

## *Expanding the Frontier and Transforming Microfinance: Continuing the Conversation*



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## An unusual collaboration with unusual results

Many of the recurrent themes that punctuated *Expanding the Frontier* – access to capital, risk-return calculations, differing target markets, inefficient regulatory environments – seemed right at home at a conference hosted at Chicago’s famously free-market Graduate School of Business.

Yet, something was notably different – and it wasn’t just the Kellogg and Harris School banners hanging next to the GSB’s at the downtown Gleacher Center.

More importantly, it was that terms like BOP (Bottom of the Pyramid, Bulk of the Population – choose your acronym) and double, even triple, bottom line intermingled naturally with “leverage” and “ROI”. And then when Chicago sociologist Richard Taub in the final panel skeptically referred to a microfinance “movement” of do-gooders, he conclusively dispelled any lingering doubts this was just an ordinary business school conference.

As the organizing committee, we welcomed the contrasting perspectives and vigorous discussions. We also found the unusual collaboration among the three schools – the GSB, Harris and Kellogg – invigorating and particularly appropriate for an important, burgeoning industry that represents an exciting intersection of business and policy, theory and practice, profit and social impact.

We look forward to continuing discussions on these themes as our annual conferences progress, reflecting deepening experiences, insights and sophistication. Cate Ambrose from the Economist introduced the day’s first panelists as leaders and practitioners “who are ushering microfinance into a new stage of maturity.”

We can scarcely imagine what the following years will bring in microfinance but we hope that we can be part of stimulating the interest of students who may one day steer us into the next stage.

*The 2005 Chicago Microfinance Conference Organizing Committee*

### ***Expanding the Frontier and Transforming Microfinance: Continuing the Conversation***

This publication offers a summary and synthesis of many of the conversations begun at *Expanding the Frontier: Transforming Microfinance into a Global Financial Markets Instrument*.

It is intended to reinforce the ideas, discussions and commitment generated by the conference with the goal of extending and sustaining its impact.

We have provided content on commercialization of microfinance, seeking to deepen the understanding and interest of our student and business audience while also offering meaningful insights to practitioners on the advances, opportunities and scholarship highlighted in the day’s sessions.

In addition to conference coverage, we have presented perspectives and insights on the *Expanding the Frontier* themes from each of the conferences’ primary audiences: students, the business community, microfinance institutions and practitioners, and the academic community.

**Remember to look for the GSB’s *Capital Ideas: Conversations on Microfinance* in the fall. *Capital Ideas*, which is distributed globally and has never before featured a student conference, will include selected transcripts from the panels.**

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The currents of commercialization seem to be sweeping microfinance along at a pace few imagined ten years ago. Yet, as they often do, success and rapid growth have introduced a host of new challenges and new expectations.

In this context and encouraged by 2005's designation as the United Nation's International Year of Microcredit, students from the University of Chicago's Graduate School of Business and Harris School of Public Policy and Northwestern's Kellogg School of Management joined in a unique collaboration.

They assembled more than 30 leading voices in microfinance and attracted students and attendees from their schools and beyond to stimulate discussion on the bridging of microfinance and business and the promises and risks of commercialization.

## The themes, debates, insights

by Micki O'Neil

The Chicago microfinance conference brought together nearly 300 microfinance practitioners, business leaders, distinguished academics, and students to explore the complex issues facing the industry at this pivotal point in its development.

In launching the day's panels, Cate Ambrose, executive director of programs at the Economist, set the stage for the discussions of *Expanding the Frontier*. "There seems to be a consensus today that commercialization is the means by which microfinance will achieve the scale and sustainability necessary to have a significant impact on global poverty reduction and to bring banking services, including savings and insurance, to the world's poor," she said.

Yet, industry growth and commercialization have not always seemed inevitable. Simply gaining widespread acceptance for the idea that financial institutions can tailor services to the poor and help them "smooth their consumption, manage their risks, build assets, and improve their lives" has been a major achievement of the sector, noted Marilou Uy, financial sector operations and policy director at the World Bank, in the keynote address.

### The trends

Uy outlined three trends that comprise commercialization: the down-market entry of commercial banks, microfinance institutions becoming more commercially oriented, and the

establishment of partnerships between corporations and specialized microfinance institutions.

The first panel immediately expanded on these developments, as speakers representing Citigroup, Women's World Banking, the nonprofit South Pacific Business Development Foundation, SKS Microfinance, which recently transformed into a for-profit bank, and New York University explored "The Challenges and Opportunities of Commercialization."

"The ticket to play is commercialization," Vikram Akula, founder of SKS Microfinance in India, said in describing his organization's transformation from nonprofit to profit status. He cited access to capital markets, restrictions on product offerings for unregulated financial institutions, and efforts to foster a "new level of rigor and discipline" as driving the conversion.

While panelists repeatedly referred to demands of efficiency and scale that require microfinance institutions to operate like commercial ventures, many also cautioned against thinking like traditional banks.

"Like Muhammad Yunus said, we must forget what we know about banking," Mauricio Moura, executive manager of Unibanco Microvest, said, referring to his meeting with the Grameen Bank founder. Unibanco, Brazil's third largest bank, is expanding its microfinance operations as part of its business plan to tap into Brazil's vast informal sector, which Unibanco estimates at 40% of the country's economy.

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# Growing need for capital drives much of commercialization

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*Counts and Taub share a laugh amid a heartfelt debate on microfinance's potential. Counts said the industry excels at highlighting what is overrated but that "there are a lot of things that are working in this field." Taub, on the other hand, called microfinance a "movement" that deflects attention from more effective poverty interventions.*

Robert Annibale, Citigroup's global director of microfinance, said that large commercial banks, while having the capacity to manage risk, provide capital, and offer a range of financial services, must "accept a bit of humility" that this remains new territory for them and often extends beyond their expertise. For this reason, Citigroup's recently created microfinance business unit forms partnerships with local institutions that have nurtured trusting relationships with borrowers and have developed specialized expertise in microfinance.

Throughout the day, panelists cited capital constraints as a primary force driving the commercialization of microfinance institutions. Annibale noted that organizations with which its foundation supported began asking to approach Citigroup as bank clients. Reminiscent of Akula's discussion of SKS's evolution, John Fischer from ACCION International said his organization shifted away from an NGO model because donations could not meet their demand for funds.

As the founder of a leading non-profit microfinance institution, Casagrande emphasized that he believes financial self-sufficiency is central to achieving his core mission of poverty alleviation because it enables the South Pacific Business Development Foundation to guarantee permanence to its

clients and remain unaffected by the whims of donors or governments. He said 95% of SPBD's financing has come from soft and commercial loans.

"Charity is limited. Profitability is not," Mary Laraia, senior vice president of civic and community development at LaSalle Bank, said in describing the constraints on further development lending initiatives by LaSalle and its parent company, ABN AMRO. For the company to expand its operations in microfinance, it will need to develop models more profitable than the small development banks it currently supports.

In the final panel on microfinance's future, Alex Counts, president and CEO of Grameen Foundation USA,

pinpointed the crucial juncture at which microfinance stands. "I think the key question on the table that we've talked about today is, where is this money going to come from, to scale up?"

## The gaps

"Fresh ideas are needed here as much as resources," Jonathan Morduch, a professor of economics and public policy at New York University, said, reiterating a point from Uy's keynote. He added that not enough attention has been given to the "nitty-gritty details" of product design.

Fischer said that while ACCION emphasizes the commercial model in its expanding global network, it recognizes that NGOs are a necessary continued model for microfinance. In highlighting the role of NGOs as innovators that can provide a "demonstrator effect", he echoed other participants who identified NGOs as more willing to accept risk and develop new products and services directed to the most poor.

Many panelists emphasized the need for improved regulatory frameworks that allow for flexibility in developing new products and structures to address the unique demands of the poor. Others added that regulatory systems in many countries have not adequately incorporated microfinance institutions.

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# Continued growth will require innovation and better metrics

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Additionally, barriers remain to dramatically expanding commercial banks' participation. Fischer isolated clashes with microfinance's requirements and banks' operations that partly explain why banks have not jumped on this opportunity despite the vaunted returns. The labor intensity of microfinance runs contrary to bank trends toward greater automation, and the agility involved in addressing poor customers' needs collides with bank bureaucracy. Further impeding banks' entrance into the sector, he said, is the high perceived risk.

