



Obtaining Funds from New Financial Instruments and Mechanisms for Commercial and Emerging MFIs: From Funds to the Web

In the afternoon of April 8, **Robert Annibale**, Global Director, Citi Microfinance and Community Relations, chaired the workshop on “Obtaining Funds from New Financial Instruments and Mechanisms for Commercial and Emerging MFIs: From Funds to the Web,” a topic of great interest to both practitioners and investors as the microfinance sector continues to mature and attract investment capital through increasingly sophisticated instruments beyond donor funds, ranging from debt and equity to bonds and guarantees. The panel featured **Lydia Koros**, Managing Director of Faulu Kenya, the first MFI in Kenya to transform into a deposit-taking microfinance institution, and three highly-regarded experts in the field of microfinance investment **Anne-Marie Chidzero**, Chair, of AfriCap Microfinance Investment Company; **Matteo Marinelli**, Senior Investment Analyst at BlueOrchard Finance; and **Ayesha Wagle**, Senior Vice-President of MicroCredit Enterprises (MCE), USA.

The panel discussion began with Lydia Koros’ synopsis of Faulu Kenya’s evolution from 1991 to 2009, the steps it needed to take, and how its investment needs and strategies evolved over time to support the growth and development of the NGO. Ms. Koros’ remarks were followed by overviews of AfriCap, Blue Orchard and MCE’s unique investment strategies to successfully achieve the returns they seek from the microfinance sector. Significantly, despite the varied strategies driving each of the four panelists’ programs, they all shared a common commitment to the importance of MFIs maintaining clear and transparent financial data for their organizations; engaging in annual audits; and ensuring that they have strong management teams and information systems in place, in order to attract investment capital or evolve into a deposit-taking financial institution.

“Funding is critical,” **Lydia Koros**, Chairman of the Board, AMFI, and Managing Director, Faulu Kenya, began. “It is a critical input to growth and evolution of an institution. [But] as the institution grows, there tends to be less of the donated capital coming through. Either because the funds that they were receiving are no longer ... sufficient or [because planning becomes too difficult when] you really don’t know [what funds can be expected].... So as the institution grows, [depending on the stage that the institution is in,] donor capital becomes less and less [reliable] and there is need to look for more sustainable funding.”

“[Faulu Kenya] started out as a [small] project of Food for the Hungry International in one of the slum-areas called Mathare in Nairobi in 1991,” Ms. Koros noted. Food for the Hungry “is a Christian relief program headquartered in the US,” and was the primary donor of this program which was 100% donor funded. By 1994, the project had grown so significantly that Food for the Hungry was no longer able to sustain the program as its primary funder. It became time for Faulu to secure its own identity, so it was formally established as a separate NGO. Faulu still relied primarily

Wednesday, April 8, 2010

3:30 PM – 5:00 PM

Aberdare Hall

Panel:

Chair: Mr. Robert Annibale, Global Director, Citi Microfinance and Community Relations, UK/USA

Ms. Lydia Koros, Chairman of the Board, AMFI, and Managing Director, Faulu Kenya

Ms. Anne-Marie Chidzero, Chair, AfriCap Microfinance Investment Company, Mauritius

Mr. Matteo Marinelli, Senior Investment Analyst, BlueOrchard Finance S.A., Switzerland

Ms. Ayesha Wagle, Senior Vice-President, MicroCredit Enterprises, USA

on funding from various donors at that point, although Food for the Hunger remained the leading donor. As the program's growth continued, Faulu began to generate some earnings as well, and we reinvested this revenue back into the organization to support its continued growth and development.

“In 1999, a decision was made to turn Faulu [from] an NGO into a limited liability company, ... incorporated by share capital.... In 2004, Faulu's growth stagnated ... [and there was need to be] more creative” about funding sources, so the idea was raised for Faulu to reach out to the capital markets to raise funds. This was very new territory for us, but in 2005 the bond was floated, and it was successful.

