

PODCAST
PRESENTATION

**MICROFINANCE: A PRIMER FOR DONORS
AND INVESTORS**

Host: Hello, and welcome. Northern Trust is proud to sponsor this podcast, *Microfinance: A Primer for Donors and Investors*. Today's discussion will center on the fundamentals of an emerging philanthropic opportunity. It will be of interest to individuals who want to explore ways to use charitable gifts and investments to alleviate poverty and who are otherwise seeking to participate in high-impact philanthropy.

Please understand that this podcast is not intended to be legal advice. As always, you should contact your legal advisors to review any strategy in light of your own specific situation.

Our guest today is Marguerite Griffin, national director of philanthropic services for Northern Trust. Marguerite consults with clients and their families and advisors on charitable giving strategies and grantmaking practices to help them achieve their charitable goals and maximize philanthropic impact. Her experience with estate and charitable gift planning, private foundation administration, and non-profit organization management has helped establish Marguerite as an expert in the field.

Marguerite, thank you for being here today.

Marguerite: My pleasure. Thanks for having me.

Host: Marguerite, from what I understand, microfinance seems to be a way to get capital into the hands of poor entrepreneurs. Just the other day, I read a *New York Times* article about how microfinance might be the



answer to fighting poverty in Africa. As we begin, why don't you explain for us just what microfinance is, and how it has become so popular?

Marguerite: In the simplest terms, microfinance is a package of financial services – loans, savings and insurance – for very poor individuals who seek to develop small businesses.

You might also describe it as a poverty-alleviation tool that gives access to credit and other modest banking services to economically disadvantaged entrepreneurs who seek self-employment.


Host: Is it fair then to assume that impoverished people do not currently have access to credit and banks?

Marguerite: In a word, yes. The field of microfinance was founded on the premise that poor people stay poor because they don't have access to capital. With credit and banking opportunities, poor entrepreneurs can invest in their own small businesses and improve their economic and social well-being.

Host: So, how did microfinance efforts start?

Marguerite: Modern experiments with microfinance began more than 30 years ago in Bangladesh, Brazil, Venezuela and a few other developing countries. One of the earliest proponents of using microcredit to encourage small business development among the poorest of the poor was Dr. Muhammad Yunus, an economist who is regarded by many as the "father of microcredit."

In 1974, Yunus personally lent \$27 to a group of impoverished Bangladeshi women whose lives had been devastated by famine. Collectively, the women paid back the loans with interest from money generated from their small businesses. In 1983, Dr. Yunus founded Grameen Bank in Bangladesh with a mission to eradicate poverty through microlending to destitute craftspeople. By the late 1980s, this model began to take root in several other countries.



By the '90s, many microcredit institutions began to transform themselves into more traditional financial services organizations in order to reach new borrowers and expand available banking-related services.

And as you may know, in 2006, Dr. Yunus and Grameen Bank received the Nobel Peace Prize for their efforts to fight poverty in Bangladesh.

Host: Incredible. Now, these microfinance institutions – are they actual banks? And where do they operate?

Marguerite: Most microcredit – or microfinance – organizations are similar to any other lending institution whether that lending institution functions on a nonprofit or for-profit model. But microfinance organizations specifically target borrowers who are poor and low-income entrepreneurs. International microfinance organizations seek borrowers, mostly women, who live in rural and subsistence farming communities, and provide them with small, uncollateralized loans to start and grow their businesses.

Domestic microfinance institutions make loans primarily to minorities, recent immigrants and women whose access to financial services may be limited because of damaged credit, a lack of credit history or capital needs that are too small for a commercial banking loan.

To your second question, microfinance organizations can be found all over the world. Internationally, microfinance institutions are concentrated primarily in developing countries: the poorest countries in Africa, Asia and Latin America.

In the United States, there are approximately 260 microfinance institutions that offer financing to low-income entrepreneurs.

Host: So what are the commonalities between microfinance organizations in the United States and those that operate in international communities?

