

FOLLOW-UP
ADA DISCUSSION PAPER | N°1



Does foreign ownership in microfinance interfere with local development?

OPINIONS & FUTURE ACTION

ADA, June 2010

INTRODUCTION

In December 2009, ADA has published its first Discussion Paper. The paper identified a recent trend towards more foreign ownership in microfinance and asked the question “Does foreign ownership in microfinance interfere with local development?” We have presented the paper at different conferences, seminars and workshops and have also discussed the question with professionals from the microfinance sector in the framework of an email debate.

The present Follow-Up Paper will take up some key points from the Discussion Paper and will summarize the opinions expressed during the different discussions. It will also evaluate the concrete proposals made by the participants and give an opinion on what future action might be possible.

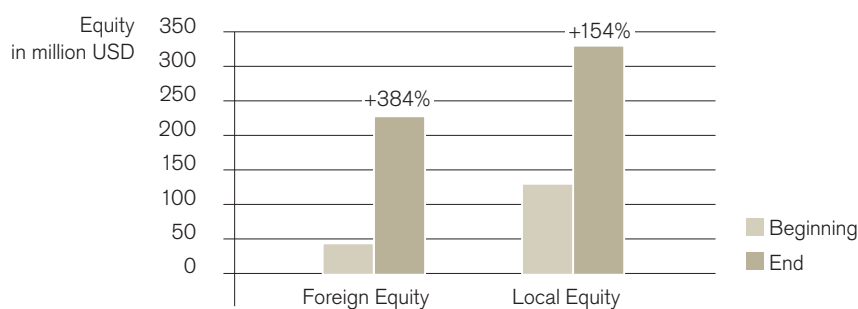
1. Taking up Key Points from the Discussion Paper No.1

ADA's first Discussion Paper pointed out that foreign ownership in a sample of 39 microfinance institutions (MFIs) grew significantly in the period from 2002 to 2007.

The analysis showed that both local equity investments in MFIs and foreign equity investments in MFIs increased during the sample period; but although the level of local equity was still higher than the level of foreign equity, the proportion of foreign equity in MFIs increased much faster than the proportion of local equity in MFIs, namely by 384% as compared to 154% (see Figure1).

THE EVOLUTION OF LOCAL AND FOREIGN EQUITY INVESTMENTS

FIGURE 1



The analysis revealed that the evolution of foreign ownership also varied according to different types of investors¹ and according to different regions of the MFIs' location².

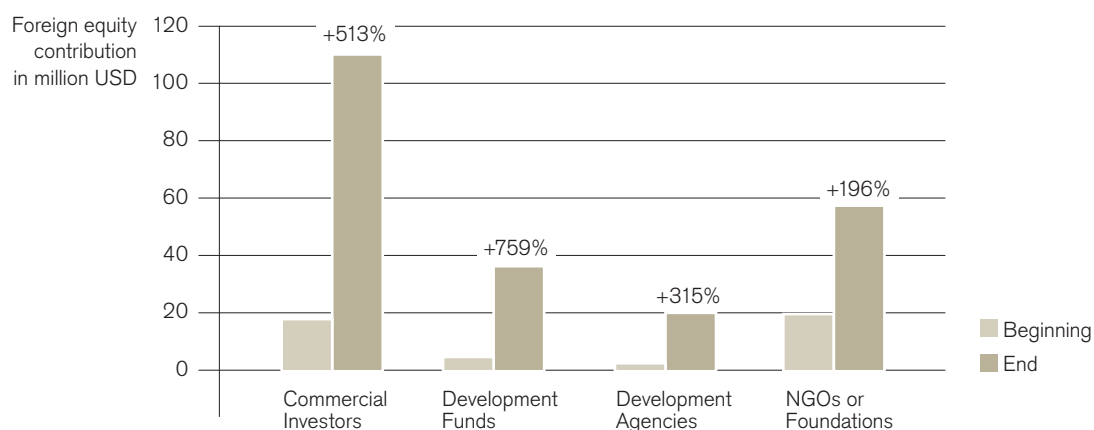
¹ We made a distinction between commercial investors, development funds, development agencies, and NGOs or foundations. Microfinance development funds were thereby defined as vehicles that have specifically been created to invest in microfinance. Development agencies were understood as financial and non-financial institutions, created by governments and supranational bodies, in order to promote the economic development in developing countries. And NGOs or foundations were understood as institutions which were usually created by the private sector, with the help of donations from corporations or individuals, and which help to improve the economic and social welfare of people in developing countries.