Addressing these real and perceived risks in a way that will increase the capital flowing to the sector will require innovation in the system of financing and directing capital to microfinance institutions, Maya Chorenge, president of the Dignity Fund, said. At present, philanthropy funds and commercial investors "are chasing the same MFIs and the same sort of deals."

Instead, Chorenge suggested that the philanthropic side focus on taking the most subordinated, high-risk piece in order to create a commercial capital investment that better matches risks and returns.

"The important idea that we're trying to convey is in order for the \$100 billion to flow in, we need the purely capitalist investors, who don't have the social-return profile, playing in the game. But until the point that we have the data and the different securities and structures," Chorenge said, "you are going to find people wearing both [philanthropic and capitalist] hats bridging the gap."

Bhagwan Chowdhry, finance professor at Anderson, UCLA's business school, added that we should not consider two types of investors but rather two types of securities: one sensitive to localized information or social concerns and the other that appeals broadly to the financial market. Investors can then create their own mix of social and financial returns.

## **The concerns**

Microfinance has historically blended social and financial goals, but Tom Coleman, a microfinance consultant and panel moderator, questioned the sector's success in directing its efforts toward social ends. According to Coleman, 87% of direct foreign investment in microfinance has gone to Latin America and Eastern Europe, even though 90% of world's poorest live in Africa and Asia. (Asia does,

however, have the highest penetration rates of microfinance.)

Academic panelists like respected University of Chicago professors Robert Townsend, economist, and Richard Taub, sociologist, also often tempered participants' visible excitement with more measured assessments of microfinance that cautioned against unsubstantiated claims. Taub expressed concern that the momentum behind microfinance, created in part by exaggerated claims made in marketing efforts to foundations, threatens to deflect interest from other, more effective interventions.

Those involved in microfinance must be clearer about what its goals are and what it can accomplish, Taub stressed more than once. He questioned its broad assurances of profit, poverty alleviation and women's empowerment, and warned that despite "the dream about perpetual motion machines," microfinance will continue to require subsidies.

The returns to microfinance are clearly not enough for the industry to survive without donations and subsidies – "despite all the euphoric talk," Chowdhry said. In a separate panel, Townsend added, "In many contexts, we actually often lack the measurements to know just how high or how low the rates of returns are."

Townsend, Taub and Morduch all discussed the difficulties in isolating microfinance's effect on poverty reduction and noted the prevalence of unsuccessful experiences. One major difficulty in evaluating effect on income is disentangling the demand side of microfinance from the provision of its services, Townsend explained. In other words, isolating microfinance as a causal factor in lifting its clients out of extreme poverty is complex and will require better data.

While there is a large need for better metrics and more focus on evaluation, many studies, including some of Townsend's, hint at microfinance's promise. And microfinance has clearly been successful in expanding the poor's options and increasing their access to credit.

Ultimately, Morduch emphasized that we do have to recognize that commercialization will require tradeoffs between poverty alleviation and financial returns, adding that "perhaps we have been too glib about this."

In response to the question of whether or not microfinance impacts poverty, Annibale quoted his boss Stanley Fischer at Citigroup: "I think so – I sure as hell hope so."

# Deepening financial services' reach

## Annibale discusses Citigroup's business decision

by Micki O'Neil

Citigroup's presence in microfinance is long-established. Its foundation began focusing on developing the sector's capacity long before microfinance was even being considered for special United Nation attention. It is its recent launch of a microfinance business group, however, that has put Citigroup in the forefront of microfinance's commercialization.

Among multinational corporations, Citigroup stands as a trailblazer in the field. Citigroup's senior business heads have driven this initiative, not its foundation officers, and Robert Annibale, the new group's global director, reports directly to the CEOs of Citigroup's global consumer and global corporate and investment banks.

Below are selected excerpts from an interview with Annibale after the conference.

**Q:** How has Citigroup's approach to microfinance evolved since its initial grant of \$5,000 in 1965 to its current practice? Why was the decision made to create a microfinance business group?

While the foundation has grown and evolved significantly over the last five or ten years, Annibale emphasized that its operations and story are distinct from the business group's. Yet, the foundation's long, recognized history in microfinance played an important role in the business group's beginnings.

"I think we were fortunate because we were able to get some pretty candid feedback from the microfinance world," Annibale said. Through relationships the foundation had cultivated and the personal philanthropy of people like then-Vice Chairman Stanley Fischer and Annibale, who was Citigroup's global senior treasury risk officer, Citigroup had grown aware of the development of a mature industry segment that wanted to engage with the formal banking sector in ways beyond philanthropy, as clients and partners.

"We were hearing these similar needs, wants, concerns, issues that we were familiar with as bankers ourselves." These included needs for capital, hedging, liquidity and cash management, and distribution questions.

"We also *wanted* to see financial services reach much deeper in the markets where we operate, and frankly, microfinance institutions were leading the way in that," Annibale said. Citigroup decided the best way to engage with the sector was to work with leading microfinance institutions as clients and partners to help them reach scale and diversify their product mix.

"There was an awareness that there was a need and an opportunity for someone like Citigroup to take a lead and really look at the sector for what it is now, a serious set of financial institutions providing access to financial services for the poor." He added, "And working with them on that basis – as well-managed institutions."

**Q:** Could you please describe one major, illustrative success of Citigroup's microfinance program?

Annibale detailed Citigroup's extensive public collaboration with Financiera Compartamos. The company is one of Citigroup's significant, growing partners in Mexico. The relationship encompasses a broad range of products and services, including capital market deals, cash management, and an imminent launch of a joint microinsurance product. Last year, Citigroup placed a major investment-grade bond issuance from Compartamos with institutional investors.

Additionally, Compartamos uses Banamex, Citigroup's branch network in Mexico. Thousands of their women use Banamex monthly to cash checks and make payments to Compartamos without Compartamos handling any cash.

Annibale said that by supporting and working with partners like Compartamos, the group has expanded beyond what even Citigroup had expected so quickly. "But it is truly treating microfinance seriously, the best microfinance institutions, working with them as you would top clients, giving them access to your products and your expertise, and trying to help them fulfill some of their objectives.

**Q:** What is one important lesson Citigroup has learned from a disappointing or challenging initiative?

Annibale said he has not been disappointed yet because Citigroup started from the assumption that commercial banks have historically not engaged deeply with large segments of the global population. He said it's important for experienced, large banks to accept humility and recognize that other, smaller institutions have led the field.

A major challenge has been many microfinance institutions' pace and scale. "The lesson of our own experience in consumer banking is that you do need reasonable scale for these products to become affordable and attractive to clients – and also sustainably profitable for institutions."

**Q:** What are the most important contributions major financial institutions like a Citigroup bring to microfinance?

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In addition to products and services like currency risk hedging, equity investor relations and intermediation with international investors, multinational institutions can help reduce the time and cost of operations through collaboration.

"Our own experience in reaching scale and doing volume can be shared with partner institutions," Annibale said. For products like credit cards that are initially capital-intensive, "leveraging off the experience, technology and scale of another institution can make a huge difference in the cost and pace of introduction."

**Q:** How would you address concerns that the commercialization of microfinance might undermine its role in alleviating poverty?

With a diversity of institutions in microfinance with differing roles, Annibale said this is a question most for those with missions of poverty alleviation. They must define what commercialization, which has wide-ranging meanings, signifies for them and how it affects their goals.

"We are not development experts, we're not using microfinance as a development agency might, to alleviate poverty only. ... Our biggest concern is to provide greater access to financial services, whether it be to microentrepreneurs, savers or those who receive remittances," Annibale said. "I think that in its own right is a very positive step."

**Q:** What do you believe are the keys to increasing business involvement?

The keys are good, demonstrated successes; leaders, both microfinance institutions and engaged commercial banks; and education about the vibrancy and heterogeneity of the industry. "I have no doubt there will be more and more people involved."

"The whole bottom of the pyramid is not the bottom of anything – it's simply the bulk of the population," Annibale concluded. "You can have all kinds of missions, but effectively, that to me is the most important thing, that everyone should have access to appropriate financial services."

