equity investors can do, and how their activity can promote the development of deeper, more active equity markets in general. The second new market is the whole commercial microfinance market, and that is another dimension of

this issue. Given preconceptions, and given historical origins of donor funded microfinance NGOs, the whole concept of commercial microfinance at market interest rates with private investors making returns serving poor people is difficult for most people to swallow unless it's well-presented, unless it's well-communicated, and unless there are concrete examples behind those concepts to convince people of its worth and of its value.”

In any education process, key concepts are best conveyed and legitimized by example, and the process of market making for commercial microfinance promises to be no exception. Examples of successful demonstration institutions, both investors and investees, will need to be identified and publicized.

The second theme participants focused on in the discussion of market making was the provision of incentives, also referred to as the removal of disincentives. Participants argued that to encourage the demand for commercial capital, subsidized funding would have to be removed and the growth, impact or profit potential of commercial capital would have to be demonstrated. To encourage the supply of commercial capital, equity funds like AfriCap would need to generate an attractive return on investment, individual MFIs would have to demonstrate profitability, and favorable macroeconomic and fiscal policies would need to be put in place.

As David Stanton noted, “Until relatively recently, many African countries have had significant problems with excessive government spending, fiscal debt, high interest rates, and the crowding out of commercial investors. Banks will tend to invest in treasury bonds or government securities yielding high returns and they will be very reluctant to even consider risk lending or enterprise lending. Until macroeconomic management in place, until interest rates come down, until there are incentives for banks to look further afield, it's unlikely that this type of investment will take place. So, in a way sound economic management is a precondition for long term economic growth, and by extension, microfinance growth.”

Clearly, at this point in time, the most important incentive for simultaneously increasing both supply and demand is the demonstration of success, not only by microfinance institutions themselves, but also by the entities who invest in them. The effort currently being launched by AfriCap, that of investing private equity capital in eight to ten African microfinance institutions, supporting their growth and publicizing their success, will be a major contribution towards the making of a commercial microfinance market on the continent. Stefan Harpe concluded with a comment on that contribution, “Our ultimate test will be whether ten years from now, we will have had a sufficiently dynamic impact to find not only a viable commercial microfinance industry with appropriate regulations, with sufficient funding, with training and credit bureaus, but also, whether we've developed the market for private equity investors sufficiently so that we have buyers for our ownership stakes.”

# Conclusion

“There are a variety of approaches in microfinance that are flourishing on the continent and what we need to be able to do is to create the kind of environment that nourishes the wide range of responses to the microfinance challenges that are emerging.”

~ Beth Rhyne, ACCION International

“We seem to be at a critical point in the development of African financial markets, where they could remain as they are or they could be poised for exponential growth in terms of outreach and sustainability.”

~ David Stanton, DFID

“There is one stakeholder that is not to be overlooked, which is the client, which is at the center of all. What is important is to see whether the clients have enjoyed the services they want and I think that competition in the market would be the way of ensuring that.”

~ Pierre-Marie Boisson, Sogebank



The closing remarks made by seminar participants were not so much conclusions as invitations to look forward. One participant remarked, “We are at a threshold.” Another asserted, “We are on the brink of a wave of activity that will see a tremendous change in the growth of the sector.” A third expounded further, “Once a certain number of investments take place, the whole thing gains momentum. I would hope that two or three years from now this type of forum would be very different. We’ll be talking about the way the market is changing and the way best to accelerate it rather than talking about the very beginnings. When the right incentives are there, I think it can happen very quickly.”

“One of the most exciting parts of the day,” Beth Rhyne joined in, “were the presentations made by people who are actually entering into the microfinance field from the private sector. We saw three examples today of institutions that came into microfinance without being donor driven. They came into microfinance of their own accord because they saw a combination of a way to make a contribution to their society and a way to address a market that they thought would be good business to address. These three institutions – Equity Building Society of Kenya, Sogesol of Haiti and FINADEV of Benin – have approached microfinance in different ways, but I think what they all illustrate is the great power that can come from melding together the know how of microfinance with the resources and know how of the banking sector. You put those two things together – and they really haven’t come together very often before – and what you are immediately getting are very impressive results in terms of rapid growth, innovation in the types of products that institutions are offering, and an amazing learning process.”

Stanton continued, “The vision of many donors, DFID included, is that the commercialization of microfinance will result in diverse financial services available for poor people. I don’t mean only credit or even enterprise lending. I mean savings and insurance services integrating with remittance services which directly address the financial needs of the poor – flexible services that all of us enjoy ourselves. We all have mortgages or savings accounts or borrowings or car loans or housing loans and why shouldn’t poor people have these as well? They have equally complex financial needs. If banks can be encouraged to offer such services, microfinance could well be the way that those services are extended to previously unbanked groups.”