² The paper concentrated on Latin America & The Caribbean (LAC), East Asia & The Pacific (EAP), Middle East & North Africa (MENA), South Asia (SA), as well as Sub-Saharan Africa (SSA), which are the regions where ADA is most active.

Whereas the foreign equity contribution of development funds increased by 759% during the sample period, the contribution of commercial investors increased by only 513%. And similarly, whereas the foreign equity contribution of development agencies grew by 315% from 2002 to 2007, the contribution of NGOs or foundations grew by only 196% (see Figure 2).

THE EVOLUTION OF FOREIGN EQUITY INVESTMENTS BY TYPES OF INVESTORS

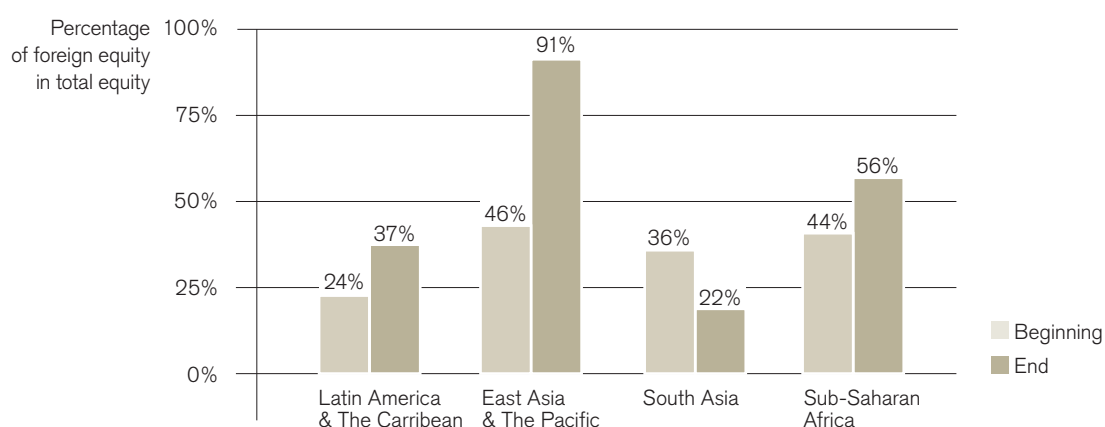
FIGURE 2



Furthermore, in Latin America, there were 23 MFIs with 37% of foreign equity in their total equity in 2007, but in East Asia, there were 8 MFIs with 91% of foreign equity in their total equity. In the MFIs from Sub-Saharan Africa foreign ownership increased to reach 56%, but in the MFIs from the South Asian region it decreased to end up at 22% at the end of the sample period (see Figure 3).

THE PERCENTAGE OF FOREIGN EQUITY IN TOTAL EQUITY BY REGIONS OF MFI LOCATION

FIGURE 3



The first Discussion Paper argued that a trend towards foreign ownership in microfinance, as pointed out by the data, could mean that more and more strategic and operational decisions concerning an MFI are taken by foreign entities, and that this might interfere with the aim of establishing locally driven MFIs, servicing empowered local clients, and contributing to well-functioning local markets. However, the question whether foreign ownership does indeed interfere with local development remains a controversial issue.

2. Exchanging Opinions

The possible consequences of a trend towards more foreign ownership in microfinance were discussed with microfinance professionals from all over the world at different conferences, seminars and workshops, and they also made up the object of an email debate. The exchanges thereby concentrated on the advantages and disadvantages associated with foreign ownership in microfinance, on possible exit strategies to foreign equity investments in microfinance, and on the possibilities of considering local ownership in microfinance as a social performance indicator.

2.1. Advantages and Disadvantages Associated with Foreign Ownership in Microfinance

The positive and negative aspects of foreign ownership in microfinance that were brought forward by the participants of the AMT Investors' Fair 2009 in Nairobi, of the European Microfinance Week 2009 in Luxembourg and of ADA's virtual debate at the beginning of 2010, can be translated into a SWOT analysis (see Table 1).