“In 2007, [we] needed to take the next step [in our evolution when we determined that Faulu needed] to become a deposit-taking microfinance institution [to ensure its sustainability]. In that year, there was a successful negotiation of seven-year subordinated debt, which we obtained. Because it was euro-based, [Faulu had the opportunity to benefit from the exchange rate at that time] we swapped it with a local currency loan, which helped cover some of the costs of the transformation, which was very expensive.¹” As of May 2009, Faulu became the first microfinance institution to receive a license from the Central Bank of Kenya to take deposits. And now, thanks to Kiva's online platform, we have a new form of financing as well, which is web financing.

Ms. Koros added, “[Once] we became regulated last year we ... opened [ourselves] up ... [to] equity investors, [and] that is the process that we are currently going through.... [We are engaged in] due diligence on [our potential investors], and they are [implementing their own] due diligence on us.” Since we had become a commercial microfinance institution, not only had we become too large to remain on Food for the Hungry's balance sheet, but “in a sense we were distorting [its] mission [as well], ... so [it] opted to divest.... The [divestiture] process ... [included] setting up ... a holding trust [that is now] looking for ... equity investors.”

Another point to be aware of, she explained, “is that central bank regulations [require] that a [regulated] microfinance institution should not have any one shareholder [owning] more than 25% of the [shares], so we had to sign a memorandum of understanding with the central bank that within a four-year period we need to divest the other shares.” In addition, “We have obtained debt ... from the capital markets through the bond, and.... the funds that we have obtained ... are OPIC funds, which are from the US government, through Citibank, and [they were favorably] priced.”

Ms. Koros concluded, “Currently, 48% of Faulu's funding comes from customer deposits. This is a mix of loan collateral, and also the deposits that are put in based on [its] products. [Faulu] also has 39% debt in core-capital. Just to elaborate on the debt, we have that percentage that is structured in that way. The corporate bonds [that were floated in the capital markets], which were 16%, have been fully repaid ... [by Faulu] as of the 31st of March.”

¹Please note that there is no guarantee that foreign exchange rates, which are subject to market fluctuations, will consistently benefit an MFI

The discussion then moved onto the AfriCap, and Mr. Annibale asked Ms. Chidzero to kindly share her perspective on attaining funds, including equity investments as well as debt investments. **Anne-Marie Chidzero**, Chair of AfriCap Microfinance Investment Company, explained that AfriCap is a Mauritian-based fund, and it has a fund manager, called Mecene Investment based in South Africa.

Ms. Chidzero shared, “AfriCap started in 2002 as a very small pilot fund ... with US \$30 million, and it was in that first round that [it invested] in Equity Bank [in Kenya. AfriCap] recapitalized in 2007 into a US \$42 million committed capital fund, and since that time, [it has established] a large footprint across the African continent [with 14 different investments] in 12 countries.... [AfriCap invests] in innovative start-ups and microfinance institutions that are poised for expansion.... [Specifically it looks for microfinance] institutions where the principals are making a financial commitment themselves, [not just through] sweat equity, [but by investing their own capital as well. AfriCap] is betting on [this] ... new generation of African entrepreneurs in microfinance, their understanding of [the marketplace], and their vision in terms of seeing their [organizations] become profitable microfinance [institutions].” AfricaCap has also established a network among the CEOs leading each of its investments, which provides great opportunities for peer exchange and sharing of best practices among these talented entrepreneurs.

Ms. Chidzero continued, “We are looking for an opportunity to take between a 20% to 50% stake in the company. [We’re taking a ‘semi-venture capital’ role] in the sense that we do participate quite heavily in supporting the growth of these institutions. We sit on the board, and in some cases we have two board seats. We provide equity and quasi-equity, usually [through] convertible debt. All of the institutions that we invest in are registered as banks, so [we have invested in] a couple that have transformed into banks. During that transformation process, we invested in terms of convertible debt, and once they transformed we converted that [debt] into equity.... [AfriCap is] structured ... as a holding company, because we believe there [needs] to be a lot of hand-holding, so as opposed to being a close-ended fund, we are more of an open-ended fund—an investment company—so that we can really partner and help grow these institutions.”