Of course, for banks or for any commercial investor to be interested in microfinance, MFIs must demonstrate that they can provide attractive returns over time. There must be a significant communications effort to inform and persuade investors about the performance and potential of commercial microfinance. A large enough number of MFIs must be ready and willing to receive commercial investment so that investors have some choice about where to put their money. Enabling regulatory frameworks will have to be implemented, and sound macroeconomic policies will have to be in place, among other things.

The reward for all of this effort would be access to durable sources of finance that would enable the microfinance industry to grow, to reach more significant numbers of clients with a better quality service, and to escape from the need to continually be subsidized by government or donors.

In this endeavor, Africa is already being described as an innovator. Beth Rhyne commented, “There are a lot of exciting things going on in African microfinance that are relevant for the rest of the world. I think it was David who characterized Africa as the emerging market for microfinance and I think that’s right, that Africa is the place where there is the most innovation going on in microfinance right now. Four areas come to mind as areas in which lessons are emerging from Africa that are relevant for other parts of the world. One of those areas is savings as the driving force for microfinance. Another is the wide variety of ownership options, particularly on the equity side. There’s been a lot of talk over the last few years about enlarging the definition of microfinance from enterprise credit to something broader, and what you see in Africa when you look across the continent at the variety of things that are happening, is the putting into practice of that definition. Finally, I think what you’re seeing is microfinance enlarging the financial sector as opposed to just being a little separate part. This is a process that’s still in the early stages, but I think that today we see it is actually under way.”

The African microfinance industry’s ability to continue this process of financial sector enlargement will depend, to a large extent, on its ability to access capital markets. Whether it be through the mobilization of savings and institutional deposits, commercial borrowing, or private equity investment, commercial capital will facilitate growth in a much more rapid, more comprehensive, and more sustainable manner than existing funding sources allow. AfriCap sponsored this seminar and produced this summary report as an initial step in articulating this argument. It was an attempt to facilitate the sharing of experiences and learning around this theme, to generate ideas, and to identify actions that need to be taken to develop the industry’s access to capital. It was an early step, yet organizers hope it will be a defining step in moving microfinance towards greater integration with the rest of the financial system. Ten years from now, both the industry and the continent’s financial sector could look dramatically different than they do today.

# Annex I: Seminar Programme

## INTRODUCTION

- 09.30:** **Opening remarks:** Martin Connell, president, CALMEADOW and AfriCap MicroVentures, Canada
- 09.35:** **Welcome address:** Oumar Sylla, directeur de cabinet, Ministry of Finance and Economic Development, Government of Senegal

## Plenary 1: ACCESS TO CAPITAL MARKETS IS VITAL FOR SUSTAINABLE GROWTH OF THE MICROFINANCE INDUSTRY IN AFRICA

- Chair:** *Hany Assaad, program manager, IFC/Global Environment Facility SME Program, IFC, USA*
- 09.45:** **The practitioner perspective,** James Mwangi, chief operating officer, Equity Building Society (EBS), Kenya
- 10.00:** **The government perspective,** Marie Seye Seck, technical adviser, Ministry of Female Entrepreneurship and Micro-credit, Government of Senegal
- 10.15:** **The donor perspective,** David Stanton, chief enterprise development adviser, Department for International Development (DFID), UK
- 10.30:** **The equity investor perspective,** Stefan Harpe, investment manager, AfriCap Microfinance Fund, Senegal
- 10.45:** Plenary Discussion
- 11.00:** Coffee / Tea break

## Plenary 2: INTEGRATION OF MICROFINANCE INSTITUTIONS INTO THE FINANCIAL SECTOR

- Chair:** *Emile Groot, product manager SME, Netherlands Development Finance Company (FMO), The Netherlands*
- 11.20:** Growing a private, profitable MFI – the case of Finadev, Patrick Lelong, managing director, Finadev SA, Benin
- 11.35:** **Strategic choice or temporary distraction - commercial banks and the microfinance market,** Pierre-Marie Boisson, chief economist, Sogebank, Haiti
- 11.50:** **Regional economic integration and the development of the microfinance industry: the case of UMOA,** Eric Amah Ekue, director, decentralised financial systems, BCEAO, Senegal
- 12.05** **Transforming MFI NGOs into private companies – the Ugandan experience,** Joanna Ledgerwood, microfinance advisor, SPEED Programme, Uganda

**12.20: Building a conducive regulatory environment for private investment in microfinance: the case of CEMAC**, Jean Claude Ebe-Evina, co-ordinator, Support Project for the National Microfinance Programme, Cameroon

**12.35:** Plenary discussion

**13.00:** *Lunch*

**Lunch-time address**, Maria Otero, chairman of the board, AfriCap Microfinance Fund, and president, ACCION International, USA

