Appui au
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EMPOWERING THE WORLD'S POOREST

International Investment Funds

Mobilising Investors towards Microfinance

Luxembourg
November 2003

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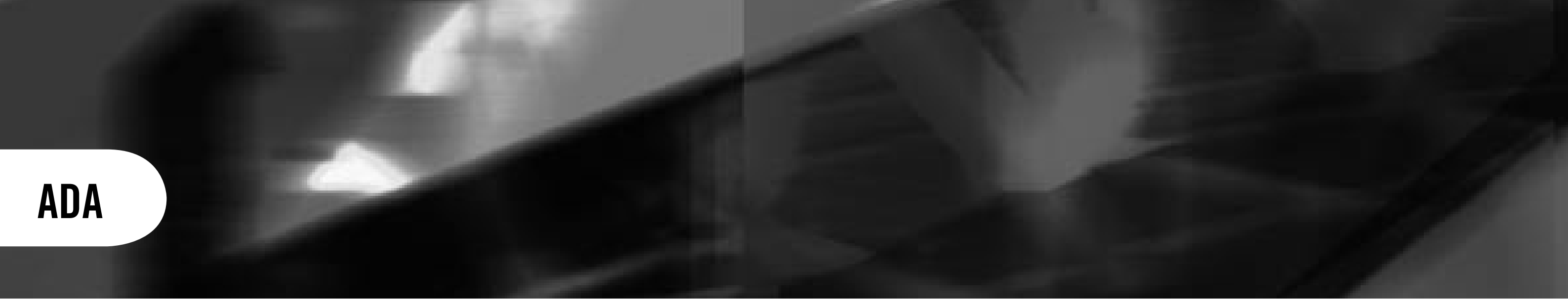

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The document can be downloaded electronically from the web-site www.microfinance.lu and any comment can be sent to ADA at adainfo@microfinance.lu

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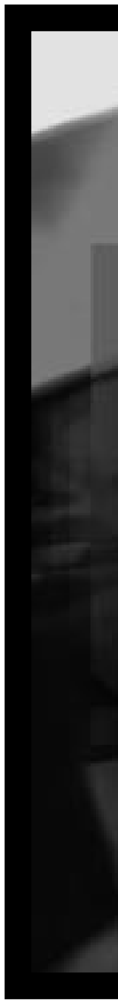
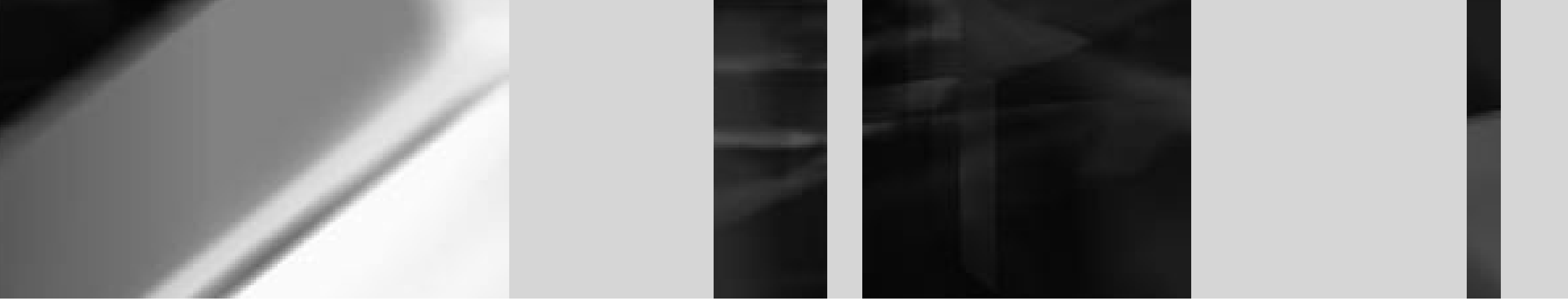




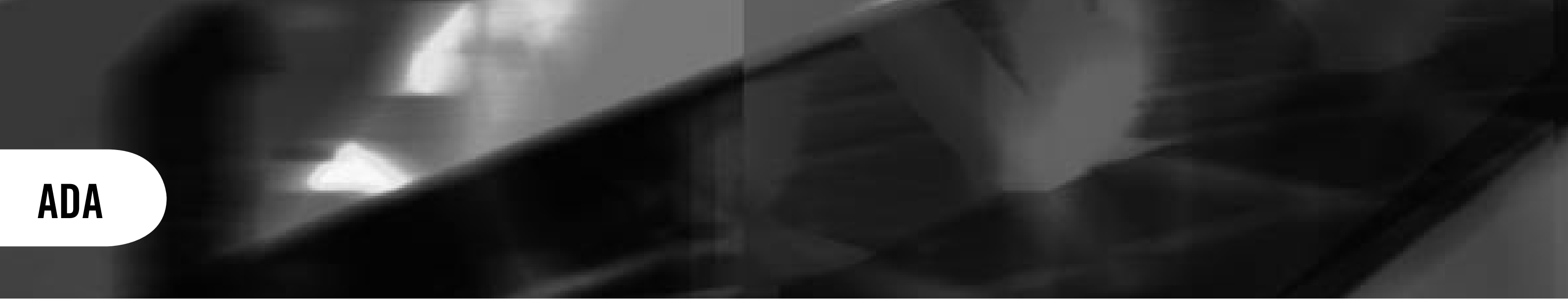
Introduction

An increasing number of institutions are used to channel money from investors to the microfinance sector. These institutions are used to indirectly invest in Microfinance Institutions (MFIs) and will take the form of foundations, co-operative companies, investment companies, mutual funds, etc. The ultimate investors range from multilateral agencies to private individuals.

The purpose of this study is to better understand these investment vehicles by analysing a number of criteria such as the objectives of the funds, the product mix, the different legal structures, the nature of the shareholders, who the sponsors and the fund managers are, how these funds are distributed, etc. Based on this research, comparisons between the funds have been established and trends in this field have been identified. Throughout this paper the term investment fund or fund will be used in a broad sense, not necessarily meaning a mutual fund as it is understood in certain financial circles.

The motivations and objectives of the shareholders have also been analysed as well as the degree of commercialisation of these funds. Some funds have been set up as part of an overall development scheme encompassing technical assistance. Others are actively targeted at individuals or at institutions.

ADA views this paper as a contribution to the dialogue between development aspects of microfinance and its increasing commercialisation. The advantages and successes of microfinance have not been presented here as the focus was more on the investment channels into microfinance. Some views may seem overly commercial to some people but the purpose is also to create a debate on the best ways forward for this industry to broaden its reach even more in assisting micro-entrepreneurs around the world. Investment funds are seen as an appropriate tool in this respect. We welcome any comments or remarks on the ideas developed in this paper.



Selection Criteria

The institutions providing financial services to MFIs which have been identified in this study have been classified according to several criteria. The list of investment funds reviewed here does not aim to be comprehensive but covers the main categories of funds.

Objectives of the Funds

The first set of criteria focuses on the funds made available to MFIs: are these funds invested for a financial return in addition to a social return, are these funds simply made available with a possibility to recuperate all or most of the funds or are they donated? The list of institutions which have been identified in the context of this study can be found in Appendix, together with their classification according to this first criterion.