## Multinationals in microfinance

*by Jeremy Mathias*

*The list below provides a sampling of the many multinational corporations that have taken the lead in developing programs to facilitate microfinance. Others include Cisco, Microsoft, AXA, UBS, ING, Cemex and McKinsey.*

**ABNAMRO:** In September 2003, ABN AMRO launched microfinance services in India, helping to provide loans and advisory services to self-help groups for women. In Brazil, ABN AMRO recently established Real Microcredito in partnership with Acción, a non-governmental organization. Over 1,000 microentrepreneurs in Brazil have benefited from Real Microcredito's loans.

**Banco Santander:** Banefe, the bank's consumer credit arm, is the biggest banking concern in Latin America with a large-scale microlending operation. Its financial group has units in 37 countries with 8,500 offices and more than 24 million clients.

**Citigroup:** In addition to the work of its business unit as described by Annibale, the Citigroup Foundation awards grants to 145 microfinance partners in more than 50 countries.

**Credit Suisse:** Credit Suisse, together with partner banks, has founded the company "responsAbility Social Investment Services AG." It has also set up the corresponding responsAbility Global Microfinance Fund to fulfill the needs of its clients who target the microfinance market.

**Deutsche Bank:** The Deutsche Bank Microcredit Development Fund, established in 1997, led Deutsche Bank to found the Global Commercial Microfinance Consortium Ltd. The Consortium provides institutional investors the opportunity to capitalize on the profit and social-benefit prospects by linking key players in microfinance, local banks and international capital markets.

**Hewlett-Packard:** H-P has partnered with USAID to introduce the Remote Transaction System pilot program in Uganda. Using the RTS device and a borrower's smart card, a field agent can capture microfinance loan and savings data electronically, storing and transmitting information formally tracked manually.

**HSBC:** In India, HSBC is the first bank to focus its lending on schools serving children from low-income families. It has partnered with an NGO that supports schools, trains teachers and assists in improving education. HSBC recently announced its intention to provide for microfinance in the Philippines.

**J.P. Morgan Chase:** At a 2005 shareholders meeting, participants requested that the Board develop policies to enable J.P. Morgan to participate in funding microfinance groups through capital markets. Additionally, in July 2004, J.P. Morgan acted as a placing agent on the first-ever microfinance securitization vehicle, as Blue Orchard, a Swiss investment boutique, raised \$40 million.

**ShoreBank:** ShoreBank helps local institutions in 30 countries provide credit to micro- and small businesses. More specifically, ShoreBank Advisory Services advises local financial institutions in all steps of starting small business loan programs. ShoreBank also designs real estate lending programs in countries where banks do not typically finance homes. In 2003, ShoreCap International was established to make equity investments in financial institutions in Africa, Asia and Eastern Europe.

**Visa:** In January of 2004, Visa International, in partnership with USAID and FINCA International, established an initiative to improve the delivery of financial services to entrepreneurial women in developing countries. The partnership includes major technical assistance and brand strength from Visa in bank partnerships, payment technology and product development.

**The Lunch and Learns provided conference attendees an opportunity to explore specific, relevant topics in more intimate settings.**

**Sessions involved discussions on branding microfinance, measuring its performance, career development, an in-depth look at the industry in Brazil, and the broader context of microfinance and economic development.**

## Building inclusive economies

by Micki O'Neil

Champions of microfinance point to its potential to lead to both profit and poverty alleviation. For Greg Casagrande, founder and president of South Pacific Business Development Foundation (SPBD), the two are intricately linked.

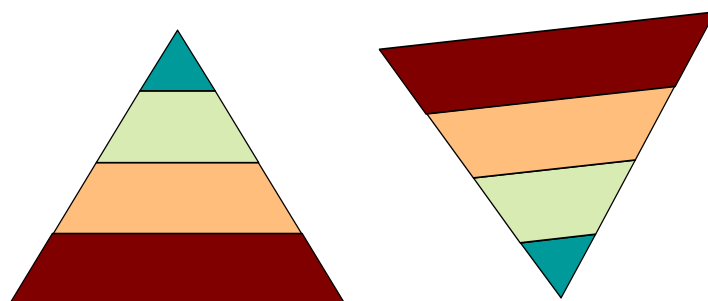
"I founded SPBD with the goal of providing permanent, meaningful economic opportunity to the poor of Samoa through the provision of training, unsecured credit, ongoing guidance, and motivation to help poor families start sustainable businesses of their own. A key part of that mission statement is the word *permanent*." Casagrande explained that financial self-sufficiency enables his organization to pursue its social mission for the long-run.

During the session "Eradicating Poverty through Inclusive Economies," Casagrande and Bill Kramer, deputy director of the Digital Dividend at the World Resources Institute, discussed microfinance's role in broader efforts to successfully incorporate the poor into global economies.

By stimulating the creation of microenterprises in economies where employment opportunities are scarce, microfinance is – in Casagrande's view – an essential part of a larger effort to empower the poor to move themselves out of poverty. "Building inclusive economies has been the best method of pulling people permanently out of poverty," he said.

Kramer began his presentation by inverting the "bottom of the pyramid" analogy and drawing an overturned pyramid balancing precariously on its wealthy tip. This, he said, argued indisputably for the need to address extreme global poverty.

Kramer emphasized the role of harnessing technology and changing mindsets in addressing the imbalances in the global economy. He believes that technology has the potential to provide a "digital *dividend*" rather than create a "digital divide." At WRI, Kramer examines and promotes ways to utilize technology to drive development through all sectors of the economy.



*Bill Kramer illustrated why he believes addressing global poverty is an imperative. He said common references to the "Bottom of the Pyramid" should be inverted: the reality is that the world balances precariously on its inequalities.*

Both Kramer and Casagrande emphasized the need to stimulate local business and highlighted the historical shortcomings in multinational corporations' operations in developing countries. In comparing small and large companies, Kramer asserted that while overall decision processes function similarly, the primary difference is "a massive cultural, perceptual barrier" in large companies to understanding markets for the poor.

Multinationals excel at replication and scale but they lack the imagination to differentially address poor markets, he said. Large companies require more, improved data to help them make better decisions on how to penetrate the informal economy, but first mindsets must change.

An additional point that both made was that the products that reach the poor in developing countries are of worse quality and are more expensive. "You can [quickly] make a poor person much richer by reducing prices," Kramer said.

Any deeper, more sustainable transformations in economies also require increased transparency and reduced corruption, Kramer stressed. He referred to an informal conversation among conference speakers about "scores of ships" full of donated goods, for tsunami victims or off the coast of Africa, that cannot land because they have no money to pay the bribes.

"At a meta-level, charity can only do so much," Kramer concluded.



# Branding Microfinance

by Chinwe Umenyi

In the Lunch and Learn session “Branding Microfinance”, Beth Houle, senior vice president of marketing strategy at Opportunity International, discussed the desire of microfinance organizations like Opportunity International to better brand microfinance.

In the last two years, Opportunity established its first marketing department to consider branding, consistency and messaging and begin assessing ways to better market the concept of microfinance generally. Opportunity took these steps because it has a 30-year history and strong measures of success but remains unknown to many potential investors.

About five years ago, Houle was part of an editorial review board through which Opportunity met with senior editors at the *Wall Street Journal*, *Business Week* and other financial publications. Only one of the editors knew about microfinance. Now, five years forward, while most of this audience has heard about microfinance, there is still a lot of progress to be made.

Houle identified important target segments for marketing and objectives for these target segments. These target segments are: 1) influencers on country agendas that shape laws and regulations; 2) current clients of microfinance, as increasing competition is drawing away customers; 3) the media to assist in getting the message to the public; and 4) financial audiences that include both financial institutions and individual investors.

According to Houle, if the reason to brand microfinance is to drive expansion, financial audiences are the primary target segment. This segment attracts varied funding, influences governments and central banks to create encouraging environments for microfinance, and influences media.

She listed key questions: What are the best ways to approach this audience? What is the best message? What is important to this audience? What are some of the challenges? She noted that expanding the mass market for the microfinance industry would require a tool that has a lower threshold so that the average person can invest and get involved in microfinance. She acknowledged one key challenge has been inconsistent

terminology, with differing definitions used by various bankers and microfinance organizations.