**14.30:** Group Discussions

Group 1: **Making Markets through Private Equity Investment**

Group chair: Alex Silva, general manager, ProFund, Costa Rica

**Panel: Emile Groot, FMO, The Netherlands**

*Stefan Harpe, AfriCap Microfinance Fund, Senegal*

Rik Vyverman, BIO, Belgium

Group 2: **Commercial Banks and Microfinance – Growing Momentum**

**Group chair: Hany Assaad, program manager, IFC/Global Environment Facility SME Program, IFC, USA**

Panel: Pierre-Marie Boisson, Sogebank, Haïti

James Mwangi, EBS, Kenya

David Stanton, DFID, UK

Frank Streppel, Triodos Bank, The Netherlands

Group 3: **The Challenges of Transformation**

*Group chair: Beth Ryne, senior vice president, ACCION International, USA*

Panel: Anicca Jansen, USAID, Senegal

Joanna Ledgerwood, SPEED Programme, Uganda

Mayoro Loum, ACEP, Senegal

**15.30:** Coffee/Tea break

### **PLENARY 3: Commercial Investment and Microfinance: The Challenges Ahead**

Chair: Professeur Abdoullah Cissé, president, Groupe Africajuris, Sénégal

Panel: Frank Abate, MicroRate, South Africa

Hany Assaad, IFC, USA

Anicca Jansen, USAID, Senegal

Alex Silva, ProFund, Costa Rica

**16.00:** Report back by group chairs and response by Beth Rhyne, senior vice president, ACCION International, USA

**16.30:** Final Plenary

**16.00:** Press Conference

**Topics:** Presentation of seminar conclusions

*Summary of AfriCap annual meetings*

Announcement of AfriCap's first investment in EBS, Kenya

## Annex II: Speaker Bios

### **Frank Abate**

Frank Abate is a lawyer and financial specialist with experience in the microfinance sector and emerging capital markets. He holds two Masters Degrees, one in International Trade and Banking Law, the other in Finance. With 11 years of experience in the Latin American private sector he has an in-depth knowledge of both regulated and non-regulated financial institutions. While working in the financial sector of his home country, the Dominican Republic, Mr Abate designed several financial instruments for the local capital market. Since 1999, Mr Abate has been working for MicroRate analyzing MFIs throughout Latin America and Africa.

MicroRate is the first rating agency specializing in the evaluation of microfinance institutions. Its objective is to link MFIs with funding sources and in particular with international capital markets. MicroRate evaluations allow lenders and investors to measure risk and they thereby help to create the transparency without which financial markets cannot work. MicroRate's comparison tables are an invaluable tool for measuring the performance of MFIs. MicroRate data are verified in the field and they can be adjusted to neutralize the effect of differing accounting practices and subsidy levels.

### **Hany Assaad**

Hany Assaad is the Program Manager of the IFC/Global Environment Facility Small and Medium Scale Enterprise Program, a US\$20 million IFC-managed facility under the Environment and Social Development Department. It is funded by the Global Environment Facility to finance and support intermediaries targeting SMEs whose activities contribute to the protection and the improvement of the global environment. For the two years prior to his appointment in August 2002 to his current position, he was the head of a newly established unit, the Micro, Rural and Small Business Financial Services and E-Finance, in IFC's Global Financial Markets Group, leading the effort to provide a strategic focus on scaling-up IFC's investments in financial institutions serving micro, rural and small businesses.

Hany joined the World Bank Group in 1986, initially working on energy efficiency projects in the Middle East and Africa. He joined IFC in 1987 and has since held various positions including Assistant to the President of the World Bank in 1996/97. Hany is the IFC director on three board of directors: the Industrial Promotion and Development Company of Bangladesh, and two private equity funds targeting microfinance institutions - AfriCap focusing on Africa and ProFund focusing on Latin America. He is an alternate member of the Investment Committee of the Consultative Group to Assist the Poor (CGAP), a consortium of 29 bilateral and multilateral donor agencies, which support microfinance.

### **Pierre-Marie Boisson**

Pierre-Marie Boisson is Chief Economist and member of the Executive Committee of the Board of Société Générale Haitienne de Banque (SOGEBANK). SOGEBANK is Haïti's largest commercial bank with about US\$ 340 millions in total assets, 27% market share of the banking system and a majority or control position in five financial institutions. These institutions include a mortgage bank, a factoring company, a credit card center, a recently established remittances company, (SOGEXPRESS), and a microcredit institution, Société Générale de Solidarité (SOGESOL). In his capacity as Chief Economist of SOGEBANK, Mr Boisson is responsible for strategic planning, management and financial counseling for the whole group, including FONDATION SOGEBANK, the group's social arm. Mr Boisson is currently Chairman of the Board of Directors of SOGESOL and

also member of the Board of SOGEXPRESS. He is also Secretary of the Board of Directors of SOFIHDES, a private development finance corporation.