1. Social Investment Funds

These institutions are usually set up in the form of investment funds or investment companies. Their aim is to provide some financial return to institutional or individual Socially Responsible Investors, while maintaining key social and development objectives. We will find for example in this category venture capital funds investing in MFIs as well as funds providing loans and guarantees at commercial or market conditions.

Examples of Social Investment Funds are Profund, IMI AG, the Dexia Micro-Credit Fund, etc.

2. Social Funds

These institutions are most commonly found among co-operative companies or Foundations. Their aim is to make capital available to MFIs through a sustainable mechanism to support their development and their growth without necessarily seeking a financial return. Investors in co-operative companies may receive in good years a small dividend (e.g. in current market conditions 1 to 2 %) but they will be asked to share potential losses. Financial conditions made available to MFIs are typically below or close to market conditions.

Examples of Social Funds are Oikocredit, Alterfin, FIG, the Calvert Community Investment Notes or Luxmint.

3. Donor Institutions

These institutions will mostly be in the form of Foundations, NGOs, Charity organisations or even investment funds or investment companies which mobilise donations. Their objective is either to make donations to MFIs or to provide financial services at subsidised conditions.

Examples of such institutions are the Deutsche Bank Microcredit Development Fund or Cordaid.

Since the purpose of this study is to focus on investment vehicles actually investing in microfinance as opposed to providing donations or funding at subsidised conditions, only one donor institution has been analysed in detail. All the other institutions analysed are considered to be either Social Investment Funds or Social Funds.

Types of Investors

The second criterion relates to the type of investors in these funds. There are a number of different possible categories, but to simplify the process, only five main categories have been retained:

1. Government / Multilateral organisations

These institutions are sometimes referred to as International Financial Institutions (IFIs) or also Development Finance Institutions. These organisations have been set up by governments and supranational bodies in order to facilitate development programmes in emerging countries.

These institutions are for example BIO, FMO, IFC, KfW, USAID, etc. BIO is the only such organisation which has been retained in this study to act as a comparison to the investment funds. In fact, its philosophy approaches more a Social Investment Fund than a traditional development organisation.

2. Private sector foundations

These institutions have been set up by private companies and are funded almost exclusively by corporate profits. They usually provide grants and donations and offer services at no cost or at subsidised conditions. Some foundations are increasingly active in microfinance as they see this sector as an increasingly effective way of contributing to the social welfare of the poorest.

Not wishing to single out any specific foundations, no examples will be given here, although many examples will come to the minds of microfinance specialists !

3. Non-Government Organisations

A diversified range of NGOs invest in Microfinance from large international NGOs to smaller entities. Examples are Accion International or Meda.

4. Private individuals

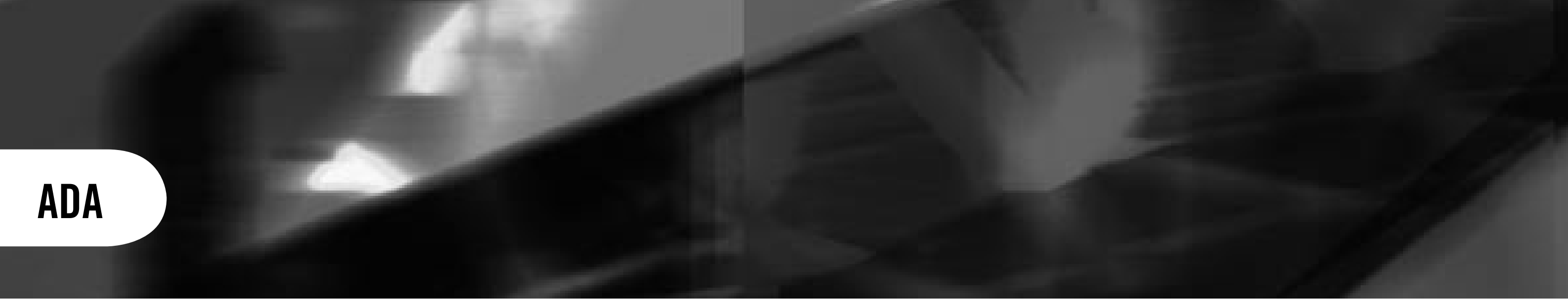
Private individuals in developing countries who are active in microfinance will usually either provide financing in the form of loans or capital to micro-entrepreneurs directly or to MFIs. There are only a handful of microfinance investment funds available domestically to private investors.

Individuals in the developed world are still very rare to invest in this field. They will make donations through recognised NGOs or even directly if they are concerned about their money reaching the intended destination, but lending to the poorest instead of giving is still met with some resistance.

5. Commercial investors

This is a relatively wide category with investors ranging from commercial companies who are willing to invest some money for a financial return as well as a social return to purely profit-oriented companies who will compare the risk/return profiles of their potential investments before taking a decision.

Investment funds investing themselves in other investment funds will for example fall in this category.



We will see later that this above classification is especially important when looking into the attitude of investors towards their capital. A Social Investment Fund with a stated objective of a given financial return may in fact have a very different strategy depending on whether its shareholders are Multilateral Agencies or private individuals.

Types of Investments

The third criteria is the general type of investments which the fund will make. There are three broad categories of financial products made available to MFIs:

1. Equity or quasi-equity participations
2. Loans, purchase of bonds, Certificates of Deposit, etc.
3. Guarantees

Technical Assistance is sometimes provided alongside an Investment Fund. Although this aspect is clearly important in this context, we will not consider it as a separate product since it involves donations and subsidising rather than investments per se.

Methodology

Based on the information provided by the MixMarket (a web-based information exchange service for the microfinance industry) on institutions funding MFIs, completed by information collected through internet, financial reports and direct contacts with the fund managers and

- Accion Gateway
- Accion Investments in Microfinance
- Africap
- Alterfin
- ASN-Novib Fund
- BIO (Belgian Investment Company for Developing Countries)
- Calvert Social Investment Foundation – Community Investment Notes
- Deutsche Bank Microcredit Development Fund
- Dexia Micro-Credit Fund – Blue Orchard Debt Sub-Fund
- Fonds International de Garantie (FIG)
- Hivos-Triodos Foundation
- IMI AG
- Investisseur et Partenaire pour le Développement
- La Fayette Participations
- Latin American Bridge Fund
- Latin American Challenge Investment Fund (LACIF)
- Luxmint – ADA
- MicroVest
- NOVIB
- Oikocredit
- Partnership Fund, Guaranty Fund and FONIDI Fund (Desjardins)
- Positive Fund
- Profund
- responsAbility Global Microfinance Fund
- Sarona Global Investment Fund
- ShoreCap International
- SIDI
- Triodos Fair Share Fund
- Triodos-Doen Foundation

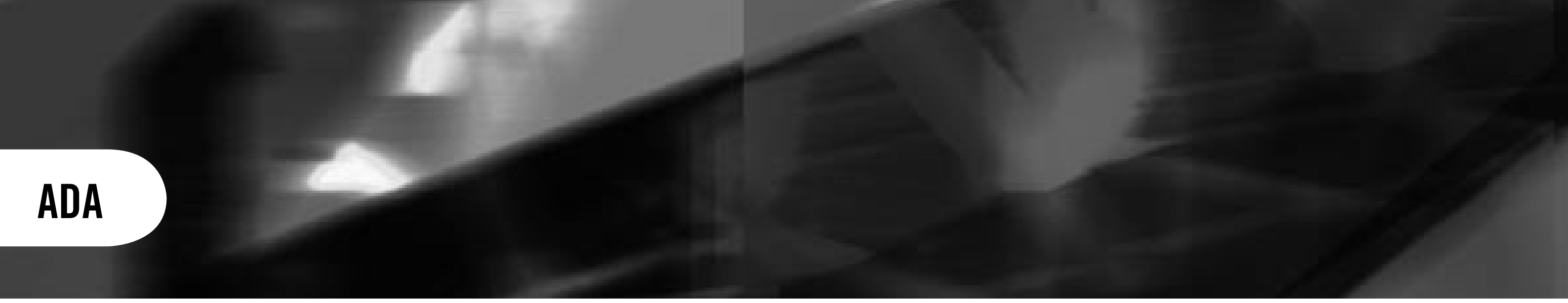
the sponsors, the following investment funds have been selected:

A list of these investment funds can be found in Appendix together with their main characteristics.