Rhonda Schaffler, media outreach coordinator at the UNCDF, contributed insights to the session from her background as a financial journalist for CNNfn. She said the microfinance story does not connect easily with journalists. A major hindrance is that, unlike other investment options, microfinance lacks coverage by a well-known rating agency. She believes that the more data is consistent and standardized, the stronger message microfinance can deliver.

Schaffler suggested a focus on the market angle and positive developments in the industry. She also suggested that there is a need for major banks and corporations to invest capital.

Houle contributed that managing perspectives and finding the best way to clarify the message were key concerns. She believed it was best to highlight both industry successes and failures and to translate the data in a meaningful way for all potential investors.

***Suggestions were solicited from session participants for the best ways to present the message on microfinance to a financial audience. Here is a peek into the issues wrestled with in the discussion:***

- Find better ways of measuring and assessing risk.
- Highlight the opportunity to expand and build expertise in new markets, shifting away from a charity perspective.
- Cast microfinance investing as an investment in people and take advantage of trends in social responsible investing and venture and performance philanthropy. Schaffler said because of cost barriers, higher risks and longer time horizons, concepts of social responsible investing would better drive the message.
- For individual investors, focus on the personal satisfaction of investing in people. Appeal to the heart through profiling individuals that benefit from microfinance. Houle added balancing “the head and the heart issue” through both financial metrics and social responsible investing messages was a concern.
- The participants believed there should be a focus on return and easily understood financial metrics like ROE, capital appreciation, measures of risk, etc.
- A challenge in taking advantage of these opportunities is the underdeveloped rating model of the industry.
- A participant suggested a moral or faith-based incentive could create greater investment. Houle responded that while microfinance makes significant impacts, this method would put it in competition with other charities and causes. She added that while most people have a cap on charity donations, such does not exist for personal investing.

# Brazil: a deeper look

by Chip Constantino

Despite a well-established presence with 171 organizations operating microcredit programs, the microcredit market in Brazil remains substantially underserved. As Eduardo Carlos Ferreira, Manager of Unibanco Microinvest in Sao Paulo, Brazil pointed out, "The Brazilian Central Bank estimates that there are 16 million microentrepreneurs in this country, yet only 2% are currently being reached by microcredit organizations."

Boasting a population of 179 million and an economy that drives regional growth in South America, Brazil is one of the world's most prominent emerging markets. At the same time, nearly 33% of the country's population survives on one dollar per day. Furthermore, less than a half of the population is considered "economically active" – a term used Mr. Ferreira to describe those individuals who access financial services through traditional channels. "To illustrate this point," said Ferreira, "checking accounts in Brazil only number 54 million."

While these numbers illustrate the economy's division among rich and poor, the market also divides along lines of formal and informal sectors. Mauricio Moura, Executive Manager at Unibanco Microinvest, said, "While the formal market includes 4 million small enterprises and employs over 25 million people, the informal market includes more than twice the number of enterprises and employs 30 million people."

Several factors drive the existence of the informal sector, including the rise in unemployment in the formal sector, efforts to avoid taxation and the bureaucracy involved in establishing a formal enterprise.

The non-profit, public and private sectors have all attempted to reach the informal sector's millions of microentrepreneurs. For example, following President da Silva's decision to make microcredit a part of his administration's agenda, the Brazil's Central Bank created the Society of Credit for Microentrepreneurs, an organization that offers credit to informal enterprises in amounts ranging from \$4 to \$25. The government also offers subsidized interest rates through the Brazilian Public Development Bank. In terms of non-profit participation, Ferreira said 80 NGOs operate microcredit programs in Brazil.

Private sector involvement began at the end of the 1990s. Microinvest, a subsidiary of Unibanco, Brazil's third largest bank by total assets, is a leader in this area. Moura described the organization's mission as having three central elements. "We want to have a positive economic impact," said Moura. "And we want to balance this social objective with profitability and the achievement of economies of scale."

While non-profit, government and private sector participation have brought gains, tremendous room for growth and many challenges remain. Microcredit organizations in Brazil will continue to expand distribution channels to reach an ever larger share of the country's 16 million microentrepreneurs. As the scale of operations grows, practitioners will also need to develop more sophisticated credit evaluation systems. And finally, business development leaders within microfinance organizations will need to continue to devise effective marketing efforts to reach the low-income entrepreneur segment.

## Financing and assessment gaps

by Rafael Ugaz

Because there are no widely recognized social performance measures for microfinance, Leslie Barcus, President of Microfinance Management Institute, focused not on calculating Social Return on Investment but instead on the financing gap faced by MFIs and socially responsible investors' role in helping to fill it.

"MFIs can seek a financial and social return and those two are not inconsistent," Barcus said. Sustainable and non-sustainable MFIs reach similar populations, suggesting that there is not necessarily a tradeoff of social welfare in the move to become sustainable.

The number of sustainable MFIs (that cover operating costs and make a return on earnings) has grown over time. Sustainable MFIs tend to be larger, totalling 80% of all microfinance loans,

in dollar terms, according to Barcus. They are also now reaching sustainability faster, with some MFIs doing so within only three years.

While funding demands are estimated at \$100 billion, the supply is only \$2 billion. Today's 43 microfinance investment funds (MFIF) have three investor types: development institutions, socially responsible investors (foundations and NGOs), and commercial investors. Development institutions provide \$1.4 billion in funding, social and commercial investors provide \$500 million and public investors an additional \$1.1 billion.

Barcus identified constraints in both MFIs searching for funding and for investors searching to invest in MFIs. Some causes she cited were: capacity constraints in absorbing investments; heavy reliance on single donors; inconsistent

*Continued on next page*

# Career opportunities for MBAs

by Homa Zaryouni

Vikram Akula, founder and chair of SKS International and Julie Peachey, senior program manager at the Grameen Foundation spoke about various career opportunities available to MBA graduates deciding to pursue a career in microfinance. The session took the form of an informal talk, with the speakers drawing from their own backgrounds to illustrate the benefits and challenges of such a career.

Microfinance institutions have changed drastically, from small organizations to larger ones with needs for a diverse group of people. Peachey recalls after ten years of finance, when she finished a development project of building a school in Honduras, she began to look for a career in microfinance. She was told in her initial searches that the only thing she could do for institutions was fundraising. Now, the environment has changed so that MFIs want to mimic traditional financial institutions, and they are looking for graduates with the skills to do that.

The best job candidate, according to Akula, has a combination of financial analysis skills and some field work experience. Field experience can be obtained on the job, but the financial analysis skills – being able to synthesize a lot of information and report it to the loan committee – are key.

Graduates interested in microfinance have several options. They can work for MFIs, banks or multinationals involved in microfinance, microfinance networks or donors, multilateral development agencies, or rating agencies who

do industry analysis. Both Akula and Peachey agree the most direct satisfaction comes from working for an MFI or starting up an MFI.

About starting up an MFI, Akula said, "I can't imagine a more thrilling entrepreneurial experience because there are so many social sides to it."

Compensation is another consideration students have when deciding to work for an MFI. Although the field pays more than other development work, the salaries hardly measure up to those in the financial sector. While there is the possibility of making more with a compensation package that includes an incentive component of stock options, this compensation is uncertain, with possible payoffs in the future.

Peachey has some advice to those who want to work in microfinance but are hesitant because of salary differences. When talking to other MBAs who are anticipating six figure salaries upon graduation, "you need to close your eyes, cover your ears, and do your own thing," she said. "You'll be much happier at the end of the day if you go according to what your values are."

On the positive side, a great amount of independence comes with working for MFIs. This gives self-starters opportunities they would not find anywhere else. A recent hire at one of the top 500 MFIs is likely to have an opportunity to meet with executives of companies such as Dell and Sun Microsystems. According to Akula, these are opportunities for which MBAs in traditional organizations wait ten years.

## Constraints, difficulties and progress in financing and appraising

*Continued from previous page*

reporting and lack of transparency; and undefined social performance results. Barcus also highlighted promising aspects of MFI and MFIF relationships, including trust, appropriate product development, donor coordination, and performance evaluation and monitoring.

