CHAPTER 13:

Commercial Investment in Microfinance: Fears and Fulfillment

Bob Pattillo

Founder and Partner, Gray Ghost Microfinance Fund

On the plane home from the KfW Symposium on microfinance investment funds, I thought about the facts, the ideas, and the feelings that we shared during those two days in November 2004. The feelings were especially important because they are what most motivate us, stir us to action or resign us to abstinence. One feeling I sensed several times was fear – the fear of private investment in microfinance. Are investors "short timers," getting in, making or losing a quick buck, and getting out? Will investors sitting on boards corrupt strategy, moving management towards consumer lending, away from the smaller borrowers and the rural markets? Will they load existing customers with more debt than they can handle? In response to such questions rooted in fear, and to explore another way of experiencing what lies ahead, I offer the view of one investor.

Can Microfinance Safely Attract Long-Term Investors?

A great debate in the microfinance industry centres on whether microfinance investment funds are long-term players or whether they are merely Trojan horses for commercial banks. Commercial banks bring scale, efficiency and the capacity to tap local savings. They also can bring credibility with regulators. But microfinance investment funds are as important as the commercial banks long-term for two reasons: 1) funds are where true innovation will occur, and 2) funds are the only mechanisms for private investors to enter this market, other than direct share ownership. The global microfinance market will become like the barbell financial market in the US. The Goliaths at one end are the huge banks that treat financial services delivery as a commodity. And at the other end, the risk takers and the relationship makers rule, creating innovative enterprises that find niches to survive and thrive.

One of the most powerful notions put forward at the Symposium is institution or enterprise building. It was the strongest point of agreement between two of the most respected people in the business, Maria Otero of ACCION and Claus-Peter

Zeitinger of IMI. An enterprise is a building block for the industry, whether an MFI, a bank, a network, or a fund. It is at the convergence of vision, strategy, and passion, making things work to attract the stakeholders that make things happen. The power of privatising microfinance is demonstrated by the fact that these stakeholders gather by choice. A compelling enterprise attracts employees, customers, and now, investors. Investors in time, experience, and financial resources are the owners, or at least those directly responsible in a way that leaves them clearly accountable.

There are now between 38 and 55 microfinance funds – depending on the reporting source. The growth in the number of microfinance investment funds is, as Damian von Staffenburg said, "one of the glories of microfinance." Each is putting forward its vision for a powerful enterprise and is just beginning to attract investors. The volume of private and commercial dollars that will flow into microfinance will be enormous. If the industry now has \$ 500 million in private funds, \$ 100 billion will surely accumulate before the growth trend levels off. There are three reasons for this expansion.

Why Private Investment in Microfinance Will Grow

First, microfinance is just beginning to tap its potential for profitability and growth. The relationship between the loan officer and the microentrepreneur is powerfully loyal, both ways. Do you remember who gave you your first loan? The opportunity to sell other very useful products and services such as life insurance or home loans through that existing distribution channel will add revenue at a low incremental cost, creating a profit for the bank. Competitive microfinance markets in Bolivia and Bangladesh demonstrate that MFIs can innovatively serve their customers at lower cost. These best practices will spread through the global industry, producing more profits in a healthy way for all stakeholders. Profits attract investors.

Growth potential in microfinance is well documented. Start with the current client base, expand that to some fraction of the 500 million potential customers, increase each loan by the potential growth of the microenterprise, then expand each client relationship with other services such as mortgages. The capital growth is enormous, far beyond the capacity of public money. The emergence and dominance of private capital is inevitable.

Second, private investors add value beyond the capital they provide. One unfounded fear is that private investors will charge too much, asking for higher returns that "squeeze blood out of a turnip." But, consider rates of return as part of a package. A privately capitalised microfinance fund can be innovative, efficient, agile and service-oriented. The cost of capital to the MFI is important, but of similar importance is the transaction cost of funds, which is low. Consider the flexibility of the capital provider, transparent strategy and decision making processes, timeliness, and smooth and quick approval and reporting processes. Funds can