Before joining SOGEBANK in 1991, Mr Boisson led a USAID-sponsored reorganization assignment of Haïti's Professional Bankers' Association in 1990. He is a former staff member of the World Bank's International Finance Corporation (IFC), where he spent two years (1988-90) and worked a total of nine years for Haitian public organizations, including four years as a member of the finance minister's cabinet. He holds an MPA from Harvard University (1988), an MSM from Arthur D. Little's Management Education Institute (1987) and a B.S. in civil engineering from the University of Haïti's Faculté des Sciences (1975).

## **Abdoullah Cisse**

Abdoullah Cissé is Professor in Private Law at the University of Saint Louis Gaston Berger where he is also President of the Scientific Council. He is a founder-director of DEA which specializes in economic and business law and also Research Director at the Centre for Research, Studies and Documentation on Institutions and Legislation in Africa (CREDILA). He is a member of the Board of the International Association of Economic Law (AIDE) as well as the Editorial Board for the International Review of Economic Law (RIDE). Professor Cissé is a senior manager, specializing in legal and fiscal advice, of @fricajuris Consulting, a 'legal engineering' consultancy company. He is also responsible for *africajuris*, a specialist publication for legal information in Africa. Professor Cissé is an expert in electronic payment systems and in this capacity he has acted as legal adviser to the Central Bank of West African States (BCEAO) on the reform of payment systems within the West African Economic and Monetary Union. He is the author of several articles and reports on business law, human rights and political criminology.

Abdoullah CISSE, agrégé des facultés de droit, est professeur titulaire de droit privé à l'Université de Saint-Louis Gaston Berger dont il assure la présidence du Conseil scientifique. Il est directeur-fondateur du DEA de droit économique et des affaires et directeur de recherches au Centre de Recherches, d'Etudes et de Documentation sur les Institutions et les Législations Africaines (CREDILA, UCAD). Il est membre du Conseil d'administration de l'Association Internationale de Droit Economique (AIDE) et du conseil de rédaction de la Revue Internationale de Droit Economique (RIDE).

Il dirige en qualité de conseil juridique et fiscal le cabinet d'ingénierie juridique @fricajuris Consulting ainsi que la revue *africajuris* spécialisé dans le traitement de l'information juridique africaine. Expert en systèmes de paiement électronique, il est chargé en qualité de consultant par la Banque Centrale des Etats de l'Afrique de l'Ouest (BCEAO) du volet juridique de la réforme des systèmes de paiement des Etats de l'Union Economique et Monétaire Ouest Africaine (UEMOA). Il est l'auteur de plusieurs ouvrages, articles et rapports notamment sur le droit des affaires, le droit des droits humains et la politique criminelle.

## **Martin Connell**

Martin Connell is President of AfriCap MicroVentures, the fund manager of AfriCap, and wholly owned subsidiary of CALMEADOW, of which he is also President. CALMEADOW is a co-sponsor of the Fund, and has lead the process of establishing the Fund, from the feasibility to the marketing, launch and implementation stages. CALMEADOW is a Canadian microfinance specialist organization founded by Martin and his wife Linda Haynes in 1983 after they had traveled to several developing nations and recognized the economic and social potential of micro-lending. Martin expanded CALMEADOW from a grant-giving foundation, to a non-profit organization with two domestic loan funds and international technical and financial assistance contracts in the field of microfinance.

He has assumed a leadership role in various path-breaking microfinance institutions, from AfriCap to ProFund to BancoSol. He chairs ProFund, an investment corporation established to invest in new and

emerging microfinance institutions in Latin America, and in 1992 he was a founding investor of BancoSol, a private commercial microfinance bank in Bolivia and was until recently an active BancoSol Board member. Until its merger in 1996, Martin was the senior executive of Conwest Exploration, a Canadian oil & gas company.

### **Jean-Claude Ebe-Evina**

Jean-Claude Ebe-Evina is Coordinator of the Support Project for the National Microfinance Programme in Cameroon. Since 1993 he has also been a director of Bureau-Gestion, a consultancy company specialising in financial, banking, audit and management advisory services. Jean-Claude is also a director of a brokerage firm, an associate of the Institute for International Relations in Yaoundé and President of the Board of a paper and cotton company. Prior to assuming his current responsibilities he spent 10 years working for a number of national and international banks holding a variety of administrative and management positions.

Jean-Claude has degrees and qualifications in a variety of subjects including a DESS in Banking and Finance and a DESS in Planning and Controlling. He was voted Financier of the year in Cameroon in 2002. Jean-Claude speaks French, English and Spanish. He is married with four children.