For each of these investment vehicles a summary information sheet has been established with the following information:

- Legal Name
- Country of Incorporation
- Legal status
- Sponsor
- Fund Manager
- Web site
- Type of Fund
  1. The assessment of whether the fund is deemed to be a Social Investment Fund, a Social Fund or a Donor Facility.
  2. Further details on the type of structure (eg limited duration)
- Objective of the fund
- Assets … as of ..
  Overall assets and/or the invested portfolio if available.
- Liability structure
  If available the split between capital, reserves, loans, etc.
- Shareholders
  These may be listed or general categories may be mentioned
- Objective of the shareholders
  Shareholders may have a wider objective than just the stated objective of the fund.
- Valuation of the Fund
  Information will be given here about the calculation of a Net Asset Value or any other means of communicating the value of the Fund to shareholders.
- Return
  The actual return or the stated objective will be mentioned here.
- Subscription and redemption processes
  This section covers how new investments can be made in the fund and how shareholders can redeem all or part of their participation.
- Board of Directors (or any other appropriate governance body)
- Products in portfolio
  If they are available details will be mentioned about:
  The split of the portfolio between equities, loans and guarantees
  The minimum, maximum, average size and duration of such investments in MFIs
  The requirement or not to obtain guarantees
- Client target
  Which MFIs is the fund targeting? Are these profitable, well-established institutions or are they start-up companies? In which region? In which countries?
- Terms offered
  Does the Fund offer conditions for loans and guarantees to MFIs which are at commercial or market rates, near market rates or at subsidised conditions?

The information sheets cannot be disclosed for confidentiality reasons, although key data is summarised in Appendix.

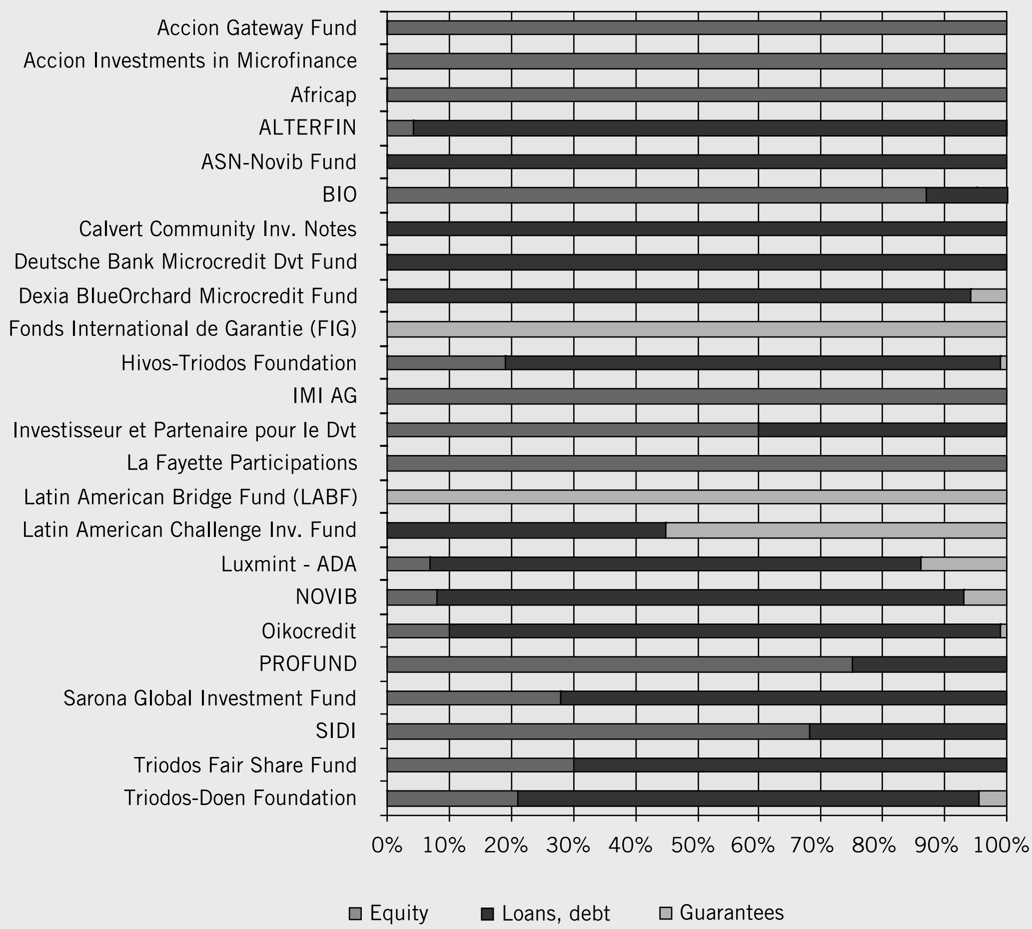


Trends in Microfinance investments

Portfolio structure of the Investment Funds

Before we bring out the main trends which appear by analysing the selected investment funds, it is interesting to focus for a while on their portfolio structures. What is the proportion of equity and quasi-equity investments, of loan and debt products and of guarantees?

The result for the investment funds analysed is the following:



It appears that most of the funds are very specialised. The main structures are:

- Mainly equity participations such as the Accion Investments in Microfinance, Africap or IMI AG.
- Mainly loans with some guarantees such as the Dexia Micro-Credit Fund, Oikocredit, Alterfin and Novib
- Only guarantees such as the FIG or the Latin American Bridge Fund.

There are only a few diversified funds which may be less focused but may offer the stability of loans and guarantees and the return potential of equities. In addition to Profund and SIDI, recent examples of this are the new Triodos Fair Share Fund and the Investisseur & Partenaire pour le Développement which are both targeted at private investors.

Risk Profile of Microfinance Investment Funds

The objective of this criterion is to situate the investment funds of this study according to the two following dimensions:

– Risk profile of the underlying investors in the funds. This is determined by:
  - The investors' acceptance of capital depreciation. For example a private individual's attitude in this respect will be very different whether he/she acts as an investor or as a donor;
  - The investors' expectations in term of return;
  - The social and financial objectives of the Funds.

- Risk profile of the investments determined by:
  - The proportion of equity vs loans vs guarantees
  - The maturity of the targeted MFIs. Making a loan or participating in the capital of a mature and financially sustainable MFI is less risky than for a start-up MFI.