After Barcus, Annette Krauss, UNCDF Microfinance Training Manager, introduced CGAP's appraisal tool for evaluating MFIs. The tool provides a common framework for both donors and investors to evaluate financial institutions, but it must be adapted to each individual context.

This approach requires qualitative analysis and assesses the MFI as a whole, not only its financial performance. In Krauss's words, "The beauty of this tool as compared to other tools is that it takes an institutional perspective."

The first step requires both donors and investors to determine their social and financial return objectives and how they want to balance them. The approach's key elements involve

analysis of strategic objectives (match between the investor/donor's vision and the MFI's); people (governance and management); clients and markets; services provided (including cost and quality); institutional factors; and financial performance. Since MFIs may not have financial statements, the assessor often needs to work with the MFI to get the necessary information.

An audience member who had worked for a donor said donors do care about sustainability. Yet, the problem in measuring financial losses is that it is unclear when losses are due to tradeoffs or from management incompetence.

Sam Moss of Gray Ghost, a fund that invests in other MFI funds, described their method of measuring each fund on four parameters: innovation, impact, outreach, and financing. They quantify the social return on investment and compare it with the purely financial return.

Despite many ideas on measuring social return, the industry is far from a consensus.

A look at some frontier issues discussed at the Chicago conference, as exemplified by MFIs spanning the globe

## SKS grows through innovation

Captures undiscovered market through technology and local talent

by Homa Zaryouni

In 1997, Vikram Akula founded an NGO in Hyderabad, India to help people in the drought-prone region of Deccan make small investments that drastically changed their income. Akula is a political science PhD, with no business training. He started the NGO as a social endeavor. He received contributions of \$52,000 from friends, family, and private donors.

"The sell was, we will do things that are best for the poor," says Akula. The surprise was, the venture for helping others generated enough revenue for SKS to expand and become a profitable organization. Today, at April's end, SKS had 91,263 clients and \$8,375,665 in outstanding loans.

"There was a market where people did not realize there was a market," says Akula. There was a market of poor who needed small loans, but they were trapped by lenders who asked for collateral before giving out loans and who charged rates as high as 72%. SKS competes with those lenders by offering loans without requiring collateral and offering them a 15% flat interest rate. The NGO has become one of the most successful microfinance companies in the world.

Akula attributes SKS's success to three factors: 1) effective use of technology, 2) a focus on customers, and 3) the ability to bring people in social development together with people with expertise in the financial world.

SKS's major innovation was the creation of an automated management system. The system automated processes, enabling rural loan officers with low education levels to handle thousands of weekly transactions and manage portfolios of up to \$250,000. The system also included a successful pilot of smartcards and hand-held devices to streamline the front end of the business.

SKS did not grow without confronting the challenges emerging microfinance institutions face. The biggest challenge was hiring and retaining talented employees, a challenge for any company that cannot afford to give out large salaries. SKS tapped into local talent. It recruited and hired uneducated village youth as loan officers, paid them 15% higher than

competing organizations, included a 20 to 30% incentive component in their pay, and installed automated systems to make it possible for them to handle large transactions. This led to a near 100% retention rate of staff, as well as borrowers' loyalty to the company, since the first people SKS recruited were sons and daughters of the borrowers.

"There is a tremendous loyalty that happens when you are customer-focused," Akula says.

At the head office level, higher pay seems the long-run solution to retain good managers. Initially, SKS could not afford large salaries and attracted managers interested in the work's social aspects. The company also attracted managers interested in developing professional skills, because it provided new hires more responsibility than they would have elsewhere.

It was an effective solution, but only for the short run, since most managers left after two years. Akula acknowledges the need to attract individuals who will stay with the company, which is why SKS has decided to pay its higher level managers salaries in 2005 comparable with the private sectors.



Vikram Akula discusses the challenges that SKS India has faced as one of the striking examples of microfinance's growth and commercialization.

# Beyond credit services

## Weathering unexpected crises through microinsurance

by Chip Constantino

Over two billion people worldwide lack any formal social security protection to insulate themselves and their meager, yet vital, assets from unexpected loss, according to CGAP statistics.

The vulnerability of the world's poor is particularly acute, as a single event can severely disrupt their already precarious financial positions and relegate them to lives of utter destitution. It is troubling to realize that while poor people are least likely to have the opportunity to acquire coverage, they are also the most vulnerable to risk and economic stress.

In the past – and to a large extent, still – most poor people have been forced to manage the risks they face on their own. As such, many

of microinsurance products, including crop, health and disability, property, term-life, and credit-life insurance.

In order to ensure that microinsurance products are relevant and well-designed, MFIs have had to carefully evaluate their clients' needs. For example, in response to identified client need, Opportunity International embarked on an aggressive strategy in 2002 to develop microinsurance for its clients, including those infected with HIV/AIDS.

According to an article published by Richard Leftly of Opportunity International, "In Zambia, a family devastated by the death of a provider from AIDS receives \$125 to cover funeral expenses and the costs of reassembling their

In 2002, **Opportunity International** implemented an aggressive strategy to develop microinsurance products for its clients around the world. To date, Opportunity has extended more than 300,000 policies covering the families of credit and noncredit clients in places like Malawi, Uganda, Zambia, Mexico, and the Philippines. A particular focus of Opportunity's efforts has been on assisting clients affected by HIV/AIDS. Its program in Zambia, for example, is one of the only to provide insurance coverage for AIDS-related deaths in order to cover funeral expenses and other costs associated with recovering from a family member's passing.

depend on a host of informal mechanisms like cash savings and moneylenders to prepare for and cope with risks like an untimely family death, severe illness or the loss of livestock.

Yet, savings and access to emergency credit alone are often not sufficient to enable people to remain out of extreme poverty following the onset of a financial crisis. In order to have a more financially stable platform from which to further grow, low-income people require access to a set of well-designed financial products.

Enter microinsurance.

CGAP provides a working definition: "Microinsurance is the protection of low-income people against specific perils in exchange for regular monetary payments (premiums) proportionate to the likelihood and cost of the risk involved. As with all insurance, risk pooling allows many individuals or groups to share the costs of a risky event."

Microfinance institutions have recently joined the ranks of national governments, communities and the private sector to offer microinsurance products to the poor. At present, low income individuals can avail themselves of a wide array

of life. Because the client buys insurance and is protected, AIDS is no longer a reason to deny a client a loan."

MFIs and others will continue to face several challenges in providing microinsurance. First, increasingly complex microinsurance products require actuarial expertise in order to forecast the probability of a future risk and price it accurately. Often, this actuarial expertise resides with one type of institution (i.e., formal insurers), while the distribution networks to poor customers lie with another (i.e., MFIs).

Bridging this gap will be crucial to the further evolution of microinsurance. Furthermore, research indicates that many poor people are skeptical about paying premiums for possible future benefits, when the insured event may not occur. For MFIs and others, creating awareness about the value of insurance, while time consuming and costly, is another critical challenge.

Improvements in the poor's ability to emerge from unexpected crises with their economic lives intact will depend on how the industry clears these hurdles.

# Unibanco expands credit access and profits

by Claudia Onofrio

"When talking about microfinance and microcredit, forget everything about traditional banking". With these words, Mauricio Jose Serpa Barros de Moura, Manager of MicroInvest, Unibanco's microcredit unit in Brazil, opened the conference's panel on Evolving Models for Microfinance Services and Products.

De Moura and Eduardo Ferreira, manager at MicroInvest, said in an interview that Unibanco believes that microcredit is a strategy for fighting poverty well-worth exploring, and it has become a critical topic in the CEO's agenda since 2003.

Brazil represents a significant market for microfinance. With the largest economy in Latin America, and eighth in the world, Brazil's socioeconomic traits suggest an environment conducive to microfinance. Income inequality is among the world's most pronounced and the country has Latin America's largest number of poor. One-third of Brazil's population, or about 60 million people, live on less than a \$1 a day.

Even with high poverty, Brazil is a top ten country globally in total entrepreneurship activity, as listed by the Global Entrepreneurship Monitor. A major obstacle in tapping 100% into the economy's entrepreneurial potential, however, is its significant level of informality.

