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microNOTE #3

Speaker's Corner on Impacts of Foreign and Domestic Investments in MFIs

> "At the very least, donor and international /quasi commercial funding should avoid pumping more liquidity into over liquid markets if there is a way to free up this money. The problem is finding the right approach to local commercial banks and incentives that prompt them to take an interest and test the risk of microfinance markets." Elissa McCarter, CHF International

"Dependency vs. Sustainability: Impacts of Foreign and Domestic Investment in MFIs" was the title of the 9th Speaker's Corner organized by the AMAP Knowledge Generation project and Chemonics International. Marc de Sousa-Shields, research director for the Transition to Private Capital topic under this USAID-funded project, facilitated a Speaker's Corner 2 day online discussion on May 9-10, 2006. Participants were requested to view a narrated, online presentation entitled "Financing MFIs: The Context for Transitions to Capital" that explores the gap between microfinance institutions' demand for commercial capital and the supply of private sector funding controlled by investors who remain cool to investing in MFIs despite the microfinance industry's demonstrated profit potential.

The Speaker's Corner event explored the specific challenges facing the industry to mobilize commercial capital, including savings, debt and equity (both foreign and domestic), as well as the impact that continued donor subsidies have on microfinance commercialization.

It concluded with suggestions to donors and other stakeholders on how to move the industry toward a more commercial vision or roadmap as the best way to significantly expand outreach to the poor. This microNOTE summarizes the above mentioned 2 day online discussion.

On Day 1, the discussion regarding guarantees went some way to explore the theme of local versus international finance. Guarantees seem to be of growing interest among funders and they seem to be useful and attractive to MFIs as well. However, as Elissa McCarter of CHF International and others pointed out, guarantees often provide but a piecemeal solution to financing (and often an expensive one at that).

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Clearly, other sources are required and we discussed this in detail on Day 2. International funds seem to be the most willing to invest– but are they the most able? Demand for external funding by far still outweighs supply, despite recent advances of some funds in attracting large amounts of capital. Issues of foreign exchange risk being borne by MFIs (and their clients), was not addressed during the online discussion but remains a hot topic among some funding organizations.

But can international funds supply the enormous demand? Clearly not- and MFIs need to look to local markets as the central source of finance -- despite regulatory barriers facing bank lending, the obvious source of funds.

Deposits are still a potentially important source of local financing, but as we know, large deposit- taking MFIs are also taking a good share of international financing now available.

As Julie Abrams noted, donor capital (as opposed to commercial capital) is *de facto* the sector's risk capital. So why are some donors and social investors lending to the MFIs who are most able to source private, local capital?

There are many good reasons for donors and some funds to continue to finance big, successful deposit-taking MFIs. From a sector building perspective, however, there are at least as many reasons why they should focus on the second tier of microfinance organizations.

From an equity perspective, development funding (whether from donors or many of the funds that act as their proxies) has stunted the natural progression of start-up, growth, and eventually, the sale of MFI equity. No one, it would seem, is pushing for mergers and sales of MFIs as would be the case in any other industry. This raises the question of whether donor capital is affecting the growth and consolidation process typically encouraged by a scarcity of capital (a theme not broached in this conference, but one that should have generated more discussion if it had). Local, profit-oriented owners might be pushier.

As microfinance grows and matures, financing will have increasing impact on the direction and nature of the sector. The role of donors and funds – and possibly networks/PVOs- will be critical, I believe, in the transition to private capital, not only for funding, but for the important work of understanding how to best form contracts, negotiate loans, find suitable investors etc. Finding appropriate local funders as well as continuing to improve deposit mobilization capacity is also critical. As one participant noted, conscientiously weaning MFIs off development intervention friendly capital and onto private sources should be a strategic pillar of advancing the sector. Private capital is after all, the only conceivable way in which billions of clients can be served sustainably.

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