The risk profile of Microfinance Investment Funds can be summarised in the following graph:

Risk Profile of Microfinance Investment Funds

* At the time of publication, these funds are in the process of being launched

The bulk of the investors are still Social Institutional Investors such as Government or Multilateral organisations, NGOs, Foundations, etc. These institutions will accept a higher risk in their investments. Although losses are not desirable, they will be accepted as part of their role in the development of microfinance. Although a certain financial return may be required, some institutions will be stricter than others in the criteria they apply. The MFIs financed will also have an influence on the acceptance of losses. Some investors may indeed specifically target start-up MFIs. In capital markets such as for a venture capital fund the risk of loss is compensated overall by the return required on each investment. But some Social Institutional Investors may keep their financial conditions low specifically because of their role in helping MFIs become sustainable.

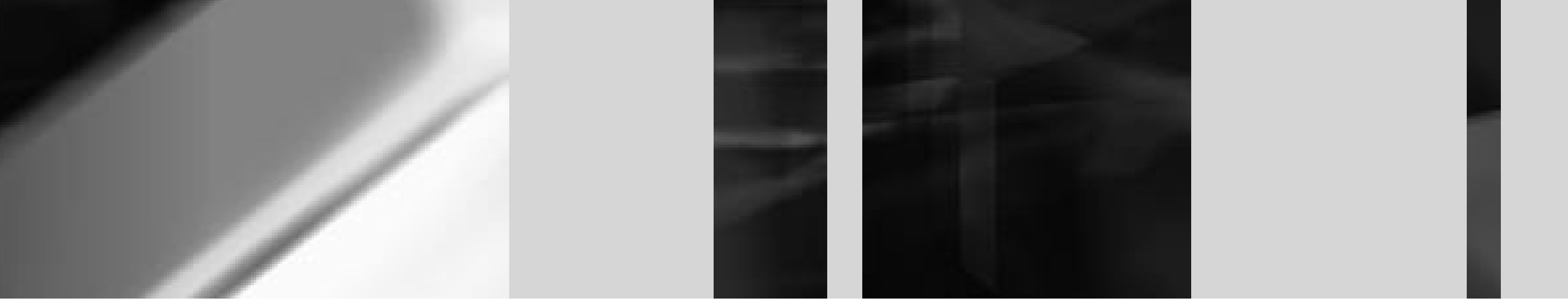
At the other end of the spectrum, true commercial investors are still extremely rare in microfinance. There are just a few pension funds as investors but the main motivation still seems to be the development factor. These investments have been made partly because in the current low rate environment and difficult equity markets, some pension fund managers have decided to allocate a small portion of their assets, essentially into debt-providing microfinance investment funds, to contribute to world development at a relatively modest return, in line or slightly above money-market returns. These returns are explained by the nature of the underlying investments which are mainly short to medium-term loans to MFIs. Some pension funds which have net positive inflows have a policy of being invested 100 % either in equities or in bonds. Such microfinance investment funds therefore find themselves outside the asset classes chosen which implies that Pension Fund managers find it difficult to justify such investments purely on financial terms.

A category of investors which are not constrained by strict allocations in specific asset classes are private individuals. It is interesting to see that one of the most successful microfinance investment funds, the Dexia Micro-Credit Fund (for which the microfinance portfolio is managed by BlueOrchard Finance S.A.), as well as a number of the funds recently launched or about to be launched - Triodos Fair Share Fund, MicroVest, responsAbility Global Microfinance Fund and the Positive Fund – are targeted at Socially Responsible private Investors. Any other investors are of course welcome in these funds, as evidenced by the involvement of some Social Institutional Investors, but these are investment funds tailored to the needs of private individuals. Due to the costs entailed by pure retail funds and by the illiquid nature of the underlying investments, it is most likely that these funds will be bought by Socially Responsible Mid to High Net Worth private Investors.

Whenever private individuals are targeted, the question of distribution channels needs to be raised. This will be covered in a later section.

Size of Microfinance Investment Funds

In the previous section we reviewed the relationship between the risk profile of the investments in MFIs and the risk profile of the underlying investors in the funds. We will now look at the size of the investment funds compared to the nature of their investments, as illustrated by the graph on the next page:



Size of Microfinance Investment Funds

Risk Profile of Investment in MFIs				
High Risk Equity	La Fayette Participations (€0.3m) Accion Gateway Fund ($5m)		Africap ($13m) Accion Investments ($18m)	IMI AG (€34.7m)
		Inv & Partenaire pour le Dvt (€8m) SIDI (€9/3.3m)		BIO (€46.2/22.5m) PROFUND ($20.6m)
Risk Profile of Investment in MFIs	Triodos Fair Share Fund (€2m) Luxmint-ADA (€1.2m)	Sarona Global Inv. Fund ($4.85/3.1m)	Hivos-Triodos Found. (€11.3m) NOVIB (€11.8)	Triodos-Doen Found. (€22m) Oikocredit(€212m)
Low Risk Loans	Fonds Intl de Garantie (€1m) Deutsche Bank MC Dvt Fund ($2.3m)	Alterfin (€7.4m) ASN-Novib Fund (€5.1m) Latin American Bridge Fund ($7.7m)	LACIF ($15m)	Dexia Micro-Credit Fund ($43m) Calvert Comm. Notes ($65m)

$/€ 5 million $/€ 10 million $/€ 20 million

Size of Funds

The first observation is that all the investment funds in this study are relatively small compared to the minimum size for a traditional fund to be considered sustainable. The numbers mentioned for the two largest funds – Calvert Foundation and Oikocredit – are misleading since they cover other investments than purely microfinance in developing countries.

Many sponsors of traditional investment funds will consider that the minimum size for a fund to be sustainable is around $/€ 20 to 30 million. Funds smaller than these amounts need to be subsidised one way or another. This is the purely commercial view. No recommendation is being made at this stage other than to examine the level of commercialisation of these investment funds.

Providers of investment funds to their customer base are constantly examining whether to continue managing small funds themselves or whether to sell the same kind of funds managed by others (possibly even their competitors in the asset management field). The rationale is that the distribution fees earned will outweigh the net fees earned in managing the small fund, especially as the fixed costs in maintaining a small fund will also be saved.

How do we therefore explain the small size of the microfinance investment funds? The first explanation is the maturity of funds in microfinance. Most of them were created in the late 90's. The use of funds as a way to collectively invest in a diversified range of products to finance a diversified range of MFIs is very new.

Most sponsors of the investment funds studied in this paper do not belong to the wider investment fund community. As the industry matures, the need for a greater commercialisation will lead to larger microfinance investment funds.

Most funds in this study are subsidised one way or another or were subsidised during the initial period. There are a number of different alternatives. Some funds are managed by institutions such as NGOs or Foundations which carry out other activities, essentially in development through donations and grants. The cost of managing and administering the fund is therefore shared with these other activities. An on-site visit, in Latin America for example, will have a double objective: review investment as well as donation opportunities.