FOREIGN OWNERSHIP IN MICROFINANCE – A SWOT ANALYSIS

TABLE 1

Strengths	Weaknesses
<ul style="list-style-type: none"> • Resources: MFIs can get access to more funds • Expertise: MFIs can get access to best practices, capacities and global networks • Local ownership is often not available (not in appropriate amounts and/ or not under appropriate conditions) • Foreign ownership can enhance the image of an MFI, especially where local ownership is available, but is seen as suspicious 	<ul style="list-style-type: none"> • MFIs can encounter difficulties with board meetings (frequency, costs) • Foreign investors can lack knowledge of and often do not adapt to the local socio-economic context • Foreign ownership can act against nationalist feelings and perceptions • Resources are expatriated • Many foreign owners have only a short or medium term investment view • Board members, representing international investors, sometimes act more as portfolio managers of their funds; their interests collide with the interests of the MFIs • MFIs compromise their vision, lose their autonomy and experience governance conflicts
Opportunities	Threats
<ul style="list-style-type: none"> • Opportunities lie in local/ national investment funds • The development of good local ownership is important to protect the mission of the MFI 	<ul style="list-style-type: none"> • Some foreign owners are only profit driven • Foreign ownership can affect local investment spirit and can lead to a weak local entrepreneurial structure.

Several participants, most of them investors from Northern countries, stressed that it was actually not the most important question, whether an equity investor was a foreign or a local one. Their view on the topic was that, as long as the MFIs and the owners shared the same identity, attitude and values, and as long as the mission of the MFI was protected, a win-win situation was possible – whether the owners were foreign or local.

This, however, requires that the MFIs formulate a clear mission statement and work out detailed, legally enforceable agreements, jointly with the investors, also covering such points as client targeting, ownership proportions, dividends etc. And in practice, this is not always an easy task.

2.2. Possible Exit Strategies to Foreign Equity Investments in Microfinance

The participants of ADA's email debate agreed that foreign equity investments in microfinance should have a long-term perspective, but should also include a clear exit strategy. One possible exit strategy is a public listing. This requires a large enough stock market and imposes important reporting obligations on MFIs, but it also helps to raise more capital and to attract more local equity investors in the future. Another possible exit strategy is the sale to another equity investor. This does not involve the same constraints in terms of stock market size and reporting, but it again requires detailed, legally enforceable agreements between the investors and the MFIs, which are not always easy to work out.

As underlined by many participants, the agreements should especially take into account the opinion of the MFI on who may buy back its shares, they should include a schedule and a minimum and/or maximum duration for the exit, and they should mention such issues as the fixing of an exit price, pre-emptive rights and shareholder constraints. As most participants of the debate agreed, the fixing of an exit price to overcome the risk for the equity investor should normally not be allowed; and pre-emptive rights should be treated very carefully, as they might either impede or facilitate the entry of local owners. Similarly, shareholder constraints should be used with caution, as they might limit the access to foreign funds, but they might still be a way to support local ownership.

2.3. Local Ownership in Microfinance as a Social Performance Indicator

The participants of ADA's email debate on foreign ownership in microfinance agreed that local ownership is not as such a guarantor of social performance, but that it can help to implement an MFI's social mission. The fact that some of the shareholders are locals is supposed to bring about decisions that are aligned with the local reality and with the clients' interests. Furthermore, local ownership is supposed to imply that the returns on investment remain in the country, are available for other productive purposes and thus contribute to the creation of wealth. So, to a certain degree, local ownership can foster the establishment of strong economic actors and of a healthy economic environment, over time.

Independently of a foreign-local dichotomy, however, it must always be analysed which specific ownership model is most adapted to a certain MFI's social mission and thus contributes most to its social performance. As some participants stressed, there exist examples of foreign investors who played a very positive role in terms of social performance, as well as examples of local investors who were only interested in the financial returns of their equity investment and not at all in the social performance of the respective MFI.

3. Evaluating Propositions and Initiating Future Action

The main outcome of the various discussions was that the initial question whether foreign ownership in microfinance does interfere with local development cannot be answered with an unqualified “yes” or “no”. But it was also agreed by all participants that an increase in local ownership in microfinance would be highly welcome.

Another outcome of the discussions consisted in two concrete proposals for future action, firstly a continued research on the criteria for good microfinance equity investments, and secondly an improved communication between MFIs and microfinance equity investors.

In what follows, these proposals will be evaluated and some pursuable paths will be identified.

