

“The Future Risks and Opportunities in Investible Microfinance”

Debate on Corporate Governance in Microfinance, 14th October, Geneva

On 14th October 2010, the World Microfinance Forum Geneva organised a lively debate bringing together leading practitioners and investors in the microfinance industry, with representatives from commercial and private banks, pension funds, insurance companies, family offices, asset managers, private equity funds, public institutions, foundations and international organisations. The debate focused on the urgent need for better corporate governance to ensure the sustainability of the microfinance industry.

Over the last 30 years, the Microfinance industry has undergone a dramatic evolutionary process. The sector has diversified from mostly credit-led, donor-funded institutions to a variety of more or less commercial business models providing a wide range of financial services to a mixed client base. Business models vary from fully commercial, regulated microfinance banks to more socially oriented NGOs providing financial and non-financial services. Recently, the combination of a double bottom line with stable financial returns has attracted private sector investment, leading the microfinance industry to unprecedented scale but also increasing complexity.

Currently, private sector investment demand exceeds the supply of investible microfinance institutions. The industry has reached a bottleneck, highlighted by recent, isolated cases of crisis and failure. These have shown that although this US\$ 8 bn industry has progressed a long way, it is still fragile. The World Microfinance Forum’s panel discussion centred on the role of institutional governance in preventing and managing future crises in microfinance. The panel comprised top executives from two renowned microfinance institutions and three investors from different sectors of the investment community.

The debate showed that there is no “cookie-cutter approach” to microfinance governance. Carlos Danel, Founder and Executive Vice-President of Compartamos (Mexico) expressed his belief that some general governance principles from the financial industry and other sectors can apply to microfinance. In fact, Compartamos’ leaders have followed these governance principles from day one, such as a majority of independent Board members and a “One Share One Vote” policy. Sajeev Viswanathan, CEO of the microfinance arm of the Basix group (India) argued that in an industry as diverse and fast-changing as microfinance, the prescription of general principles may be more of a hindrance than a help.

Many microfinance institutions (MFIs) are seeking to transform from not-for-profit NGOs to for-profit institutions in order to achieve greater scale and economic leverage. It is during this transformation that good governance is particularly crucial to ensure survival of the institution. The panel agreed that governance structures must be tailored to individual transformational stages through which MFIs must pass and may need to differ by region. However, they did not reach consensus on any specific governance principles that should be applicable to all MFIs, regardless of their business models.

Recent events in the Indian microfinance industry show that stronger governance might have helped to prevent the current crisis in Andhra Pradesh. It will be interesting to see the changes in governance that will emerge from this crisis over time, in India and elsewhere.

From the investor point of view, the panellists agreed that governance is a key factor in any due diligence process and often affects investors' decisions. On the debt side, investors have instruments to push MFIs towards improved governance: "When we are not happy with the governance of the MFI we may decide to invest less, or we make it more expensive, or shorter term" (Klaus Tischhauser, responsAbility). If governance is very poor, debt providers will not invest at all. On the equity side, investors like to feel they have an active role to play in the governance of the institution, and often insist on a Board position in the MFI. For those MFIs with disorganised governance structures, it will thus be difficult to attract profit-seeking investors, although they may still attract financing from those that do not look to make a profit. Guy Rosa, Deputy Head of BNP Paribas' Microfinance Group underlined that his department selects investee organisations by their social ambitions, rather than by their governance strength. Along with its investments, BNP Paribas provides MFIs with technical assistance to help them develop better governance structures.

Governance in Microfinance is inherently more complex than in other sectors, due to the industry's implicit double bottom line. The Board of Directors of an MFI must ensure it achieves both financial *and* social performance. However, before implementing a strategy to cater to a dual mission, MFIs must clearly define what they mean by "social value". Carlos Danel explains that one of the biggest sources of confusion in microfinance is that every player has a different interpretation of social value: "Compartamos believes that financial returns lead to the provision of financial services to the largest number of people in the shortest amount of time. This is the financial inclusion angle. You can of course also take the poverty alleviation angle: Financial returns are not enough to create some sort of social wealth." In line with this, Ernst Brugger, Chairman of Blue Orchard, believes that the definition and subsequent implementation of a mission is the most important function of a Board of Directors. Amid criticisms of mission drift in MFIs and imposed mission drift from external investors, his words are a warning that the microfinance industry should not get ahead of itself. Industry stakeholders must agree on practical measures to embed good governance in the microfinance value chain to fulfil its ultimate purpose: to provide financial services to those at the margin, whilst giving viable economic returns to investors, such that they continue to finance the industry's expansion.

In response to this fundamental need for better governance, a necessary condition for the industry to grow and mature, the World Microfinance Forum Geneva is launching a Governance Platform. Microfinance practitioners, investors and other stakeholders can endorse the platform's mission online to show their commitment to stabilising the microfinance industry through improved governance. Endorsers will be able to contribute their own ideas and practical tools for the further development of governance in microfinance.

The World Microfinance Forum believes that this platform can lead to lasting improvements to governance in Microfinance, to ensure the long-term sustainability of this industry. The online platform will be launched in March 2011.