With Brazil's informal sector continuing to grow – from 38% of the active economic population in 1991 to 51% in 2004, according to the Central Bank – the need for microcredit is only increasing. Microcredit, a subset of microfinance, is business loans made to microentrepreneurs in the informal sector, or in other words, loans aimed at generating continuous income streams that allow individuals to repay loans and improve their lives.

The Brazilian market for microcredit remains far from saturated, and it represents an attractive opportunity for Unibanco. Brazil's 171 microfinance institutions, with a total portfolio size of \$60 million, have penetrated only 2% of the potential market, by the central bank's estimates. Often, the only financial services available to the poor are credit cards or, more commonly, store cards. About 40% of store card holders live on less than \$3 a day.

Unibanco, the third largest private bank in Brazil, is its only private bank offering microcredit services, having joined with the World Bank's International Finance Corporation (IFC) to operate MicroInvest. Created with capital from both Unibanco/Fininvest (82%) and the IFC (18%) in October 2003, MicroInvest provides services to poor communities in Rio de Janeiro, Sao Paulo and Porto Alegre. Today, MicroInvest's

active portfolio is around \$2.5 million and 85% of its clients are informal microentrepreneurs.

MicroInvest's mission balances social objectives and profitability by providing small working capital loans to microentrepreneurs. Its strategy centers on three pillars: acquiring businesses able to provide microcredit on a large scale, extending customer lifetime value, and aggressively controlling for service costs.

Unibanco's overall low-income customer segment includes 9.4 million clients served with consumer credit services provided by Fininvest, ProntoCred or LuizaCred. MicroInvest is targeting 3% of them, or 300,000, as clients.

MicroInvest's credit process centers not on traditional requirements and scoring systems but on the loan officer. The loan officer, as used by other MFIs, visits the client's business to collect relevant, first-hand information and develop a profile. Based on this, Unibanco decides if it should extend a line of credit.

Although this process has been successful in providing credit to microentrepreneurs while reducing the default risk, it poses challenges for achieving scale because of high costs. Unibanco is studying options for more efficient models.

Distribution is another important aspect of the operationalization of Unibanco's strategy. Because cultural and educational levels differentiate client segments, MicroInvest utilizes alternative distribution channels to reach low-income clients. For example, Fininvest, the leader of personal credit directed to the low-income segment, has 246 branches all over Brazil located next to or in low-income areas and "favelas".

So, why has Unibanco tapped into a market most banks have considered risky and expensive?

First, the market exists. Second, potential clients have already experienced credit through store and credit card services, although at high interest rates. Third, the Brazilian government has recognized the microcredit's potential to fight poverty. Fourth, the United Nations and other multilateral organizations are promoting the introduction of microcredit into mainstream financial systems. And finally, Unibanco has gained knowledge and advantages through its partnerships and acquisitions that put it in a privileged place to embark in this adventure.

Challenges are not few, and large-scale impact and business sustainability of microfinance are still in question. However, if the right formula is found, de Moura and Unibanco believe, this would be a breakthrough in portfolio growth in the competitive Brazilian financial market and an important tool of its economic development.

# GMA awards celebrate Year

by Christine Jacobs

Founded in 2004 by the United Nations Capital Development Fund (UNCDF), the Citigroup Foundation and a network of business school students, the Global Microentrepreneurship Awards (GMA) program is one of the central initiatives commemorating the United Nations' 2005 International Year of Microcredit.

The GMA works to raise global awareness of microfinance and demonstrate how microfinance fosters entrepreneurship in developing countries by awarding the skills and contributions of microentrepreneurs from across the world.

In collaboration with professionals from the UNDP and Citigroup, the business school students are involved in every aspect of the design and development of the GMA program in each of the 31 participating countries.

This year teams of students at Northwestern University are participating in the GMA program. Their efforts are focused on Madagascar, Mexico, Peru, and Brazil.

## Kellogg student shares insights from his participation

*Continuing the Conversation* had the opportunity to speak with one of the students involved in the GMA. Steve Hallaway, a 1<sup>st</sup> year MBA student at the Kellogg School of Management, shared his thoughts on microfinance and the GMA. Before attending Kellogg, Hallaway worked as a consultant to pharmaceutical and biotechnology companies. Hallaway is part of a team of Northwestern University students assigned to promote the GMA in Madagascar.

*Q: How and why did you become interested in microfinance?*

A: Fellow 1<sup>st</sup>-year Kellogg student Budiman Wikarsa has long been interested in economic development in emerging economies. After speaking with him at length about his experiences with the GMA, and about other charitable efforts within Indonesia, his enthusiasm for such projects rubbed off on me. I have also long had an interest in both entrepreneurship and international markets. The GMA program allowed me to pursue these interests simultaneously.

*Q: In your opinion, how does the Global Microentrepreneurship Award initiative work to support the spread of microfinance?*

A: The GMA publicly acknowledges successful entrepreneurial businesses that contribute to the economic development and vitality of an emerging economy. The GMA raises awareness of entrepreneurship, economic opportunity and business practices around the world. I also believe that it encourages people to think creatively about the resources available to them in their own country.

*Q: How has your involvement with the Global Microentrepreneurship Award initiative added to your skill set as a businessperson?*

A: It has encouraged me to look for business and economic opportunity in areas that I might not have otherwise considered. One of my responsibilities with the GMA is to help create public awareness of the program within Madagascar. As I worked with media outlets to publicize this opportunity, I gained important experience managing media and public relations.

*Q: In your view, what does the future hold for microfinance?*

A: As microfinance spreads to an increasing number of countries, my hope is that economic progress within the targeted countries will begin to be self-sustaining. This would bring improved standards of living, better healthcare and improved environmental conditions. Microfinance will also bring opportunity for entrepreneurs within developing countries and expanded markets for those in developed regions.

**Students from the University of Chicago and Kellogg reflect on direct personal experiences with microfinance**

## An evolving understanding

*by Rafael Ugaz*

My first exposure to microfinance was on a World Bank project in Peru. While identifying housing finance options for low-income households, I was unconsciously thinking in terms of traditional financial products offered by commercial banks. Soon, however, I realized that because of irregular cash flows and a lack of information and collateral — basically different realities — the characteristics and terms of traditional financial products do not match low-income families' needs.

It are these contrasting realities that microfinance seeks to address. The sector requires different risk assessment techniques and a lot of creativity to design financial products that fulfill the poor's needs. From this experience, I learned that when thinking about financial products for low-income families, we need to break the mold and be innovative about designing new products and services.

Later, while working at a Peruvian bank as risk analyst assessing microfinance institutions, I directly observed the outstanding performance of some MFIs that were gaining importance in the Peruvian economy and that were profitable with good risk indicators.

Nevertheless, by visiting Cajas Municipales and Cajas Rurales in poor regions, I began to comprehend first-hand the challenges and weaknesses that the microfinance industry faces. On one side, new risks arise in those MFIs that are expanding operations to other localities and that are engaged in vertiginous growth. On the other side, the high operational costs of their models that translate into still high interest rates restrict them to only a small portion of the potential market.

I want to be part of the expansion of the microfinance industry in developing countries, but this requires creativity to design new financial and managerial structures that will reduce costs and better manage risks. Nothing is already set in this field but I would like to learn from practitioners and academics about the successful and failing experiences in different parts of the world. This is why I find experiences like the Chicago microfinance conference so valuable.

*Rafael Ugaz just completed his first year at the Harris School of Public Policy at the University of Chicago. He is originally from Peru.*

## A free-market solution

*by Shehreyar Hameed*

I became interested in microfinance while working for ABN AMRO Singapore. We had approached Grameen Bank in Bangladesh to securitize their loan receivables but Grameen was not interested. Although we did not deal with Grameen, I was intrigued by microfinance and Grameen's business model. I saw microfinance as a powerful poverty alleviation tool and began developing my knowledge base. Then, before coming to business school, I flew to Dhaka to spend time at Grameen Bank.

I visited Grameen branches across numerous villages and was struck by the tremendous empowerment microcredit provided poor women villagers. I was amazed by the entrepreneurial spirit they had used to bring their families out of poverty and become a source of employment for their villages. The pride and dignity that microcredit provided was truly inspirational.