Ms. Chidzero further explained, “Because [AfriCap is] investing in institutions that are start-ups or expanding, [it has raised funds to develop] a technical assistance facility.” Through these facilities we have set up a completely separate NGO in Mauritius called FINTECH, through which “grants [can be made] to service providers that [offer] capacity-building support to [the microfinance] institutions [in which AfriCap invests]. One of the key areas in which FINTECH has been focusing its efforts, is [helping MFIs build good] information [management] systems” and providing information technology support, which are among the biggest challenges in microfinance sector.

The next panelist on the agenda was **Ayesha Wagle**, Senior Vice-President, MicroCredit Enterprises, USA, who shared MicroCredit Enterprises unique fundraising strategy. “At MCE we don’t really have investors,” she explained. “We have what we call guarantors, and what those guarantors do for us is pledge collateral without actually moving any assets, which backs a commercial bank loan that is made to MCE. What that means is we are able to approach commercial banks and

ask for a line of credit or a term loan, and that commercial bank [has a real] incentive to lend to us at good rates based on the pool of guarantees that our guarantors provide. At this time, we have 42 guarantors. Each one [has provided] a US \$1 million guarantee, and we actually only borrow half of that, so our capacity to lend right now is actually US \$22 million, and [I believe] we have about US \$18 million of that out in the field at this time.”

Ms. Wagle continued, “To give you a quick sense of our exposure in Africa, at this time we only have about 1.5 million dollars in debt in Sub-Saharan Africa. And that is at the moment in Nigeria and in Mozambique, but I think, like a lot of people here, we are really hoping to extend our portfolio in the region.”

Ms. Wagle also explained, “[MCE] is a non-profit, so at the end of the day, in terms of the commercial versus non-commercial debate within the microfinance industry, [it tends to] come out ... less [on the] commercial [side], ... [and is seeking to fund] MFIs that can’t [secure] commercial funding yet.”

In closing, Ms. Wagle advised, “From the perspective of a funder, [transparency is] crucial.... Anything an MFI can do to make a funder comfortable with [its] numbers, [its] capacity, and [its] ability to [manage the] organization, [is a good strategy].... Whether [it] means getting an audit [or a] rating [done, we recognize that these activities can be costly, but they are very important] as you start to approach investors.... [Lastly, promoting] your own transparency is [a great way to approach potential] creditors or equity investors [as well].

Matteo Marinelli, Senior Investment Analyst at BlueOrchard Finance, took the microphone as the final speaker on this panel. He briefly shared background on BlueOrchard for the Summit attendees. Established in 2001, BlueOrchard Finance is an asset management company specializing in microfinance that currently manages US \$1.2 billion in assets and has an active portfolio of 140 microfinance institutions in emerging markets worldwide. Currently more than 50% of the money it raises comes from institutional investors, mainly pension funds in Europe, a little bit from North America, and very little at the moment from Africa and Asia and the rest are private investors, who are all seeking to make a double bottom-line investment. BlueOrchard offers an interesting, acceptable risk-adjusted premium on their investment, so that they don’t lose their money. They earn something and they have social impact as well, which are tracked through BlueOrchard’s social performance due diligence and social performance publications. The profile of a typical BlueOrchard investor is either a high net worth individual or pension fund that is interested in doing good by investing in microfinance.

