

Commercialization: Overcoming the Obstacles to Accessing Commercial Funds While Maintaining a Commitment to Reaching the Poorest

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EXECUTIVE SUMMARY

Can money with a commercial price tag be used to reach the world's poorest microfinance clients? This chapter looks at the current supply of commercial capital available for microfinance and compares it with the demand expressed for that capital and the capacity of microfinance institutions to deploy it effectively. It looks closely at the different actors involved in bringing market capital to the grassroots level, so that multimillion-dollar investments can be distributed in \$50 and \$100 loans.

Through interviews with leaders on the supply and demand sides, as well as with those that help build connections between the two, this chapter examines how commercial funds are deployed to serve very poor clients, and the obstacles that prevent this deployment from happening more often. It concludes with recommendations on steps that various actors in the world financial community can take to ensure that funding from domestic and international capital markets is made available to those for whom it will have the most impact.

HAVING OUR CAKE AND EATING IT TOO

These days the left and the right sides of the political spectrum cannot find much on which to agree. Microfinance is one of the exceptions. For liberals, microfinance reaches into the poorest areas of the world, making \$50 loans that help people living on the edge of survival move into the economic system by starting their own businesses. For conservatives, microfinance puts the magic of the marketplace to work to help overcome poverty. Microfinance organizations that charge market rates of interest can cover their own costs and expand their operations by borrowing or selling equity and providing commercial returns to investors. By doing this they can attract the almost limitless sources of commercial capital available, reducing the need for public subsidies to take care of the poor.

I have often wondered what would happen if you got the two groups in the same room and had them each describe their reasons for supporting microfinance. How long would it take for them to realize that they were talking about the same thing?

Or are they? The reason microfinance attracts both groups is the illusion that both goals are possible at the same time: you can reach extremely poor people while providing investors with commercial rates of return for their investments. Clearly, there are many microfinance institutions that do reach down to the poorest of the economically active in their countries. There are also many microfinance organizations that make use of commercial funds of different types—savings, borrowings, and equity investments. But are there any institutions that can do both at the same time, reach down to the lowest levels of poverty and pay commercial rates for their funds?

This is currently a key question for our industry. If it is possible to do both at the same time, then one of the major constraints facing microfinance since its inception will suddenly have been lifted. An industry once dependent on subsidies from government donors (which combined ranged from \$500 million to \$1 billion a year) would now have access to the hundreds of trillions of dollars that are traded every year in the world's capital markets or deposited in savings instruments. On the other hand, if it is not possible to do both at the same time—if you cannot reach the poorest when you have to pay commercial rates on your funds—then the microfinance community is headed for a nasty divide. Those who use commercial funds to fuel their growth will work increasingly with the higher end of the microfinance market. They will generate positive returns by doing this and become an ever-growing presence in their country's financial marketplace, while leaving the poor behind. Those who focus on reaching the very poor will not be able to access commercial funds and will find their growth limited to the subsidies that governments and other donors are willing to provide them.

This material is excerpted from the book *More Pathways Out of Poverty* (Bloomfield, CT: Kumarian Press, 2006). To order go to: www.kpbooks.com.