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Microfinance Meets Wall Street

Susan Davis and Rod Dubitsky 03.26.08, 6:00 AM ET

Susan Davis



Just outside of Kampala, Regina buys, cleans, cooks and sells roasted chickens every evening to commuters on their way home. Her business was made possible by a \$180 loan from BRAC, an international development organization headquartered in Dhaka, Bangladesh, with microfinance operations in Asia and Africa. Half a world away in New York City, a banker from Credit Suisse is finalizing one of the first and largest IPOs of a microfinance institution (MFI), Banco Compartamos.

The growing needs of MFIs and the growing availability of alternative capital ensure that these strange bedfellows will be seeing much more of each other. The question is: Will this grand coming together of the world's poorest and the world's richest help alleviate the capital constraints of MFIs on a mission to serve poor entrepreneurs, while providing acceptable returns to investors?

Rod Dubitsky



MFIs are financial intermediaries that provide small loans without collateral to borrowers living in poverty. Two key distinctions between MFIs and other commercial banks are: 1) MFIs generally lend to their clients for income generating purposes (so-called working capital loans), while commercial lenders typically lend to individuals who have collateral, or for consumption purposes; and 2) MFIs focus on those at the bottom of the economic pyramid, whereas traditional commercial lenders typically serve those far above the poverty line.

Another interesting difference between MFIs and other commercial lenders is that MFIs send their loan officers to the homes of their poor clients while, on Wall Street, private banking for the world's wealthiest clients is generally the only time banks invest in cultivating personal relationships. MFIs epitomize the concept of "relationship banking."

MFIs have seen tremendous growth over recent years--about 50% a year over the past five years, according to the MIX Market. Estimates of potential demand reach \$300 billion, while the current supply of foreign capital is a mere \$4 billion (this represents a tripling over the past three years). The growth of MFIs coupled with limited pools of traditional capital is resulting in an unlikely alliance: Wall Street and poor micro-entrepreneurs. As the microfinance industry fervently discovers how to tap the far bigger pool of capital available in the for-profit world, the trade-off between poverty alleviation and profits is of paramount importance.

Notwithstanding the fact that most foreign microfinance funding comes from public entities and socially motivated private investors, over a hundred new debt and equity funds have been created in the past decade, and particularly in the past three years.

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Three examples highlight the range of capital market tools that MFIs have begun to use: 1) BRAC's securitization of retail microfinance loans; 2) Blue Orchard's securitization of wholesale loans to MFIs via a collateralized loan obligation; and 3) the IPO of Compartamos, Mexico's largest MFI.

BRAC's securitization represents one of the first and largest securitizations to date of retail microfinance loans. Led by Citibank, BRAC's deal was issued locally in Bangladesh, denominated in taka and bought by local investors. BRAC's microfinance program in Bangladesh serves over 7 million poor borrowers through its innovative credit ladder model. BRAC also operates a publicly traded, commercial bank that serves small and medium-size enterprises in Bangladesh and Afghanistan.

Blue Orchard is a wholesale lender to MFIs and, in April 2006, executed the largest single commercial investment transaction in the history of microfinance in the form of a collateralized loan obligation (CLO). The transaction known as BOLD I raised \$99 million for 21 MFIs in 13 different countries in five different currencies. In May 2007, the BOLD II transaction was priced at a \$110 million equivalent of unsecured loans to 20 MFIs in 12 countries and was rated by Standard & Poor's. This marked the first microfinance transaction rated by a major rating agency, and thus represents a significant milestone for the microfinance industry.

Finally, the Compartamos deal was a landmark transaction that will be remembered as the first truly global IPO in the microfinance industry, which also made a groundbreaking entrance into the capital markets, achieved at record valuation levels for a financial institution. The IPO will also be remembered for generating much debate among the microfinance community about how to distribute the proceeds of the IPO and what is the appropriate interest rate to charge microfinance borrowers. The visibility the IPO gained in both the microfinance world and the broader capital markets ensures that this debate will continue.

Microfinance is the first breakthrough strategy to make significant inroads into defeating poverty that is market-based, scalable and sustainable. To provide capital to the world's 3 billion poorest individuals who need it to support the livelihoods of themselves and their families, MFIs realize that they must tap capital markets. As a result, the microfinance industry is embracing the tools and techniques of the capital markets.

As MFIs reach deeper into the for-profit capital pool, more and more of their investors will seek to maximize profits, potentially at the expense of the MFIs' social mission. The challenge then for MFIs will be whether they are willing to make this sacrifice. Will those MFIs that reject the capital markets be able to satisfy the growing needs of their clients? Also, how will those MFIs that tap into the capital markets pool compete with those that decide not to but instead continue to tap into public sector, socially motivated and philanthropic capital? Though they may seem premature at this stage, it is better to ask such difficult questions too soon rather than too late.

Susan Davis is chair emeritus of the Grameen Foundation and president and CEO of BRAC U.S.A., a unit of the Bangladesh-based nonprofit, which seeks to improve the well-being of the poorest in Africa and Asia. Rod Dubitsky is managing director and head of asset-backed securities research at Credit Suisse.

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