### **Eric Ekue**

Eric Amah Ekue is currently Director of the Department for Decentralised Financial Systems at the Central Bank for West African States (BCEAO), a post he took up in February 2003. Prior to his current position he was a director responsible for the regulation and development of the microfinance sector. Since joining the BCEAO in 1978 he has held a number of different positions including Adviser to the Director in charge of Decentralized Financial Systems and Head of the bank's Credit Section. He has also worked as Authorized Representative in the Department for International Relations at the BCEAO's head office in Lomé

### **Emile Groot**

Emile Groot obtained a Masters Degree in Economics at the University of Tilburg, Netherlands (1974). He started his career with UNESCO at the Instituto Politecnico Nacional in Mexico City teaching courses in economics. In Mexico he also worked for the ILO/Geneva at the Instituto Nacional de Trabajo and later on as a private consultant. He continued his work for the Ministry of Development Cooperation/The Hague at the Fondo Nicaraguense de Inversiones in Managua for two years.

Mr Groot joined FMO in 1985. Currently he is in charge of FMO's micro and small Enterprise Programme. Besides managing FMO's Small Enterprise Fund (USD 100 million) he represents FMO on several Boards in (Micro and SME) Financial Institutions in Latin America, Asia, Africa and Eastern Europe. His specialised knowledge of Micro and SME-development is widely used by FMO for the promotion and finance of this important sector of the economy in emerging markets.

### **Stefan Harpe**

Stefan Harpe is Investment Manager for AfriCap. He managed CALMEADOW's effort to develop and market a microfinance investment fund for Africa, leading to the establishment of AfriCap in October 2001. Prior to taking up his current appointment, he oversaw the First Closing of the Fund and its incorporation in Mauritius, relocated to Dakar and opened the AfriCap office there, and recruited a small team of managers and support staff. He is engaged in raising the remaining capital for the Fund, and responsible for implementing the investment strategy, in collaboration with the Investment Committee. Prior to joining AfriCap, Stefan was a Director of International Operations at

CALMEADOW, since September 1995. He was involved, as member of the Investment Committee, with the implementation of the investment program of ProFund, a \$21 million fund created by CALMEADOW and others in 1995, to invest in Latin American microfinance institutions.

Stefan has solid strategic and practical experience in both the public and private sector. He was appointed as Advisor to the Minister of Economic Development in the Ontario Government in 1990, where he helped develop an industrial policy, advised on large corporate restructurings, and coordinated community economic development initiatives. Prior to his appointment, he worked for ScotiaMcLeod (a Canadian investment bank) as VP-Corporate Finance, negotiating and marketing new issues of debt and equity securities and managing diverse M&A assignments. Stefan graduated in 1985 with a Masters of Business Administration from the University of Western Ontario. He also holds a B.Sc. (Econ.) from the London School of Economics and speaks French, German and Spanish.

### **Anicca Jansen**

Anicca Jansen is USAID's regional advisor for microenterprise development in West Africa. She is currently based in Dakar. As part of her duties she provides technical assistance to seven USAID offices in the region, and provides technical oversight to several USAID projects. Dr Jansen has worked in the USAID Office of Microenterprise Development since the launch of USAID's Microenterprise initiative in 1994. Prior to that she was an Economist with the US Department of Agriculture's Economic Research Service where she focused on economic development in the rural United States. She has taught microfinance and economic development at American University, Washington, DC, and the University of Maryland. She has provided technical assistance in several African countries, Eastern Europe, and Haiti.

### **Joanna Ledgerwood**

Joanna Ledgerwood is currently based in Kampala, Uganda where she is the Microfinance Adviser for the USAID-funded Support for Private Enterprise Expansion and Development (SPEED) Project, which focuses on assisting MFIs to become regulated deposit-taking institutions. Prior to this she was the Deputy Chief of Party for the Microenterprise Access to Banking Services (MABS) Project, a USAID-funded project located in the Philippines which assists rural banks to provide financial services to microenterprises. Before MABS, Joanna spent eight years as an independent consultant to the micro-finance industry. Her clients included the World Bank, Save the Children, FINCA, SEEP, CGAP, IRIS, Bankakademie, among others. Prior to working as an independent consultant, Joanna was employed by Calmeadow, during which time she authored an Accounting Guide for Microfinance, a Financial Management Guide for Microfinance and developed an accounting board game for microfinance. She is also the author of the World Bank's Microfinance Handbook, a publication widely used throughout the microfinance industry.

### **Patrick Lelong**

Patrick Lelong is Managing Director of FINADEV SA, the first private MFI in francophone Africa, funded by GROUPE FINANCIAL, the IFC, the FMO, and the HORUS Group. Since July 2002, Patrick has also held the post of Auditor General of FINANCIAL Bank in Benin. During the four years prior to his current appointment, Patrick worked as a consultant on MSME development throughout Africa. Between 1991 and 1997 he held several positions with Groupe FINANCIAL BC including two and a half years as managing director of FINANCIAL Bank in Chad. Patrick started his banking career with International Bank for West Africa (BIAO) with whom he spent nearly 20 years on assignments in France, Cameroon, CAR and Ivory Coast. He is married with two children.