Marguerite: Interesting question. Domestic and international microfinance institutions share many common characteristics:


- Both are supported by charitable contributions, private and public foundations and commercial investors.
- Both respect the entrepreneurial energy in marginalized people.
- Both recognize that financial services are key for poor people's asset development.
- Both offer relatively small loans and use high-touch strategies to support borrowers and ensure repayment.
- And both have demonstrated that poor borrowers can repay loans with the right structure and support.

The fundamental differences between domestic and international microfinance institutions are:

- the availability of savings products,
- the average size of loans,
- the scale, sustainability and profitability of the organization and
- the kinds of complementary microenterprise development programs offered to borrowers.

Host: Okay. So can you give us an example of how having access to capital or a microloan helps poor entrepreneurs?

Marguerite: I could tell you many stories of how a microloan or series of loans helped jumpstart a business enterprise. One example involves Orlando Correia of Fortaleza, Brazil who received a microloan of \$160 from CrediAMIGO, a partner of ACCIÓN International. Correia works as a soap maker and salesman, selling two-liter



bottles of homemade soap from his bicycle. With a loan of \$160, he was able to acquire additional supplies, which allowed him to produce more soap and expand into three nearby villages. Correia's monthly profit increased from \$150 to nearly \$240.

Host: That's pretty amazing. Are there notable success stories here in the United States?

Marguerite: Yes. While microfinance here in the United States is generally not as prevalent as it is abroad, there have been some incredible entrepreneurs who have benefited from microloans. For example, Stephanie Mack, a New York resident, had been working in the health care industry and took note when a new law required health care providers to follow stringent document destruction policies. Seeing the opportunity for a new business venture, Stephanie took out a \$25,000 loan to start a document destruction service. And after seven years in business, the company holds contracts throughout New York and employs six people.

Host: It sounds like a lot of good can be done just making loans to people who need some seed capital. Why don't regular banks meet this need?

Marguerite: Traditional banks may not be willing to engage in microlending because many low-income borrowers often cannot provide sufficient collateral nor can they meet minimum deposit requirements, and they often have poor credit histories. Also, microfinance programs – small loans and weekly collection schedules – are labor-intensive, resulting in higher operating costs as compared with commercial banks. Nonprofit microfinance institutions in the United States are generally not able to charge higher interest rates to recoup these transaction costs in the same manner as international microfinance institutions, due to our commercial banking regulations and usury laws.

In addition, it's important to remember that in many poor, rural communities throughout developing countries, there simply is no tradition of using banks or

bank-like entities for sources of capital or to safeguard excess money.

Host: Marguerite, if microfinance institutions lend to people most banks would consider too risky to take on as clients, how successful are microfinance institutions? How profitable are they?

Marguerite: Perhaps surprisingly, micro-lending practices have been quite successful. Estimates indicate that there are now more than 7,000 international microfinance organizations serving approximately 16 million poor people in developing countries alone. The data on loan repayment rates indicate that 97-99 % of borrowers repay their loans, so by no means do microfinance clients typically default on payments.

Most microfinance organizations are organized as nonprofits, and they remain viable through charitable donations and by expanding into new markets. New clients and new deposits help increase the loan portfolio. Any profits are reinvested to expand operations and services.

In fact, both domestic and international microfinance operations have been so successful that a number of commercial microfinance organizations have emerged. These for-profit entities are run like traditional financial services companies. They are controlled by shareholders, who in addition to promoting a social justice agenda seek to obtain profits for their shareholders.

Host: This leads us into an important question. How can someone who is interested in microfinance participate in this endeavor? I've heard of microfinance Web sites – like Kiva.org and Microplace. I've even been asked to contribute to microfinance while paying for my groceries at Whole Foods. Are these legitimate opportunities?

