

Investment Funds

Doing Well by Doing Good

The secret has gotten out that microfinance institutions can be profitable. As the news spreads, investors are positioning themselves to get a piece of the action. A variety of recently created funds provide resources to microlenders and help link them to capital markets in win-win deals that increase microlenders' loan capital, bring a profit to investors, and channel money to microentrepreneurs with no other access to credit.

Conventional investors' participation in microfinance is testimony to the successful track record of microfinance institutions during the last two decades and the growing trend of microlenders to convert to regulated institutions whose risks are supervised by national banking authorities.

The market for microfinance is enormous: existing institutions serve only a fraction of the estimated 500 million people worldwide who need financial services. In dollar terms, the amount of lending capital needed is also vast; in three Andean countries alone—Bolivia, Colombia and Peru—it could reach as high as US\$300 million. Since neither international donors nor the microfinance institutions can provide enough resources to reach the waiting market, they must go where the money is: to financial markets around the world.





L-R: Fernando Lucano,
CEO of LA-CIF; Alex
Silva, CEO of ProFund;
and Francisco (Pancho)
Otero, founder of
Banco Sol, Bolivia



MICROFINANCE COMES OF AGE

Sophisticated new funds—such as ProFund Internacional (Costa Rica), the Latin American Challenge Investment Fund (Peru) and Triodos Bank (Holland)—that can boost the lending capital of microlenders reflect the trend toward creating “second tier” institutions which lead to microcredit portfolios.

ProFund: Public-Private Partnership for Profit

“We seek to have a demonstration effect, to show that microfinance and microcredit can and must be a function of traditional banking,” says Alex Silva, CEO of ProFund. The fund is dedicated to achieving “superior financial returns for its investors by supporting regulated, efficient financial intermediaries serving primarily small and microenterprises in Latin America and the Caribbean.” ProFund operates on the theory that if its investments in microfinance institutions turn a profit in 10 years, the fund will have proved that microcredit is viable for commercial banking, Silva says.

Created in 1995 with \$22 million, ProFund sees itself as a public sector partnership for profit. A 10-year closed-end fund, it was established with capital put up by four multilateral and bilateral donors, three non-governmental organizations and two private investment funds dedicated to ethical investing. The donor agencies hold 76 percent of the shares; NGOs, 16 percent; and private investors, 8 percent. So far, ProFund has earned a higher than expected return and met its commitment to hold annual operating expenses to less than 3 percent of total capitalization; because the portfolio is concentrated in investments that have not matured, however, it cannot yet predict the return on investment, Silva reports.

The fund invests in three types of microfinance institutions: non-governmental microlenders that are converting to regulated institutions; traditional

financial intermediaries with subsidiaries dedicated to microfinance; and non-bank intermediaries, such as leasing and factoring companies, that serve micro and small enterprises.

ProFund has invested \$16.2 million in 10 microfinance institutions in the Andes and Central America, the Latin American regions where the microfinance sector is most highly developed, says Silva. The fund is seeking new investments in Guatemala and Haiti.

LA-CIF: Linking Microfinance and Capital Markets

The Latin American Challenge Investment Fund is designed to introduce investors to the risks—and profit opportunities—of short-term investments in microfinance and small-business banking institutions, says Fernando Lucano, CEO of LA-CIF. The tool used to persuade conventional investors to take a stake in small-scale banking is risk analysis for investments that include loans, bonds and guarantees.

LA-CIF projects that it will offer an average 11 percent return on investments over the three-year period that ends in 2002. Although this is based on the expected performance of sound microfinance institutions, it is backed up with compelling evidence; the LA-CIF analysis of the best five microlenders in Bolivia and Peru—where microcredit is highly developed—show average returns on equity ratios of 10 percent in Bolivia and 30 percent in Peru, even while both countries were suffering marked economic slowdowns.

The fund attracts financing to microlenders by structuring transactions for local institutional investors. It puts together deals that include simple guarantees to back a local bank which lends to a microfinance institution; syndicated loans and bonds; or paper issued on local markets by microlenders, says Lucano.

To give investors adequate market information, LA-CIF prepares macro-economic risk analyses that examine country risk, policies on interest rates and foreign investment, and regulatory standards, says Lucano. In addition, the fund prepares risk analyses of the microfinance institutions that cover their liquidity; quality of their loan portfolios; adequacy of their capital reserves and loan loss reserves; profitability; and the match of currencies and loan repayment periods.

Created in 1999 with commitments of US\$5 million, LA-CIF aims to use these funds to generate US\$35 million by 2003. The shareholders include nine multilateral and bilateral aid agencies and one NGO.

LA-CIF finances only regulated institutions, such as banks, finance institutions and cooperatives. The investments are made at market interest rates for 180 days—which can be extended to three years—for a maximum of US\$750,000 or 20 percent of the assets of the client. If the client defaults, the repayment schedule is accelerated and other protections are applied, says Lucano.

The fund invests in four types of capital market instruments: direct loans denominated in U.S. dollars for micro-lenders in highly dollarized economies; syndicated loans, to reduce the borrowing costs of microfinance institutions and small-business banks; bonds and certificates of deposit issued by micro-credit institutions; and direct guarantees, provided by a letter of credit from a local bank and additionally backed by the U.S. Agency for International Development.

Triodos Bank: Ethical Savers and Profit-Making

The Triodos Bank, a commercial lender with a social purpose, began lending to microfinance institutions in the 1990s, when its savers demanded that bank resources be directed toward developing

LA-CIF SHAREHOLDER PARTICIPATION

Organization	Share (%)
MIF (Multilateral Investment Fund)	31.4
Norfund – Norway	26.2
Desjardins – Canada	13.1
CARE – Ecuador	6.5
Argidius Foundation – Switzerland	5.2
Swedfund – Sweden	5.2
Swedish Central Cooperatives	5.2
Scdf – USA	2.4
SIDI – France	2.2
MEDA – Canada	0.8
FUNDA-PRO – Bolivia	0.6
Etimos Italia	0.4
Enlace Ecuador	0.4
Fundes Switzerland	0.4

countries in the Southern Hemisphere, says Eric Guerts, senior investment officer of Triodos Bank. As part of this mandate, since 1993, lending to microfinance institutions has become one of the main lines of action of the bank.

Triodos Bank attracts funds from ethical savers and invests in companies that benefit society either by protecting the environment through organic agriculture or by using renewable energy sources.

The bank offers several types of products to microfinance institutions, including long-term loans, convertibles, and subordinated debt; and purchase of shares, says Guerts. Through the North-South account, which is funded by 800 private investors, Triodos offers loan guarantees. In seven years of financing microfinance institutions, the bank has made loans to financial institutions in Bolivia, Ecuador, Guatemala, Peru and El Salvador. In Africa, Triodos more commonly takes equity participations in microfinance institutions.

Since 1994, the bank has intensified its emphasis on fee products that include insurance, fund management and research for ethical investments.

LA-CIF 2000–2001 PORTFOLIO (13 Clients)

Bolivia: Caja Los Andes, FFP FIE, Prodem

Peru: Cajas de Arequipa y Tacna / Mibanco / EDPYMES: Crear-Tacna, Proempresa, Confianza

Dominican Republic: Adopem

Nicaragua: Finde

Ecuador: Banco Solidario

Paraguay: Visión de Finanzas

Founded in 1977, Triodos grew slowly until 1990, but began to take off during that decade. In 1999, the bank grew by 30 percent and its profits grew by 25 percent. In 2000, Triodos assets increased by 34 percent. Its net profits grew by 81 percent between 1994 and 2000.

—BY LUCY CONGER