## **Mayoro Loum**

Mayoro Loum is the general manager of the Alliance de Crédit et d'Épargne pour la Production (ACEP). He joined ACEP in 1988, two years after the organisation started its life as a USAID project. Mr Loum is a graduate of the school for law and economics at the University of Dakar and he has three years work experience in the commercial banking sector. After being promoted to Assistant General Manager in 1990, he took over the role of General Manager in 1993, when the technical assistance programme for ACEP came to an end and the institution was formally registered.

Mr Loum has participated in a number of international seminars and microfinance training events. He is actively involved in the development of an ACEP network in Africa and he is also a contributor to a number of different capacity building programmes, working in close collaboration with various donor agencies. In addition, Mr Loum is an active participant in various professional organisations and networks in Africa and beyond.

## **James Mwangi**

James Mwangi has been the Finance Director of Equity Building Society in Kenya for the last 8 years. Before joining Equity in 1994, James worked as an auditor with Ernest and Young Certified Public Accountants and as a Group Financial Controller of a leading bank in Kenya. James joined Equity Building Society when it was a technically insolvent mortgage provider with negative asset value. He led a team that oversaw the transformation of Equity by re-focusing its mission on microfinance and turning it into the most dynamic MFI in Kenya. One of James's main tasks is to enable Equity staff to develop their maximum potential while contributing to the organization's ambitious growth strategy. He is also a key driving force behind Equity's medium and long-term strategic plans.

James was a member of a Kenyan think tank on economic recovery after the presidential elections in December 2002. He has attended courses and/or presented at business educational institutions in the USA, Senegal, Uganda, Edinburgh, Germany, South Africa and Thailand. James is a Certified Public Accountant and he holds a Bachelor of Commerce degree with accounting option.

## **Maria Otero**

María Otero was named President & CEO of ACCION International in January 2000, where she had been Executive Vice President since 1992. She is also the Chair of AfriCap's Board of Directors. Ms Otero joined ACCION in 1986 as director of its microfinance program in Honduras, where she lived for three years. She has published several monographs on microenterprise and co-edited *The New World of Microfinance*, published by Kumarian Press, and is internationally recognized as a leading voice on microfinance.

ACCION's strategic expansion into Africa and commitment to develop new investment instruments and vehicles to demonstrate the viability of commercial microfinance are at the base of ACCION's co-sponsorship of the AfriCap Microfinance Fund. Maria Otero was elected Chair of AfriCap's Board of Directors in October, 2001.

Ms. Otero serves as Chair of the MicroFinance Network, a global association of 26 leading microfinance institutions, and has served in an advisory capacity to the World Bank's Consultative Group to Assist the Poorest (CGAP). In 1994, President Clinton appointed her to serve as chair of the Board of Directors of the Inter-American Foundation, a position she held until December 1999. She also serves on the Advisory Board for the United States General Accounting Office. Since 1997, Ms Otero has been an adjunct professor at John Hopkins School for Advanced International Studies. She was born and raised in La Paz, Bolivia, and resides in Washington, DC.

## **Elisabeth Rhyne**

Elisabeth Rhyne is ACCION International's as Senior Vice President for International Operations/Africa and Senior Vice President for Policy. She leads ACCION's operations in Africa and directs ACCION's research efforts to develop new financial products for the poor, including rural lending products, housing credit and savings and remittances. Recognized as a leader in the field of microcredit, Ms Rhyne has published numerous articles and four books on the topic. Most recently, she co-edited *The Commercialization of Microfinance: Balancing Business and Development* (Kumarian Press, 2002). Her book, *Mainstreaming Microfinance: How Lending to the Poor Began, Grew and Came of Age in Bolivia* was published by Kumarian in 2001. She is also co-editor of *The New World of Microenterprise Finance* (Kumarian Press 1994).

Ms Rhyne's experience in microfinance includes her work as Director of the Office of Microenterprise Development at the U.S. Agency for International Development (USAID) from 1994 to 1998, where she developed and managed USAID's microenterprise program. Programs developed under her guidance include Microenterprise Best Practices, the USAID Implementation Grant Program, the PRIME fund, and the AIMS Project. From 1989 to 1993, she designed and coordinated USAID's GEMINI project, a microfinance research initiative responsible for publishing over 100 titles on microenterprise best practices. Prior to joining ACCION in 2000, she worked as an independent microfinance consultant based in Mozambique. Ms Rhyne's consulting assignments have included advising several governments on microfinance policy, as well as conducting diagnostic assessments and business planning for multiple microfinance institutions.

