mecene investment.

Address to the Subcommittee on International Monetary Policy and Trade

Mr. Wagane Diouf

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Mr. Chairman and honorable members of the Subcommittee on International Monetary Policy and Trade:

Thank you for providing me with this opportunity to speak to you regarding microfinance in Africa, and the role that development institutions can play. This is a very exciting moment in African microfinance development, and I look forward to sharing my experiences with you today.

I would like to begin by telling you a story that I think demonstrates the power that investment in microfinance can have on the African continent:

In 2001, the fund management company now known as Mecene Investment, along with several development finance institutions (DFIs) and non-governmental organizations (NGOs), launched the AfriCap Microfinance Fund (AfriCap). It was a $13 million fund (initially $10.5 million) dedicated to equity investments in sub-Saharan Africa. At the time, many doubted that we would be able to find MFIs in which to invest. Rumor has it that some of our investors wrote off the investment shortly after the closing, hoping for a social impact but not expecting any significant financial returns on their investments.

Two years later, in 2003, we invested $1.6 million in a small Kenyan MFI called the Equity Building Society. This investment allowed the company to pursue its ambitious expansion plans. As equity investors, we played an active role in improving the strategic direction and governance of the company. The company went public in 2006, under the name Equity Bank. It is now the largest bank in Kenya, with 3.5 million clients[1] and a market capitalization of approximately $700 million as of December 2009.

Without a doubt, this is one of Africa's great microfinance success stories. The Equity Bank experience has helped to prove that commercial microfinance in Africa can be spectacularly successful, and has helped to draw additional private capital into the space.

AfriCap was recapitalized in 2007 to $50 million. Its shareholders include social investors, such as Calvert, Blue Orchard and Nordic MicroCap, microfinance networks such as Accion International, and DFIs such as the European Investment Bank, Finfund, Swedfund, and Norfund. To date, AfriCap has invested roughly $30 million in MFIs and MFI-related technology companies, across 17 African countries. In 2008, current and former AfriCap investees disbursed $1.5 billion in loans to more 800,000 borrowers, and counted as clients more than four million savers. Every dollar that AfriCap has invested has attracted $6 in investment from private sources.

To fully understand the potential of microfinance in Africa, we must consider why development aid has been ineffective to this point. Consider a country where the great majority of workers live and work in the informal sector. Not only are these people ignored by most businesses, but government is rendered nearly meaningless. It does not collect taxes, and its decisions do not influence economic activity. It should come as no surprise, then, that the development aid it receives often does not reach the people who need it most. This is precisely the case in Africa, where the informal sector represents between 70-80% of the populations of most countries[2]. Unlike traditional banks, microfinance institutions actively serve

[1] Equity Bank Annual Report 2008

[2] A 2002 study conducted by the International Labour Organization estimated the size of the informal economy in five African countries, including: South Africa, Chad, Benin, Guinea, and Kenya. The average informal employment

this market in a sustainable manner. Through the extension of financial services to the low income population, therefore, we create a trusted channel to the informal sector. Beyond credit, microfinance institutions provide a variety of important services, including savings, insurance, housing finance, and money transfers. As people become financially independent, they begin to hold their government accountable and to make their voices heard. In this way, microfinance effectively promotes democracy by empowering the individual.

Donors and DFIs were instrumental in getting the microfinance industry off the ground. As the AfriCap experiment proves, however, microfinance can now serve clients profitably. Africa needs to continue to build strong financial institutions that do not require foreign aid. Due to strong investment returns, the private sector is beginning to help build these institutions.

In my decade of experience in African development finance, I have grown to believe that the most appropriate and effective method for institutional investors to support the microfinance industry in Africa is through partnership with dedicated financial intermediaries, namely microfinance investment vehicles (MIVs).

These intermediaries play a critical role in the development and scaling of the African microfinance industry. In addition to injecting capital, microfinance investment vehicles also help management face the challenges of rapid microfinance growth. With strong governance support and capital investment, MIVs can spur the development of local and regional companies. These companies have a transformational effect on African economies by encouraging local investment, creating employment and exponentially increasing economic activity. AfriCap's experience with Equity Bank is evidence of the promise offered by this approach to development.

Still, the issues and barriers facing the African microfinance industry remain great. The global financial crisis has taken its toll on the microfinance banks of Africa, leaving many of them weak and undercapitalized. Governments and international donors still have an important role to play in the development of the industry, but they must tread carefully to avoid crowding out emerging private sector investment.

Any contributions offered by public funders must be both incisive and catalytic, capable of yielding effects that are proportionally greater than the initial investments. We have just referred to the benefits of investing in financial intermediaries. Beyond these investments, public funders looking to support the industry should aim to improve the environment for both organic industry growth and for private-sector investment on the continent, rather than try to "pick winners" among competing MFIs.

Currently, the three most important industry-level interventions that grant funding can address include credit bureau development, IT infrastructure, and management capacity building programs.

First, credit bureaus. A functioning credit bureau can transform a country's financial sector. By enabling microfinance institutions to share information about their clients, credit bureaus help to streamline lending processes, reduce over-indebtedness among clients, and ultimately increase the overall stability and growth of the industry. Globally, access to credit bureaus has been proven to cut loan-processing time,

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rate across these countries was 72%. This is despite the inclusion of South Africa's 52% estimate, which can be considered an outlier.

operating expenses, and defaults by more than 25 percent[3]. Because sub-Saharan Africa displays the lowest rates of credit bureau penetration in the world, the region's MFIs are disadvantaged relative to their global peers.

Second, donors can fund IT improvements. IT has revolutionized the financial services industry, greatly reducing the cost of services. Unfortunately, many microfinance institutions in Africa lack the resources to invest in management information systems, relying instead on paper or spreadsheet-based solutions. Poor core IT systems limit growth and profitability, and prevent MFIs from taking advantage of innovative technologies, such as branchless banking. Funding provided for the development of industry-wide IT infrastructure could transform the African microfinance landscape.

The third area that development groups could consider is human capital development. A 2008 global survey revealed management quality as the global microfinance industry's most severe risk. The problem is magnified in Africa, where demand for quality managers far outstrips supply. When MFIs develop managers, they are often poached by commercial banks. Development institutions can help by establishing management capacity building programs to help train local African microfinance managers.

The African microfinance industry holds tremendous potential for poverty alleviation. While it is developing quickly and beginning to attract private capital, there remains a place for development institutions. The best way to invest is through private financial intermediaries who understand the market and can provide targeted, value-added services. Additionally, development institutions can benefit the industry by helping to improve in the microfinance environment, such as supporting the creation of credit bureaus, improving IT systems, and developing human capital.

Thank you all for your time; it has been a pleasure speaking with you.

Mr. Wagane Diouf
Managing Partner
Mecene Investment

[3] Miller, Margaret J. "Credit Reporting Systems around the Globe: The State of the Art in Public Credit Registries and Private Credit Reporting Firms." MIT Press. 2003.