A delicate issue is that of technical assistance. The creation of some microfinance investment funds is accompanied by technical assistance grants provided to the consulting arm of the institution launching the fund. A loss or a weak return by the investment arm can be compensated in such a way. The growth of the fund does not need to be pursued actively as it may be seen to be ancillary to the provision of technical assistance. A further point worth mentioning here is the conflict of interest arising out of such a situation. To what extent does the technical assistance influence or interfere with the investment decision process? If all the shareholders are aware of these conflicts of interest, understand them and accept the potential consequences, then the situation is acceptable. But clearly an investment fund targeted at private individuals should avoid such situations in the interest of the shareholders themselves.

Another subsidising is that of a lower return to the investors who have accepted this situation as their principal objective is usually social. These same investors may allocate a greater portion of their investments if the financial return was marginally higher. This can be obtained by the growth of the investment funds which will help cover the fixed costs.

Some institutions, such as Triodos, NOVIB and Accion International, manage a number of different funds, either on their own behalf or on behalf of other institutions. Triodos for example manages two funds for two Dutch Foundations, Hivos and Doen, in addition to their latest fund, the Triodos Fair Share Fund, launched in December 2002. This allows them to spread their costs across different structures. The objectives of the funds may be different but there will be cost benefits. Research may also be shared with the shareholders of the investment fund.

All the situations described above contribute to subsidising the costs in managing and administering the investment funds. Such subsidies are financed indirectly by grants and donations. Is it their function? And if so, to a certain extent, for how long? Until the fund has reached a viable size? More commercially oriented SRIs (Socially Responsible Investors) will require greater transparency in the cost structure, as well as more information on the social impact of these funds.

One of the most transparent and commercial microfinance investment fund to-date is the Dexia Micro-Credit Fund. But this fund only came into existence thanks to an initial seed money of US$ 10 million which was allocated by Dexia BIL in Luxembourg. Subsequently, most of the seed money was withdrawn and the fund is now growing to become sustainable without any subsidising, associated technical assistance or sharing of asset management expertise. It is nevertheless quite reasonable to think that the Dexia Fund, as well as the industry as a whole, was somewhat helped by the availability of independent performance evaluations / ratings.

Distribution of Investment Funds

The key to success in the traditional investment funds market is distribution, access to the final investor. We have seen in the previous section that sponsors of investment funds are constantly examining whether to keep their smaller funds or whether to sell comparative funds managed by others. Part of this assessment is also the feasibility of a more active distribution of their own funds by other institutions. This industry is evolving to a greater extent in the direction of an Open Architecture where fund promoters are selling each other's funds, to the benefit of the largest and most profitable funds.

Within a company, the asset management arm often sees itself as the natural choice of the distribution arm when it comes to creating and managing funds. Increasingly, the distribution arms, essentially those in contact with private individuals, are having to offer a choice of the best investment funds if they want to avoid their customers from shopping around. This evolution creates tensions within financial groups between these two areas. In fact, in most cases, the decision to also sell external funds has often prompted the asset management units to increase their own efficiency and the returns of the funds they manage, since these funds are constantly compared to external investment funds.

There are many Socially Responsible private Investors who would be interested by the social and financial balance of a microfinance investment fund. But there are currently very few distributors which offer such funds to their customers. Almost all the funds in this study have no reference to external distribution in their prospectuses or their offering memoranda. The Calvert Notes are a rare example, being distributed by US broker-dealers in addition to being distributed by themselves. A new Luxembourg-based fund, the responsAbility Global Microfinance Fund, expected to be launched by the end of 2003, is integrating external distribution in its structure.

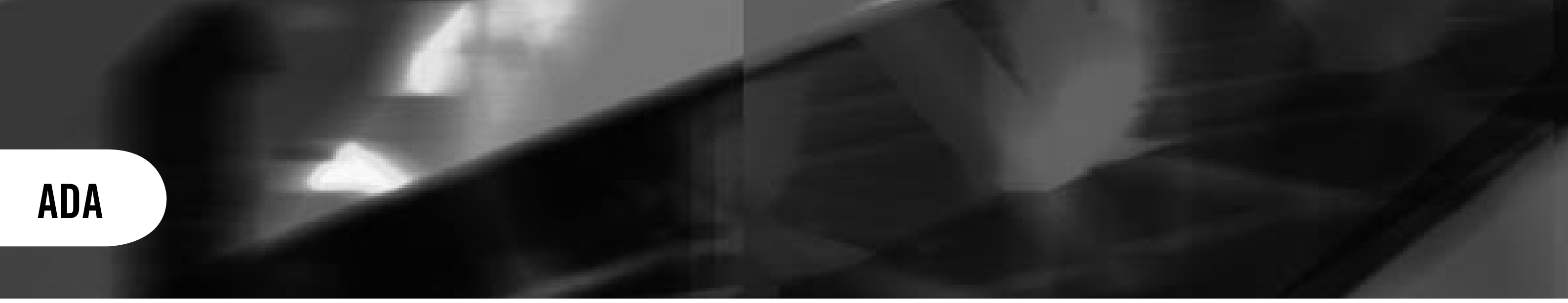
This industry is new indeed but the time is probably right to involve distributors more actively, which also means sharing management fees. We are currently in a chicken and egg situation. Microfinance fund managers are unwilling to share their management fees because their funds are small meaning the absolute amount of fees they receive is insufficient.

But then, how do you grow the funds if you do not pay distributors to sell them? A fund manager or a sponsor can approach its existing customers but its capacity to grow significantly the number of institutions or individuals reached is limited. Distributors already have access to their established customers. Motivating distributors is of course achieved by making them believe in the product offered but also by making them participate in the sharing of the management fees. Because of the nature of the business, management fees for a microfinance investment fund tend to be higher (2 to 4%, depending on the size and the complexity of the fund) than for a traditional fund in order to cover the costs involved in having to assess small institutions in developing countries. Distributors could therefore receive an absolute percentage somewhat higher than what they would receive for a traditional fund offering some comparable aspects.

Naturally, selling such funds needs to be consistent with the distributor's policy and the image it wants to deliver to its customers since the absolute revenues earned from distributing such funds will be marginal in the initial stage.

Unless a fund is situated in a country where the potential market is large, attention needs to be paid to the possibility to market the fund in different countries. Depending on the countries and the investors targeted, some legislations are more appropriate than others. Sponsors of microfinance investment funds may want to locate their funds in such a location to avoid setting up domestic funds in each country and bearing the cost of each structure.

An aspect which has not been covered so far is: where are the potential individual investors in microfinance located? In fact, many MFIs already borrow money from wealthy private individuals in their own countries, usually at higher rates than from local banks and foreign institutions. Investing through a fund would diversify the risk on behalf of the individuals and would ensure a greater stability of resources to the MFIs. But one of the aims of this paper is to show the advantages of enhancing the distribution of international microfinance investment funds which can be promoted across borders. Some countries, being sufficiently large, advanced in microfinance and disposing of an adequate investment fund legislation, such as India, could envisage launching microfinance domestic funds targeted at local investors.



Final observations

Microfinance investment funds are gradually moving towards a greater commercialisation but they are probably not ripe yet for true capital markets. The risk/return dynamic and certainly the perceived risk/return dynamic of these funds is currently not in their favour. Commercial money is still mixed with donor or agency money. The offer of independent, commercially-oriented, microfinance investment funds is still insufficient.

Many lessons have been learned over the last few years in funding MFIs through investment funds. The International Financial Institutions (IFIs) have played a central role in creating the first funds solely dedicated to microfinance. In also acting as shareholders, they have contributed to building a product which is gradually being recognised as a powerful development tool.