Ms Rhyne earned a Master's and Ph.D. in public policy from Harvard University. She holds a Bachelor's Degree in history and humanities from Stanford University.

## **Marie Seck Seye**

Marie Seck Seye is Technical Adviser to the Senegalese Minister for Female Entrepreneurship and Microcredit. Between 1996 and 2003 she was Technical Adviser to the Minister for Labour, Employment and Professional Organisations in charge of employment issues. She was also responsible for the National Action Plan for Employment. She held the position of Divisional Head of the Support Unit for Employment Promotion between 1990 and 1996.

## **Alex Silva**

Alex Silva is General Manager of ProFund and Chair of AfriCap's Investment Committee. He serves as director on the Board of several micro-finance intermediaries in Latin America including: BancoSol (Bolivia), MIBANCO (Peru), Banco Solidario (Ecuador), Finamerica (Colombia), SogeSol (Haiti) and Compartamos (Mexico).

As Investment Manager of ProFund, for the past six years, Alex has been responsible for investing ProFund's capital of \$22 million (in eleven institutions in ten countries) and subsequently contributing to the growth and profitability of those investments as an active Board member. Alex has built a small management team, based in Costa Rica, who collectively provide oversight and governance to ProFund's investees, and currently are actively developing divestment strategies for most of the investments. Prior to joining ProFund at its inception in 1995, Alex worked for the Interamerican Investment Corporation (the investment affiliate of the Interamerican Development Bank) where he was the Central American Regional Manager. In addition to his ProFund management responsibilities, Alex is also a member of CGAP's Advisory Committee.

Alex holds an MBA and Engineering degrees from Cornell University as well as a BA in Economics from Louvain University.

## **David Stanton**

David Stanton is Chief Enterprise Development Adviser for the Department for International Development (DFID) in the UK. He leads a global technical team that supports programmes across the developing world that enhance pro-poor private sector development. He has Master Degrees in English and Business Administration, and his career spans nine years in the printing and venture capital industries, and thirteen in international development. This included spells with CARE International, and other international NGOs and foundations. He has written a number of papers on small enterprise development, and is an Executive Committee Member of the Consultative Group to Assist the Poorest (CGAP).

# Annex III: Participant List

## **Belgium**

Charles TOLLENAERE, Direction Générale de la Coopération au Développement  
Rik VYVERMAN, BIO (Belgian Development Bank)

## **Benin**

Patrick LELONG, Finadev SA

## **Bolivia**

Andrea SEELING, APEMIN

## **Cameroon**

Jean-Claude EBE-EVINA, Support Project for the National Microfinance Pr. (PPMF)

## **Canada**

Catherine BERARD, Canadian International Development Agency (CIDA)  
Martin CONNELL, Calmeadow  
Gérard ROBARD, Canadian International Development Agency (CIDA)

## **Costa Rica**

Alex SILVA, ProFund

## **Democratic Republic of Congo**

Ramazani DIHUMBA, RIFIDEC

## **The Gambia**

Yero HJ BALDEH, The Gambia Social Development Fund  
Cherno A SOWE, The Gambia Women's Finance Association

## **Ghana**

Robert Kwadwo ASANTE, First Allied Savings & Loans Ltd  
Paa Kwesi BARNES, Global Solutions Ltd  
Nana Asante BEDIATUO, Citi Savings & Loans  
Ernest MINTAH, PSME Project

## **Haïti**

Pierre-Marie BOISSON, Sogebank

## **Ivory Coast**

AA SAÏD ATTOUMANE, Africa Microfinance Network (AFMIN)

## **Kenya**

James MWANGI, Equity Building Society (EBS)  
Henri OKETCH, INAFI

## **Madagascar**

Alphonse RALISON, SIPEM

## **Mali**

Boubacar DIALLO, Freedom from Hunger  
Hubert RAUCH, GTZ (German Technical Cooperation Agency)

## **The Netherlands**

Gauke ANDRIESSE, Cordaid  
Emile GROOT, FMO (Dutch Development Bank)  
Frank STREPPPEL, Triodos Bank  
Koenrad VERHAGEN, Argidius Foundation

## **Niger**

Gazobi RAHAMOU, Madalla

## **Nigeria**

'Toye ABIOYE, Growing Business Foundation  
Victor ABODUNRIN, Inlaks Computers Ltd