In my research, I realized that the lack of viable institutions serving the poor, coupled with the lack of property rights (*a la* Hernando De Soto), was preventing the poor from access to capital — a fundamental right. Microfinance essentially provides a "free market" solution to financial market failures in developing countries, and so, from the time I landed here at the Chicago GSB — the home of free markets — I began promoting microfinance.

Then, in 2004 after being appointed "Student Ambassador" for International Year of Microcredit 2005, I started planning a conference that would celebrate the year, highlight the power of microfinance and be part of microfinance's march beyond its initial frontier.

*Shehreyar Hameed just graduated from the Graduate School of Business at the University of Chicago. He is originally from Pakistan.*



# Witnessing microloans' power

## Exploring Grameen, from the field to the top

by David Vinca

While casually strolling through a Cambridge bookstore in late 2000, I stumbled across the book *Banker to the Poor* by Muhammad Yunus. The tagline read: "Micro-Lending and the Battle Against World Poverty." I immediately felt I had been searching for this.

For about four years, while working as a consultant based in Philadelphia, I had searched for an entrepreneurial opportunity that could combine business with my desire to make a positive impact on the world. Examples of businesses that sought social returns were rare. This one sounded fascinating.

After reading the book, I was inspired to travel deep into the heart of the Bangladeshi countryside, 8,000 miles from home. There, I found myself sitting on the straw floor of a bamboo hut crowded with 20 women. It was the weekly meeting of the local branch of Grameen Bank, the unique bank founded by Dr. Muhammad Yunus that has helped 2.5 million poor women escape from extreme poverty in Bangladesh.

After bank meeting, I spent time with an old woman who was a long-time borrower of the bank. As the woman looked in my eye, she told me she would beg for food to feed her family before receiving a \$15 loan to buy a

milking cow. She cared for her cow, milked it and sold the milk for a profit to other villagers. She then used the milk profits to pay off her initial loan and take out a larger loan for a small plot of farming land. From this humble beginning, she grew her farming businesses.

I saw the pride in her face as she showed me the fruits of her labor: her sturdy, concrete-reinforced bamboo hut. Her face lit up even more when she spoke about her son who was in school studying medicine. This woman was empowered...empowered by the micro-loans from the Grameen Bank.

After experiencing the bank at the grass-roots level, I secured a meeting with Muhammad Yunus, Grameen's famous founder. In the meeting, Dr. Yunus spoke of his strong determination to eliminate poverty from the world. He said his goal was to put poverty in a museum.

After grasping the power of microcredit from this experience, I came to the GSB to build my business knowledge and expertise. I hope to combine the power of microcredit with my GSB experience to help me found an influential organization that improves the lives of the poor.

*David Vinca just graduated from the Graduate School of Business at the University of Chicago. He hails from Pennsylvania.*

# An invitation to volunteer

## A field experience energizes and sustains commitment

by Luca Torre

Students interested in pursuing a career in international development might consider volunteering for a few months for a microfinance institution. While some may advocate such an experience primarily as an opportunity to develop a better understanding of the industry, I personally believe that, beyond professional achievements, working for an MFI in a developing country offers an amazing human experience that is essential to gain the energy and the motivation to embrace a career in international development.

Working in microfinance offers the opportunity to share experiences with the poor and to understand their daily problems. Volunteering in India prior to joining Kellogg inspired me by making me aware of how much could be done to improve this world. Meeting with beneficiaries means

breaking the stereotypes of poverty without hope. All the microfinance initiatives to which I have dedicated myself at Kellogg are the fruit of the enthusiasm and energy I gained during those four months in India.

Yet, for this recommendation to be meaningful, it is important that practitioners work to make it easier for students to join or contribute to their organizations for few months. During the conference several people asked me if MBA students have a longstanding interest in microfinance. I believe that the interest in microfinance is high, but it is important to offer real-life projects to turn an interest into a commitment.

*Luca Torre just completed his first year at the Kellogg School of Management at Northwestern University. He is originally from Italy.*

# Microfinance book outlines tradeoffs

by Micki O'Neil and Rafael Ugaz

The week of the conference Jonathan Morduch and Beatriz Armendáriz de Aghion released the book *The Economics of Microfinance*, one of the first comprehensive looks at the mechanisms, historical experiences, present landscape, and potential paths of microfinance. With depth, accessibility, and clarity, the book seeks to bridge academic research with practitioner experiences and lofty rhetoric with industry realities.

"We live in a world of tradeoffs, and microfinance is no exception," Morduch, a professor at New York University's Wagner School of Public Policy, said in an interview after the conference, addressing the book's conceptual framework. "The book is really, chapter by chapter, a way of taking apart how these things work so we can really map out some of the tradeoffs."

"As we think about commercialization, which opens up incredible possibilities and brings in incredible resources into the sector, we should also be aware that moving toward commercialization may have tradeoffs for the kinds of clients you can reach, the way that

you reach them and the way that you engage with them," he said.

Morduch emphasized recognition of the inevitable costs of various models as necessary for any serious, open conversation about the microfinance industry's divergent possibilities.

"My belief has always been that for microfinance to achieve its potential it's going to be achieved through a diversity of different approaches," Morduch referenced the importance in different contexts of commercial, NGO, even government, actors. Despite many failed efforts, there are examples of workable government models, and some successful NGOs that emphasize poverty reduction may always require subsidies and donations.

Morduch cautioned that focusing on one particular path may distract from efforts to improve other approaches. "And so the book is also trying to be more even-handed in setting out the possibility for a world of microfinance that we're going to see in a decade or two decades."

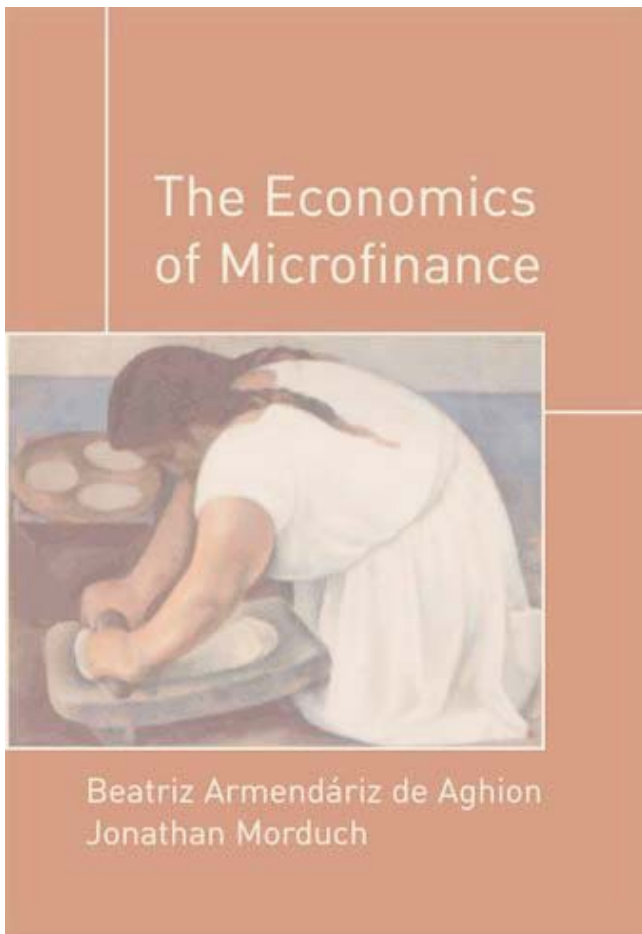
*The Economics of Microfinance* details the movement from microcredit to microfinance, developments beyond traditional group lending and, of course, trends toward commercialization. Chapter topics include microfinance's roots, the role of gender, measuring impact, subsidies, and management challenges.

Morduch said he and Armendáriz joined together because they both believed many academic advances in the field of microfinance were not translating into practice and many ideas in the field were not being investigated rigorously.

In the book's preface, Morduch and Armendáriz write that despite significant bodies of work on microfinance produced by both practitioners and academic economists, "the two literatures have for the most part grown up separately and arguments have seldom been put into serious conversation with each other. Both literatures contain valuable insights, and both have their limits; one of our aims in this book is to bridge conversations, to synthesize and to juxtapose, and to identify what we know and what we need to know. In this way, this book is both retrospective and prospective."