Marguerite: Actually, they are. And your experience at Whole Foods isn't unusual. The company's Whole Planet Foundation provides grants to microfinance institutions in the countries where Whole Foods sources its products. So

really what you're doing is making a loan to the subsistence farmer who grew the organic bananas that you just bought, so that he can expand operations to increase his profit.


As you mentioned, you can also engage in microfinance online. Kiva is a **nonprofit** Web site and microcredit clearinghouse that allows individuals to invest in microenterprises and track how the entrepreneurs to whom they are making the loans are doing. Lenders receive e-mail updates and can track repayments online. And at the end of the loan period, the funds that you lent are returned to you and you can then re-lend those funds to another entrepreneur.

The other side of the coin is Microplace, which is a **for-profit** Web site. Microplace connects investors with global microfinance institutions looking for capital. It too is an online resource, but in contrast to Kiva, Microplace investors receive principal *and* interest payments from the lending organizations. So when you make a loan through Kiva, it's considered a donation. A loan made through Microplace is essentially an investment that may generate a small, but not insubstantial, monetary return.

Host: So, if I were to decide to engage in microfinance as either a donor making a charitable gift or an investor seeking a return on assets, how would I start?

Marguerite: Great question.

If your goal is to participate as a funder of international microfinance or microcredit programs, you might want to spend some time learning about the social and economic issue in the region or country that you want to support, and all of the alternative strategies that governments, nongovernmental organizations and microfinance institutions are implementing to tackle widespread poverty. A few of the largest microfinance institutions offer special exposure outings for donors. For example, *Opportunity International* offers "Insight" trips for funders who want to see for themselves how microlending works.



You also want to ask yourself some questions about your tolerance for risk and your expectations for social and financial returns.

It's remarkable, but as of 2006, socially focused investors in the United States have channeled more than \$663 million into microfinance. Most of these investors choose microfinance because they expect financial as well as social returns. And now, thanks to a new evaluation tool, philanthropists and investors are better able to evaluate the effectiveness of microfinance programs and track how quickly microfinance clients are able to leave poverty.

Once you're confident in your own motivations, try to work directly with local microfinance providers –that is, microfinance organizations located in the regions you want to support. In many cases, your philanthropic investment will have the greatest impact if you target and make direct contributions to small, effective organizations in developing countries.

You should also familiarize yourself with the values, missions and financial histories of the organizations you're thinking of supporting. Many microfinance institutions are faith-based; some want to reach the poorest of the poor; while others assist moderate-income entrepreneurs. These don't have to be mutually exclusive objectives, but it's important that you choose an organization that aligns with your values. And if you want to support non-U.S.-based international organizations, there may be legal, tax and regulatory restrictions that will affect how your charitable contribution or investment is employed.

Finally, decide whether you want to make a gift or a loan. The tax effects and reporting requirements of donations versus loans may vary dramatically. If you are considering making a substantial gift or investment, you may also want to consult your financial advisor or accountant, who can advise you regarding the tax benefits of your gift or investment.

Host: That's great advice. Any closing thoughts before we go?

Marguerite: I would just add that we will more than likely continue to see microfinance evolve as a viable poverty-reduction model. It is an opportunity for philanthropists to participate in highly leveraged giving and an attractive alternative for socially responsible investors. And while microfinance may not be the solution for ending global poverty, it is a way for billions of poor entrepreneurs to earn income. The social and economic impact of any charitable gift or investment you may choose to make may be immediately apparent or take years to adequately evaluate. It's important to be flexible, cautious and realistic as you navigate the world of microfinance.

Host: We've been talking with Marguerite Griffin, national director of philanthropic services at Northern Trust. Thank you for joining us, Marguerite.

Marguerite: You're welcome. It's been my pleasure.

Host: For our listeners, we hope that after spending this time together, you've learned a bit about microfinance that may be relevant for your particular situation.

For more podcasts and resources on philanthropy, please visit our Web site, at northerntrust.com/philanthropy.

On behalf of Marguerite Griffin and Northern Trust, thank you for listening.