“On the investor side,” Mr. Marinelli shared, “[BlueOrchard offers] fixed income funds and private equity funds [and] on the MFI side, we offer senior unsecured loans.... One hundred percent of our loans are unsecured and we don’t ask for collateral.... [However,] to qualify for [BlueOrchard’s] funds, ... [the MFI must have been operating for] at least two to three years, [it must have a] minimum of ... US \$1 million dollars in assets, its primary business [must be] microfinance [and it must have a] good management [team in place and] good governance. Sustainability [is also a] key [criteria for an MFI to obtain a loan from us].” If the MFI is not yet self-sustaining, it will be required to provide us with a detailed sustainability plan, including the how, when and why. “We [also] look for [completed external audits

from the MFIs], ... and external [ratings are] great, but ... a portion of our portfolio is unrated [as well].... [Additionally,] as a foreign funder and investor, our maximum exposure with each MFI [on] the debt side is 15-20% of their asset size, so we encourage a lot of diversification of funding sources. We don't want to be the biggest source of funds for the MFI. So the remaining 80% ... needs to [be well balanced, coming] from local sources, commercial sources, or deposits.”

In regard to BlueOrchard's activity in Africa, Mr. Marinelli shared, “We work in Kenya, Mozambique, Cameroon, and Egypt. We used to work in Uganda, and now there are some historical clients. We have a pipeline in Rwanda, Madagascar, Nigeria, Ghana, and the good news is that in the last few weeks, we have closed a couple of new ISDA agreements and we are now able to offer new currency, African currency, so we offer not only hard currency loans in dollars and euro, but we also offer Kenyan shillings or Ugandan shillings– ... if there is mutual interest from the MFI and if the MFI qualifies for our criteria. What we do is ... organize a due diligence visit on the ground with our team, trying to understand and meet the senior management and a couple of board members. So that's part of our risk process, our due diligence process, that is then completed back home in Geneva with collection of some online reports and the required documents like business plan, rating, audited accounts, etc.”

Following are a few key comments from the Q&A session:

Comment from Mr. Marinelli: “It is important to mention here that everybody was very excited about our two CDOs, and especially on the investment banking side and the markets in London and Europe. A couple of those banks even set up their own microfinance team and then the [economic] crisis [came] and they [dismantled their] teams after just a few weeks, while BlueOrchard has been there since 2002. So it is a question of commitment and vision. Does [a] bank believe that microfinance can be considered an asset-class, and a business-line? Or do we do microfinance simply because we want to look good, and [produce] a nice corporate social responsibility report. And that's something that you have to take into account. There are banks that consider microfinance an asset-class and a business-line, [as in] the case of Citi, and there are other banks that are less involved, [where their] microfinance [activities] fall under [their communications] or corporate social responsibility [functions], which says a lot about [their view of] microfinance. But on the other side, as you mention, we have ISDAs, so we have swap agreements basically in place with some banks in Europe. And that is another area, where banks definitely can play an important role. Because as of today, local currency funding is [the] key to opening and expanding your portfolio ... [and] you cannot be competitive in Kenya by offering [US] dollars.”

Comment from Ms. Chidzero: “I support everything that Matteo has said. Our MFIs are in desperate need of liquidity and debt in local currency, and that is very hard for them to get. So there are huge opportunities for that. Many of them are beginning to mobilize savings as a way of financing their growth, but certainly there is just a huge opportunity for investment banking in local currency debt.”

Comment from Mr. Annibale: “[Lately], almost every opportunity we find [where] we [can] add value, [are those that] we are doing in a local market. It's in local currency. It's in local capital markets. It is intermediating for funds that want to have

the funding and exposure, but don't have [the] local capability. And so I think that local banks, to be honest, and local emerging banks, as they develop or exist, are going to play a very important role as microfinance institutions ... need more access to complex funding or equity. So that's probably where investment banks will play a bigger role. In most case they will be very visible ones, when they are international. But I think ... for most of the practitioners working in local markets, they ... [will] need access to [domestic] funding.”