With the fast development of the microfinance industry and the limited resources of IFIs, other sources of funds are having to be found. With pure commercially-oriented Institutional Investors not fully ready yet to embrace this industry new to them, the best and most promising prospect for microfinance seems to be the Mid to High Net Worth Socially Responsible Individuals in developed as well as in developing countries. Individuals committed to the social aspect of microfinance and wishing to allocate a part of their investment portfolio, not just donation money. Individuals with minimum amounts of capital to invest, in order to make it worthwhile for the investments to be made due to the nature and the still small size of these investment funds. These individuals are ready to invest but they need to be presented with the right product, with the right investment fund. We will see later some suggested characteristics.

Retail investors will come but at a later date. The main issue is the very nature of the investments. In the European legislation for example, there are constraints in the type of investments allowed for investment funds to be able to be sold actively to the general public. A Luxembourg fund such as the Dexia Fund is structured under the part of the law (Part II) which allows it to make loans for example but which cannot be marketed actively to the retail market. A mass mailing is for instance prohibited. Even publicity on the internet requires careful planning. To be worthwhile and effective a contact with an individual therefore requires the potential investments to be of a minimum size.

There are still some commercial Institutional Investors with a social and long-term view which are ready to contemplate lodging some assets in microfinance if presented with the right opportunity. Some socially responsible investment funds could (and some do) invest a small portion of their assets in microfinance if this is compatible with their investment objectives. Some Calvert sponsored US mutual funds for example invest between 1 and 3 % of their assets in the Calvert Foundation which has investments in MFIs.

We are talking here about a more active commercialisation of microfinance investment funds. But is the MFI market ready to digest it? Are the IFIs, the investment funds, donor money, etc. not concentrating too much on the 300 or so sustainable or profitable MFIs? Hopefully the number is growing! It clearly is a slow process but all components need to move together. Building and developing collective investment vehicles is a necessary part of the equation.

We have seen that many investment funds have been created with related technical assistance facilities. It is interesting to note that some of these funds have had a limited growth, especially when compared to funds without technical assistance. The sustainability of independent funds depended surely more on growth than the other funds, hence the greater emphasis on promoting these funds. As this market is still nascent, there is a place for all structures, but some will grow faster than others depending on which investors they target, ranging from commercially-oriented investors to IFIs.

Investment funds require a very similar process to MFIs. Some subsidising may be required in the initial stage, until the institution has reached a critical size or until it approaches sustainability. This is necessary to ensure the fixed and the launching costs do not weigh too much on the investors. IFIs and more commercially-oriented investors can be very complementary in this respect. Seed money could be partly funded by government, multi- and bilateral agencies while financial institutions could focus more on the distribution aspects. The structuring of the investment fund, the assessment of the MFIs and the investment process would be a joint effort.

The requirement seems to be for a tiered responsibility in microfinance based on the risk appetite or the risk tolerance of the fund providers. Shouldn't IFIs focus on developing MFIs while investment funds focus on sustainable MFIs? Shouldn't IFIs focus on providing seed capital while investment funds focus on providing loans or growth capital? There is also probably a market for venture capital like investment funds investing in start-up MFIs such as the Investisseur & Partenaire pour le Développement which was recently launched in Mauritius by a group of French private investors.

We could also envisage IFIs providing a guarantee mechanism to mitigate the risk taken by more commercial investors. As microfinance becomes more commercial and grows in size and maturity, capital markets solutions will become available to these funds. But at present, simple structures would meet the social and financial needs of a large number of these Mid to High Net Worth Individuals who need to be presented with the right product.

In addition to having government agencies involved, tax breaks could be introduced for those investing in microfinance. The Dutch tax laws currently provide for tax breaks for some socially responsible investments, although there are talks about reducing them. Other governments allow tax breaks for specific investments. Microfinance could be one of them. This would naturally require long efforts and discussions with the competent authorities.

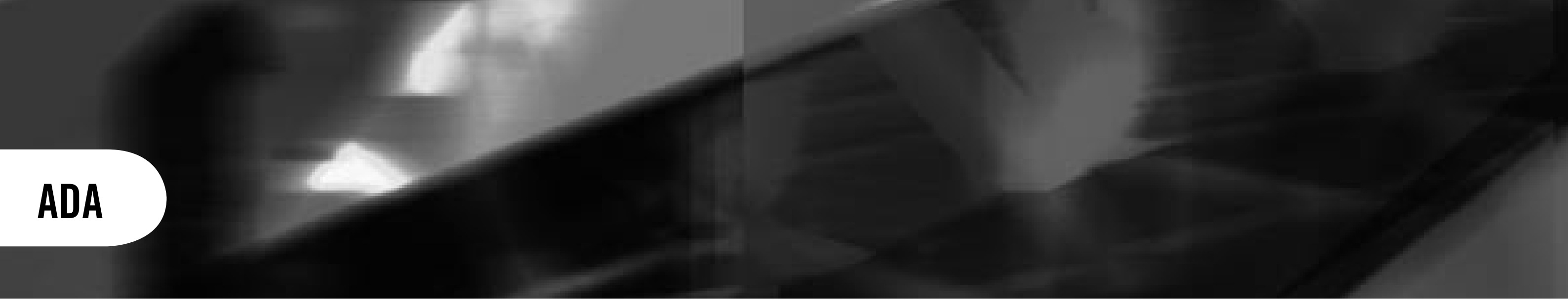
Recommendations

The benefits of investment funds for both the investors and the companies financed have already been demonstrated in traditional investments. MFIs also have a clear benefit in having investment funds finance them. Larger and more stable resources are made available to them through such channels. A few characteristics for a microfinance fund to be effectively promoted to Socially Responsible Mid to High Net Worth Individuals are mentioned here:

- Regulated entity
The investment fund should be an entity regulated by authorities recognised as competent by the targeted investors. It can be in the home country of the investors or more efficiently in a centre allowing cross-border distribution.

- Trusted or proven sponsor / fund manager
Some legislations put more onus on the sponsors (or promoters), others on the fund managers. In any case, especially as microfinance, in its approach to investors, is a new industry, the participation of proven professionals in this field is necessary.

- Transparent structure and clear objectives
Some investment funds in this study had a clearer structure and clearer objectives than others. Information provided in the prospectus (or equivalent) and in the annual reports was sometimes limited. The reason is probably because these funds were targeted at microfinance institutional investors which did not require such transparency. Targeting private individuals is very different especially in a legislation concerned about the private investor's protection and information.



- Open-ended with an indefinite duration
There were a number of closed-ended funds set up with a definite duration (eg 10 years). Having to unwind positions, especially equity positions in small MFIs can be a lengthy and difficult task. The shareholders in these cases were multi and bilateral agencies. But with private individuals, the situation is different. A regular and gradual flow of money into the fund is beneficial to all parties, not least the MFIs involved.

The constraints on open-ended funds are also greater such as the necessity to have regular valuations to allow new entrants. Greater transparency in terms of financial information is also required.

- Guarantee mechanisms?
It is more a question at this stage as simple structures already offer tremendous social and financial investment opportunities.

- Distribution arrangements and target market
As in the traditional investment fund market, an efficient cross-border and domestic distribution strategy is key in ensuring the fund is made available to the markets targeted by the fund.