During the conference, both Morduch and University of Chicago economist Robert Townsend expressed sentiments on the need for theory, deliberate data and careful examination of mechanisms and results in order to guide the replication, expansion and evolution of microfinance. While Morduch repeated a quip

*Continued on next page*



## Morduch highlights further areas for exploration

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about economists finding what works in practice to test if it works in theory, his book is a subtle defense of theory that expounds on the academic research and thinking with continual connections to real-world experiences.

Yet, Morduch also recognizes shortcomings in the academic work on microfinance, including an overemphasis on group lending models and underdeveloped work on the poor's savings constraints. A disjuncture has often existed, he explained, between economists' work and what happens on the ground. For example, while academics continued to write almost exclusively about group lending, Morduch was witnessing other interesting developments in Bangladesh that had already emerged in the field.

A host of areas of microfinance will require more in-depth exploration as the industry progresses. Morduch highlighted a topic that arose at the conference that he said receives too little attention. An emphasis on microfinance's staff-intensity emerged during the conference's first panel, in which Morduch participated. Microfinance practitioners Vikram Akula and Greg Casagrande both stressed the importance of management practices and hiring and retaining people.

"[This is] a challenge and a really, really important part of the equation," Morduch said. "It's also an area in which the economists, the academics, haven't had that much to say in this microfinance conversation. We focus so much on contracts. ... I think one of the great omissions is paying attention to just how important the staff has been in places with all these clever contracts."

The importance of this human element, however, will pose a key challenge as institutions scale and need to maintain good operations and proper incentives. At the low-end, Morduch said it becomes critical to develop a system for delivering financial services that is rule-based with the loan officer role remaining important but requiring less discretion. For larger, more complicated projects in which loan officers inevitably exercise more judgment, designing incentives and replicable systems is more difficult.

In detailing microfinance's expansion beyond credit to encompass broader financial services, Morduch addresses the efforts to develop savings products for the poor. "In that chapter, I'm trying to both push the practitioner world and the academic world a little harder."

He challenged a prominent contention among practitioners that the poorest households need



*"It's great moment to be able to step back and figure out new strategies and new directions," Jonathan Morduch said during the panel on microfinance's challenges and opportunities.*

savings *more* than credit. "If you spend time trying to understand how households piece together their economic lives, they're both trying to save as much as they can and also using credit simultaneously."

"Similarly," Morduch said, "academics have had a hard time getting their minds around the idea of savings constraints, that people have limited abilities to save, because there's no obvious market failure there."

The chapter "Subsidy and Sustainability" tackles "a huge, divisive issue in the field" that was a recurrent topic of the conference. "Certainly the push toward commercialization is a push away from subsidies," Morduch said. The book, however, discusses the role that "smart subsidies" – that pay attention to creating the right incentives and limit distortions – can continue to play in helping microfinance build capacity and reach the poorest. The continuance of subsidies also strengthens the call for better data collection, for the sake of accountability to taxpayers, Morduch asserted.

In charting the industry's progress and development, *The Economics of Microfinance* also highlights its vast room for growth. Morduch explained that the poor continue to piece together their financial lives through many formal and informal transactions.

"Poor households ultimately demand the same kind of financial services that people like you and me do – something that is flexible, something that will fit into their cash-flow strategies." As microfinance matures and innovates, Morduch said, it should allow the world's poor to achieve their financial goals more simply.

**What:** Chicago Microfinance Conference

**When:** Friday, May 20, 2005

**Where:** The Gleacher Center, Chicago

**Who:** University of Chicago's Graduate School of Business and Harris School of Public Policy Kellogg School of Management, Northwestern

**Why:** See article below

## Microfinance and business school?

In welcoming conference attendees, Chicago GSB Dean Ted Snyder noted the importance and uniqueness of this Chicago Microfinance Conference, the first time the GSB, Kellogg and Harris have joined together to host a major event.

"The topic of microfinance is extremely important – [one that] cuts across economics, finance, public policy, economic development. And I think it makes a lot of sense that we're all here together," he said.

In the keynote address, Marilou Uy of the World Bank highlighted students as significant potential contributors to industry growth.

"We are pleased to see schools of the caliber of the University of Chicago's Graduate School of Business, the Harris School of Public Policy, and the Kellogg School of Management taking such a keen interest in microfinance," she said. "Such interest is critical to encouraging research and development of new ideas and structures. But we also look forward to students like you as future leaders, potential policymakers and entrepreneurs that can make a difference of pushing the frontiers of inclusive finance."

There is growing student interest and an increasing number of collaborations between various business and policy schools on microfinance. At the conference, NYU public policy professor Jonathan Morduch detailed joint initiatives at both Columbia and NYU.

"General MBA and MPP programs give you great tools and what I'm hoping is that the ... fresh ideas that are coming from people like you will enrich conversations," he said in a post-conference interview. His new book, even as it avoids technical jargon, overflows with implicit theories and disciplines that policy and business students will readily recognize.

Chicago economist Robert Townsend also emphasized the relevance of students' degrees.

"Use some theory, gather the data – use all that good stuff you've learned in your MBA – and take it into practice."

From a practitioner's perspective, Vikram Akula, founder of SKS India and a political science PhD from the University of Chicago, reiterated the importance of attracting talented students into microfinance. "One of the key levers to move from 10% penetration to 100 is to have students like yourselves involved in a serious way." He said it was vital for involvement to extend beyond a couple months and into careers. He has recently joined the consulting firm McKinsey to "learn how to scale," and emphasized that this is an essential expertise that MBAs can bring.

Supporting students' decision to organize a major conference on microfinance fit naturally with the GSB's central mission, as articulated by Snyder.

"Our strategy is very simple: we want to strengthen our value system. And the core of that is questioning, the core of that is dialogue, the core of that is really pushing the envelope: why is this an important phenomenon, how can institutions work, what infrastructure is needed, what's the role of NGOs, what is the commercial case for microfinance, what's the future going to be, what's the role for people graduating from Harris, from Kellogg, from the GSB?"

Uy quoted one of the GSB's distinguished professors, Raghuram Rajan, now chief economist at the International Monetary Fund: "It is the incumbent financial institutions in countries that ultimately decide whether financial systems are open, deep and broad, competitive and well-functioning." She then added, "Many of you will work for these incumbents – you may even be leading them at some point – and you will ultimately be able to make choices about how inclusive financial sectors are or can be."

## Panels and Speakers

*Keynote:* Marilou Uy, Director, The World Bank

*Challenges and Opportunities of Commercialization*

Vikram Akula, SKS Microfinance; Robert Annibale, Citigroup; Greg Casagrande, South Pacific Business Development Foundation; Jonathan Morduch, New York University; Louise Schneider, Women's World Banking. Moderator: Cate Ambrose, The Economist

*Evolving Models for Microfinance Services & Products*

John Fischer, ACCION Investment Management Company; Rick Halmekangas, Opportunity International; Mauricio Moura, Unibanco Microvest; Robert Townsend, University of Chicago. Moderator: Rhonda Schaffler, UNCDF

*Lunch and Learns (see pgs 8-11 for details)*

*Financial Innovation and Strategic Risk Management*

Maya Chorengel, Dignity Fund; Bhagwan Chowdhry,

UCLA Anderson School; André Laude, International Finance Corporation; Sam Moss, Gray Ghost Microfinance Fund LLC; Saurabh Narain, Shorebank Advisory Services. Moderated by Tom Coleman, Microfinance Consulting

*Microfinance Best Practices*

Kip Darcy, Hewlett-Packard; Michael Eber, Grameen Foundation USA; Mary Laraia, LaSalle Bank; Anna Paulson, Federal Reserve Bank of Chicago. Moderated by Robert Gertner, Chicago GSB

*Exploring the Future of Microfinance*

Robert Annibale, Citigroup; Alex Counts, Grameen Foundation USA; Mary Houghton, ShoreBank Corporation; Richard Taub, University of Chicago. Moderated by Christina Barrineau, UNCDF