

CHAPTER 15 :

A Donor-Investor's Vision for Enhancing the Future of Microfinance

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Finding ways to engage private capital in microfinance requires use of the most valuable capital available in the fight to alleviate poverty: the human capacities of compassion, ingenuity, and resolve. Applying capital through microfinance investment funds (MFIFs) for poverty reduction in turn requires the evaluation and forecasting of trends in socially responsible investment and in microfinance.

Key Issues in Play

As more questions are answered, more are unearthed:

- Private capital is starting to flow into microfinance, but will this cause a shift away from micro-clients in efforts to reduce costs? What happens when margins decline as a result of increased competition, which is – on the other hand – indispensable to the sustainable development of the real sector?
- Investment funds can provide capital, but how can microfinance be linked to the capital market most effectively?
- New investors are being attracted to microfinance investment funds, but will management resources be sufficient to guide these funds fruitfully?
- There is a proliferation of MFIFs. Will their influence focus MFIs on only the same business segments, or will they broaden the frontier of micro-finance to reach poorer households and rural areas?
- Sound governance structures are essential. How will they be created and sustained? What innovative structures are required?

Asking new questions is a measure of learning, and the lessons that evolve must be applied in order for financial cooperation to be effective. At KfW we learned in

the 1990s that business-oriented microfinance banks have vast potential to fight poverty. Now these banks contribute to achieving the Millennium Development Goals. As early as 1994 we helped establish micro banking in Albania, and later we were instrumental in setting up a network of microfinance institutions (MFIs). We have now reached a new level of cooperation as we contribute to the consolidation and strengthening of those networks through the creation of holding companies such as IMI AG (now ProCredit Holding AG) and AIM.

Our present challenge is to develop MFIFs as a standard, core instrument that will strengthen the entire commercial microfinance industry. We already have relationships with MFIFs that have a broader investment perspective, such as LA-CIF, and through the Global Microfinance Facility, for example. But to meet this challenge effectively we must innovate.

Funding for the Future

What is the appeal of microfinance investment funds; what purposes do they serve? The answer is that microfinance has the potential to contribute massively to the fulfilment of the Millennium Development Goals. But this is possible only with substantial amounts of refinancing. Our outreach is limited: tremendous volumes of financial resources are likely to be mobilised only through MFIFs. These funds offer the opportunity to manage risks and transaction costs in such an efficient manner that private capital will be attracted to microfinance.

The difficult government budget situation around the world means that private capital has to play a pivotal role. Some argue that the only successful way to engage sufficient private capital is through private funds that are purely commercial and credibly rated. In my view, at least for the next decade donor funds will continue to be a major source, which means that development banks like KfW will still play a decisive promotional role. Donors' support in establishing well-functioning MFIs is not being phased out – to the contrary.

But what should and shall be our role in building well-functioning MFIFs and mobilising private capital? In this regard, and taking KfW as an illustration, the following functions are increasingly important as microfinance evolves:

- *Public-private cooperation:* KfW is an institution that integrates public and private institutional strengths. It is therefore well-positioned to serve as a platform for the creation of innovative financial tools and products that involve a range of actors in both the government and private sectors.
- *Leverage:* Applying public development aid to the financial structuring of microfinance investment funds leverages the flow of private capital. KfW's participation in a MFIF signifies a certain quality assurance and builds confidence for private investors, especially the institutional investors who