Greater clarity should also be made about the true nature of some microfinance investment funds. Some investment vehicles, created for development purposes with just a few institutional shareholders may not be suitable for other shareholders such as individuals. The temptation to manage a fund with a sufficient critical mass is great but the focus on clear target markets is an important step to success.

- Regular valuations with possible redemptions
If an investment fund is targeted at private individuals, a regular valuation is preferable. Only two of the funds studied have a publicly available Net Asset Valuation (NAV) once a month, the Dexia Micro-Credit Fund and the Triodos Fair Share Fund. All the others only offer a yearly valuation or at best a quarterly valuation on a discretionary basis. The difficulty here is of course to value the underlying assets. In the case of a debt fund such as the Dexia Fund, you can adopt a straight line valuation with discounts if it is felt a loan is at risk. But for equity participations in MFIs, it is far more complex as the shares of the MFIs are not publicly quoted and the MFIs themselves are only officially audited once a year. Some MFIs are also better than others in providing monthly updates. Even in this case these updates are not audited. The usual approach is to value such investments on a yearly basis for closed-ended funds and at least quarterly for open-ended funds. There may be a disadvantage to new or existing shareholders as the difference between the value of the MFI in the NAV and its «true» value increases, one way or the other.

Other investment companies such as IMI have taken a different approach, which is really only compatible with institutional shareholding. The latest institution to invest in IMI entered the capital at a price determined specifically for it and duly audited by the firm's auditors.

For a number of funds in this study, the actual value of each share of the fund was not readily available, probably restricted to the shareholders. Assessing the actual return was therefore not possible.

- Seed Capital
The importance of providing sufficient seed capital has already been covered but it is certainly not the easiest part of launching a fund. Without adequate seed money, a fund can carry fixed and initial costs for some time, preventing it from showing its true underlying return to shareholders.

- Critical Mass
Here again we have emphasised the importance of having microfinance investment funds of a minimum size in order to ensure fixed costs are sufficiently spread out.

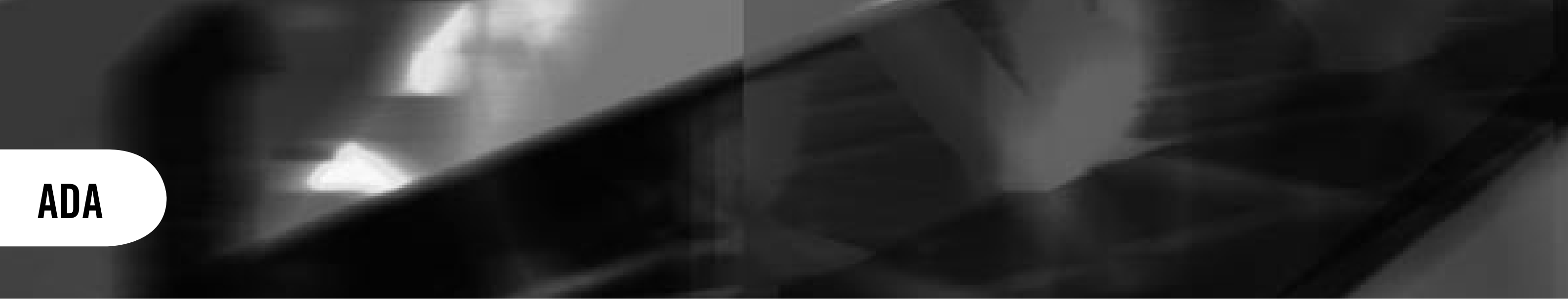
Conclusion

As the commercialisation of microfinance increases, investment funds in their broad definition are a convenient tool to collectively invest in a diversified pool of MFIs. Investors are able to diversify their risks and to invest relatively small amounts of money. MFIs can finance themselves from a more stable and larger source of funds.

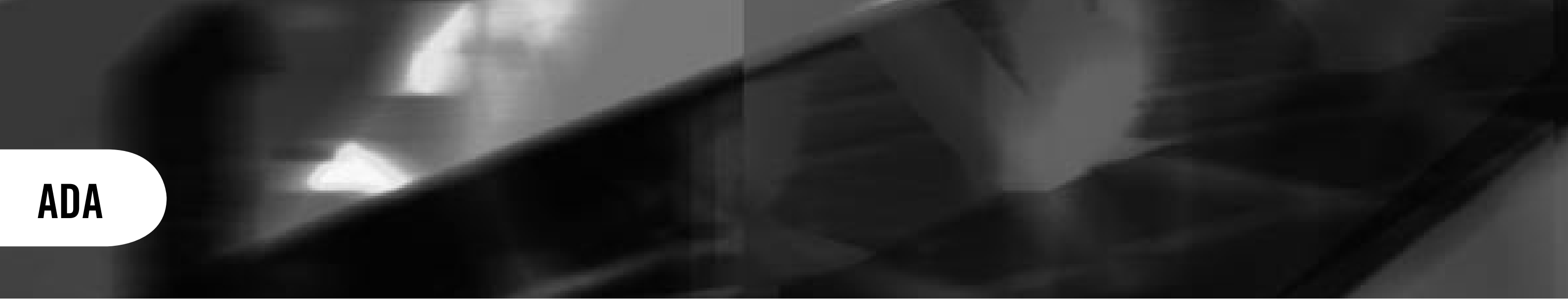
The type of structure (a mutual fund, an investment company, a cooperative company, etc.) as well as the location of the structure (US, Mauritius, Luxembourg, Netherlands, Ireland, etc.) will depend on the objectives of the promoters as well as the investors targeted.

There may also be various sub-funds within a unique structure: a microfinance debt fund, a microfinance equity fund, a start-up fund, USD share class, EUR share class, currency hedges or not, etc. Some jurisdictions are more flexible than others in allowing such diversified offering.

We are at the beginning of a genuine interest in microfinance by individual investors who are willing to invest in this activity because its provides a double return, social as well as financial. Microfinance specialists, together with traditional capital markets professionals, need to continue to build and promote the adequate structures to meet this demand.