3.1. Continued Research on the Criteria for Good Microfinance Equity Investments

As the discussion about ownership issues in microfinance is still a very recent one, and as many issues about foreign and local equity investments in MFIs have not yet been addressed, it was agreed that the research and the debate on this topic should continue. Furthermore, it was decided that there should be a focus on the definition of the main criteria for good microfinance equity investments, both foreign and local. The participants proposed to create a working group, and more than 20 persons, representing organisations from all around the world, already signalled their interest to actively participate in this group. ADA highly welcomes this initiative, but instead of creating a whole new working group, ADA makes the following proposition:

ADA proposes to identify two key persons who would be willing to contribute to the activities of the already existing e-MFP Action Group “Making Microfinance Investments Responsible” (MIR).



The MIR action group was created at the beginning of 2010. It is coordinated by CERISE and currently includes members from ADA, Alterfin, Blue Orchard, CGAP, EIB, FIG/ RAFAD, Grameen Crédit Agricole, LuxFlag, MIL, Oikocredit, Pamiga, SIDI and Triodos Facet.

The specific objective of this action group is to build a common framework for socially responsible investments in microfinance through defining criteria for such investments, developing audit, rating, reporting and certification standards, publishing the results of the group work, and creating synergies among microfinance actors. The focus thereby lays on microfinance investment vehicles (MIVs).

Concretely, what the designated persons could do is the following:

They could either join the MIR action group – in which case they have to be e-MFP members – and integrate the aspect of foreign and local ownership in microfinance in the reflections and exchanges of the group, as well as write an article for the upcoming special issue of the *European Dialogue* about this aspect. Or they could – as e-MFP members or not – prepare a contribution for the so called “Perspectives” part of the *European Dialogue*, which would not have to be an article, but could also consist of an interesting interview or the like.

Once there exist concrete outputs of the MIR action group, ADA would be happy to contribute to the creation of further synergies between microfinance actors. For example, we would be

ready to promote the articles and other contributions on socially responsible investments among our members, or to use our worldwide connections to microfinance institutions, networks and investors, in order to organise and to co-finance workshops that make the respective actors familiar with the newly established concepts and tools.

3.2. Improved Communication between MFIs and Microfinance Equity Investors

The discussions about ownership in microfinance clearly showed that there is a need to foster the communication between MFIs, local and foreign equity investors, as well as political authorities. The participants suggested to create an open communication platform for the involved parties which would allow the MFIs and the investors to present themselves and to facilitate all kinds of exchanges on equity investments in microfinance.

ADA proposes to form a group of several persons which would coordinate and manage the content of an open communication platform on the e-MFP website.



The e-MFP website will soon offer the possibility to set up public forums for exchanges on specific subjects. These open contact platforms will allow people to raise questions, to discuss ideas, to share documents and to interact in many other ways. The content of the virtual space will depend on the participants' own contributions and has to be coordinated and managed by a team which is independent of ADA and of the e-MFP. ADA and the e-MFP could, however, offer some assistance when specific moderated sessions are planned, and they are, of course, ready to put people in contact for the formation of the team.

CONCLUSION

The consequences of a trend towards more foreign ownership in microfinance, as it was traced out in ADA's first Discussion Paper, were discussed at different occasions with microfinance actors from all around the world, but of course the question whether foreign ownership interferes with local development was not answered straightforwardly with a "yes" or "no". Nevertheless, the participants of the different discussions agreed that an increase of local ownership in microfinance would be highly welcome, and as future action, they proposed to continue the research on the criteria for good foreign and local equity investments in microfinance, and to improve the communication between MFIs and microfinance equity investors.

Now, in response to these excellent proposals, ADA suggests to identify two key persons who would be willing to contribute to the activities of the e-MFP Action Group "Making Microfinance Investments Responsible" and, in addition to this, to form a group of several persons which would coordinate and manage the content of an open communication platform on the e-MFP website.

If you would like to contribute to the activities of the e-MFP Action Group, or if you would like to make part of the team that coordinates and manages the content of the online open communication platform, please contact Sophie Wiesner, Project Officer in the Research and Development Department of ADA, at discussion.ada@microfinance.lu

We highly encourage the representatives of MFIs as well as investor organisations to take part in the proposed activities, and we are already looking forward to your input!