## **Senegal**

Véronique AHYI, Avapress  
Vincent AKUE  
Kane ASSANE, FDEA  
Madina ASSOUMAN, GERME  
Bernard BATONGA, International Finance Corporation (IFC)  
Gladys BESSANE, AfriCap Microfinance Fund  
Malik BESSANE, AfriCap Microfinance Fund  
Genevieve BREMOND SARR, Africajuris Consulting  
Alan BURNER, Ambassador of Great Britain  
Abdoullah CISSE, Groupe Africajuris  
Patricia CISSE, Locafrique  
Sada Ly CISSE, CRS  
Sambou COLY, Citibank  
Hélène Sow DAHOU, Dynaentreprises Sénégalaises  
Roch Gnahoui DAVID, Africajuris Communication  
Sékou DIABATE, AQUADEV West Africa  
Cheikh M DIOKHANE, Fédération Nationale FNGPF  
Adama DIOP, ARAN  
Aminata DIOP, Cellule AT-CPEC / MEF  
Mane Demba DIOP, Fonds de Promotion Economique du Sénégal  
Seynabou DIOP, RECEC  
Abdoulaye DIOUF, UNACOIS

Samba DIOUF, ASACASE  
Wagane DIOUF, AfriCap Microfinance Fund  
Eric EKUE, BCEAO  
Alioune FALL, PMIA  
Momar FALL, Insertech  
Mamadou FAYE, CONACAP  
Pierre FORESTIER, Agence Française de Développement (AFD)  
Sylvie GAUVIN, Développement International Desjardins  
Bénédicte GAZON, Performances Management Consulting  
Tanguy GRAVOT, CAPAF  
Holger GRUNDEL, AfriCap Microfinance Fund  
Mamadou L GUEYE, CRS  
Stefan HARPE, AfriCap Microfinance Fund  
Anicca Jansen, USAID  
Sébastien JOBERT, Canadian Embassy  
Lalya KAMARA  
Emmanuelle KEINDE, Panafcom  
Valérie KWASSI, BCEAO  
Sanou LEYE, Fonds de Contrepartie Sénégal-Suisse  
Majoro LOUM, ACEP  
Cheikh Sadibou LY, Agence du Fonds de Développement Social  
Daouda LY, Fonds de Contrepartie Belgo Sénégalais  
Tafsir Amadou MBAYE, UMECU  
Anne-Pierre MINGELBIER, Belgian Technical Cooperation  
Imencio MONRENO, Banque Senegalo-Tunisienne  
El Hadji NIASSE, INAFI  
Abibatou NDIAYE, FAFS  
Baba NDIAYE, Fonds National de Promotion de la Jeunesse  
Sokhma MM NDIAYE, FNGPF  
Papa Ali NDIOR, ACEP  
Denise F NDOUR, Fonds de Contrepartie Sénégal-Suisse  
Hamet NDOUR, REMIX  
Bintou Ka NIANG  
Abdou PAYE  
Coumba Pathé PAYE, European Commission  
Khadu SAMBA, Ministry of Female Entrepreneurship and Micro-credit  
Babacar SAMBE, Fonds de Promotion Economique du Sénégal  
El Hadj Daouda SECK, Africajuris Consulting  
Marie Seye SECK, Ministry of Female Entrepreneurship and Micro-credit  
Rabi Hagne SECK, Plan Sénégal  
Papa Yatma SENE, MECARUL  
Mamadou Lamine SYLLA, CBAO  
Omar SYLLA, Ministry of Finance and Economic Development  
Fayol Dioum TALL, Cellule AT-CPEC / MEF  
Coumba Loum THIAM, Fonds de Promotion Economique du Sénégal  
Awa THIAW-GUEYE, MGP - Afrique  
Ousmane THIONGANE, Christian Children Fund  
Ndeye Marianne THIOYE, FDEA / INAFI  
Bernard TISSOT, Crédit Mutuel du Sénégal  
Michel K TOKO-PUKU, Christian Children Fund  
Mamadou TOURE, PAMECAS  
Mamadou WADE, PAME AGETIP  
Patricia WALL, Christian Children Fund

Juliette Paule ZINGAN, Fenagie Pêche

## **South Africa**

Frank ABATE, MicroRate

Thomas BEDENBECKER, Advisory Service for Private Business

## **Sweden**

Lars-Olof HELLGREN, AfriCap Sweden

## **Switzerland**

William PALLADINO

## **Tanzania**

Cheryl FRANKIEWICZ

## **Togo**

RA NASSIROU, WAGES

## **Uganda**

Benjamin BYARUGABA, SOMED

Joanna LEDGERWOOD, SPEED Programme

Peter OKAULO, Uganda Women's Finance Trust (UWFT)

## **United Kingdom**

David STANTON, Department for International Development (DFID)

## **USA**

Hany ASSAAD, International Finance Corporation (IFC)

Vincent BURGI, MicroRate

Kiendel BURRITT, United Nations Capital Development Fund (UNCDF)

Mwaghazi MWACHOFI, International Finance Corporation (IFC)

Maria OTERO, ACCION International

Beth RHYNE, ACCION International

## Annex IV: Additional Reading

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