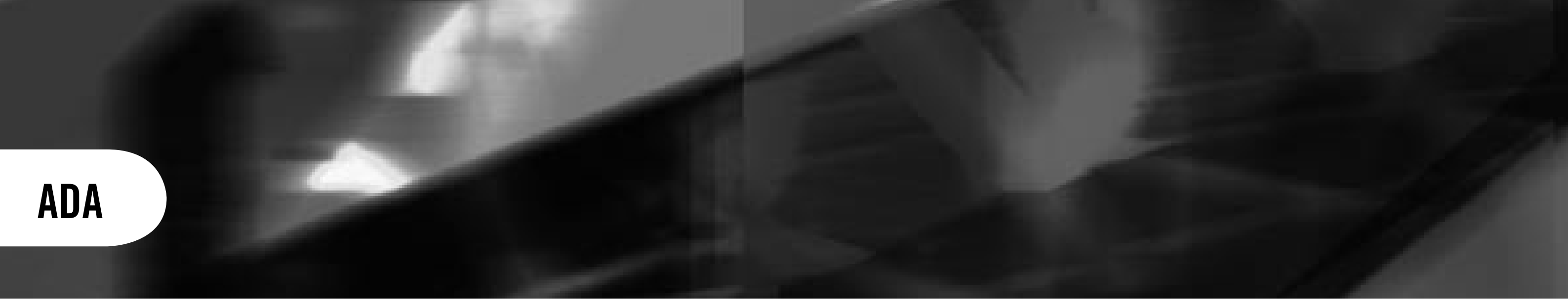


Appendix



Fund Legal Name	Country of Incorporation	Legal status	Sponsor
Accion Gateway Fund	USA	LLC	ACCION International
Accion Investments in Microfinance	Cayman Islands	Portfolio company	ACCION International
Africap	Mauritius	Private Equity Fund	ACCION Intl & CALMEADOW
ALTERFIN	Belgium	Société coopérative à rl	NA
ASN-Novib Fund	Netherlands	Mutual Fund	ASN Bank & NOVIB
BIO	Belgium	SA	Majority-owned by the Belgian state
Calvert Social Investment Foundation - Community Investment Notes	USA	Public Charity - Non-profit 501(c) 3 corporation	Calvert Group
Deutsche Bank Microcredit Development Fund (DBMDF)	USA	Non-profit 501(c) 3 corporation	Deutsche Bank
Dexia BlueOrchard Microcredit Fund	Luxembourg	SICAV	Dexia-BIL
Fonds International de Garantie (FIG)	Switzerland	Non-profit Cooperative institution	RAFAD Foundation
Hivos-Triodos Foundation	Netherlands	Foundation	Hivos Foundation and Triodos Bank
IMI AG	Germany	Investment Company	Initiative of IPC
Investisseur et Partenaire pour le Développement	Mauritius	Investment Company	NA
La Fayette Participations	France	Société par actions simplifiée	Groupe Horus
Latin American Bridge Fund (LABF)	USA	Part of Accion, Non-profit 501(c) 3 corporation	Accion International

Fund Assets		Fund Manager	Type of Fund/Structure	Terms offered to MFIs	Shareholders
$ / €	As Of				
$ 5 million	31-Dec-01	Gateway ACCION Intl Manager	Social Investment Fund	Subsidised and near market rates	CGAP and USAID only
$ 18 million	27-Feb-03	Gateway ACCION Intl Manager	Social Investment Fund	NA	Social Inst. Investors and private individuals - Min. $ 250,000
$ 13.3 million	31-Jul-02	AfriCap MicroVentures Ltd, Dakar	Social Investment Fund	NA	Social Inst. Investors
€ 7.4 million	31-Dec-02	Alterfin	Social Fund	Near Market rates	Social Inst. Investors and private individuals
€ 5.1 million	March 03	NOVIB - FSU	Social Investment Fund	Market Rates	Social Inst. Investors and private individuals
€ 46.2 million	31-Dec-02	BIO	Govt-owned institution seeking investments in microfinance	Market Rates	Belgian Govt & SBI
$ 65 million	31-Dec-02	Calvert Social Investment Foundation	Social Fund	Near Market rates	Social Inst. Investors and private individuals
$ 2.3 million	31-Mar-02	Deutsche Bank New York	Donor Facility	Subsidised rates	NA
$ 43 million	30-Sep-03	Dexia BIL and BlueOrchard Finance S.A., Geneva	Social Investment Fund	Market rates	Private individuals and some commercial investors
CHF 1.57 million	15-Nov-02	Fonds International de Garantie	Social Fund	Near Market rates	MFIs, Social Institutional Investors and private individuals
€ 11.3 million	31-Dec-02	Triodos International Fund Management B.V.	Social Investment Fund	Market rates	NA
€ 34.7 million	June 03	IMI AG	Social Investment Fund	NA	Social Inst. Investors
€ 8 million	July 2003	I&P Etudes et Conseils	Social Investment Fund	Market rates	Private individuals
€ 0.3 million	May 2003	Horus	Social Investment Fund	NA	Social Inst. Investors
$ 7,7 million	31-Dec-02	Accion International	Social Investment Fund	Near Market rates	Social Inst. Investors and private individuals



Fund Legal Name	Country of Incorporation	Legal status	Sponsor
Latin American Challenge Investment Fund, S.A.	Panama	S.A.	Seed Capital Development Fund
Luxmint - ADA	Luxembourg	Non-profit organisation	Lux government
MicroVest I, LP	USA	Limited Partnership	MEDA, CARE & SEED
NOVIB	Netherlands	Foundation	NOVIB
Oikocredit	Netherlands	Co-operative Society	NA
Partnership Fund, Guaranty Fund and FONIDI Fund	Canada	Limited Partnership	Développement International Desjardins
Positive Fund	Cayman Islands	Portfolio Company	A group of individuals
PROFUND	Panama	Investment Fund as an S.A.	Calmeadow
responsAbility Global Microfinance Fund	Luxembourg	Fonds Commun de Placement	Swiss Bank(s)
Sarona Global Investment Fund, Inc.	USA	Nonprofit Corporation	MEDA
ShoreCap International	Cayman Islands	For-profit Investment Company	Shorebank Corporation, Illinois
SIDI (Solidarité Internationale pour le Développement et l'Investissement)	France	S.A.	Comité Catholique contre la Faim et pour le Dvt
Triodos Fair Share Fund	Netherlands	Mutual Fund	Triodos Bank
Triodos-Doen Foundation	Netherlands	Foundation	Triodos Bank and Doen Foundation

Fund Assets		Fund Manager	Type of Fund/Structure	Terms offered to MFIs	Shareholders
$ / €	As Of				
$ 15 million	31-Dec-02?	Cyrano Management S.A., Panama	Social Investment Fund	Market rates	Social Inst. Investors
€ 1.35 million	31-Mar-03	ADA - Luxmint	Social Fund	Near Market rates	NA
Due to be launched in 2003 or 2004		MicroVest Capital Management, LLC	Social Investment Fund	Market rates	Social Institutional Investors and private individuals
€ 11.8 million	March 03	NOVIB - FSU	Social Fund	Subsidised and near market rates	NOVIB
€ 212/197.6 million	31-Dec-02	Oikocredit	Social Fund	Near Market rates	Essentially church related org. incl. local parishes
$ 11.6 million	31-Dec-02	Développement International Desjardins	Social Fund	Near Market rates	NA
Due to be launched Q4, 03		Positive Investment Initiative, Geneva	Social Investment Fund	Market Rates	Expected to be Social Inst. Inv and private individuals
$ 20.6 million	May 2003	Omtrix S.A., Costa Rica	Social Investment Fund	Market Rates	Mainly Social Institutional Investors
Due to be launched Q4, 03		Responsability as General Portfolio Manager	Social Investment Fund	Market Rates	Social Institutional Investors and private individuals
$ 3.1 million	31-Dec-02	MEDA Investments, Inc.	Social Fund	Near Market rates	MEDA as shareholder and inst. and private ind. as lenders
Due to be launched in 2003 or 2004		TBD	Social Investment Fund	Market rates	Mainly Social Institutional Investors + 2 Financial Inst.
€ 9.9/3.3 million	31-Dec-02	SIDI	Social Fund	Near Market rates	All categories of investors
€ 2 million	May 2003	Triodos International Fund Management B.V.	Social Investment Fund	Market rates	Social Inst. Investors and private individuals in Holland
€ 22 million	31-Dec-02	Triodos International Fund Management B.V.	Social Investment Fund	Market rates	Doen Foundation

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