Question: “My name Is Dorothy. I work for a microfinance institution called Kenya Rural Credit.... My question ... as I listen to all of these opportunities for microfinance [institutions] to access funds [is about] thresholds.... Where [a microfinance institution] should be [in order] to access funding. What you might not know, for example, is here in Kenya we have more than 45 microfinance institutions, and 44 of them have already applied to the central bank to be allowed to take deposits.... Only two [have made it so far], Faulu and Kenya Women's Finance Trust.... So my question is ... [since] the majority of these 44 [MFIs] ... are below the thresholds that [are required for investments, perhaps] the correct threshold should ... [be] 20 million in Kenya shillings.... Many private investors have money to put up; capital from their own [pockets] and they are dedicated to [carrying] out microfinance businesses, but they are at [a] level which is actually very ... small, as far as [investors] are concerned. So how can these [microfinance institutions] access funding?”

Response from Ms. Wagle: “I think that is a fantastic question, and it is one that I continue to face at this conference and in many regions, because you see fantastic MFIs that are ... stuck. They are stuck at the [US] \$250,000 to US \$700,000 level. They can't quite get over that benchmark. Funders are saying: 'We will fund you if you grow.' MFIs are saying: 'We'll grow if you fund me.' And it is [a] vicious cycle. I don't have a fantastic answer for this. MCE definitely prides itself in funding MFIs that have perhaps, not been around for so long or [are not] as mature, and MFIs that are smaller. But unfortunately, we do have the same basic threshold [of US] \$1 million [in assets], and I'll try to tell you the reason behind it. It is not arbitrary and [at the end of the day, it's really about risk,] whether it is BlueOrchard protecting its investors or MCE protecting our guarantors. If we have a limit of 20% of an MFI's portfolio and [that] portfolio is [US] \$500,000 dollars that means the maximum I can lend to you is a US \$100,000 dollars. And it [will be a lot] of work and [a lot] of time ... on your end [as well as mine] to get that money.”

“[That's why] I think one of the phenomenal things about Kiva ... has been [its] ability to spread risk among hundreds of thousands of investors, lending at zero interest rates, who have made very small contributions. So Kiva is really able to push down-market, I don't want to put words in your mouth [Tim], but I think it is one of the reasons that Kiva has been so successful. And a lot of times, when I see great MFIs that are small ... I really do point them towards Kiva. And Kiva has been such a natural pipeline to MCE. Kiva works with an MFI for a few months, the portfolio grows and then we can go in and actually really do [some] sizeable funding. So it is not a great answer to your question, [but] I think it is a really important question.... Tim, would you like to [add to] that?”

Response from Tim Hassett, Vice President, Kiva (in the audience): “Thanks again for the question. I [have to] admit that even Kiva has standards. I should tell

you that our standards are two years of operation with audited financial statements and 1,000 borrowers. Now what that can mean though, is that we can [work with] some [of the] smaller MFIs. We clearly don't have to get to [US] \$1 million dollars in capital, but if you want to ask yourself why Kiva has standards, [please] think about it this way—our individual lenders put their [US] \$25 dollars down on the table—they do that without getting any interest. [On] one level, they can [accept the] foreign exchange risk, and if an individual borrower defaults the Kiva lender doesn't get repaid. The Kiva lenders are okay with that, but if we start having problems with individual institutions that default, then ... Kiva lenders get awfully upset. And we are concerned about our franchises and to be able to support the MFIs that we deal with already.”

Response from Ms. Chidzero: “Thank you for posing a very challenging question, but I think I would like to throw back at the industry. I think, when you talk about 45 MFIs in Kenya and the threshold being very small. I think it is important to make the investment attractive to the investor. One of the thoughts that come to mind is ‘why aren't these MFIs consolidating?’ [They could be presenting themselves] as a more attractive investment because they have consolidated. [Additionally,] I think it is very important to have ... good, [transparent] financial information.... [MFIs] also need to think about how [they present themselves] to attract investments, because there is money out there. We're practically fully committed at the moment and hopefully we can raise additional funds. But there are interested investors and I think there are many here in this room, but I [also] think the industry needs to make itself attractive, and [MFIs] need to think about how [can] they do that.”



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