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Philanthropy: Microfinancing the future Families in Business No39 Jul/Aug 2008 July 2008

Mike Scott explores the booming world of microfinance and discovers the impact this branch of philanthropy can have

Microfinance is the new buzzword in banking circles. It involves lending small amounts of money to some of the world's poorest people, who often have no collateral and no credit history. And servicing the needs of those "at the bottom of the pyramid" is an area where there is a significant role for individual investors lucky enough to find themselves at the top of the pyramid.

It is a cliché that banks only lend to those who don't need the money, so microfinance is counterintuitive to many people. Since economics professor Mohammed Yunus (pictured) first lent \$27 to a group of women who had no means of paying him back in 1974, the sector has grown into a multi-billion dollar market that has helped more than 50 billion people. Professor Yunus has since been awarded the Nobel Peace Prize in recognition of his efforts.

The in and outs of microfinance

One of the features of microfinance is that its interest rates are considerably higher than those of conventional banking – they range from 15% to 70% per year, Deutsche Bank says – but they are considerably better than those of the loan sharks, while the absolute amounts involved are small, given the size of the loans. In the Philippines, for example, loan sharks can charge up to 1,000% per year in interest, according to Deutsche Bank.

The reason the rates are high is that administration of a \$20 loan costs much the same as a \$2,000 loan, while many microfinance institutions operate in remote areas and have to provide detailed advice and support to clients with little financial literacy.

Perhaps surprisingly, given these factors, repayment rates are exceptionally good. Grameen Bank, which has now spread around the world, claims repayment rates of more than 98%. "Microfinance is the only hope some of these customers have, so they will do almost anything to keep up payments," says Meera Sanyal, head of ABN Amro India, which has a microfinance operation.

"Treating a poor person as a customer who has a stake in what they are acquiring affords a level of dignity that might not exist when you give a handout," agrees Sasha Dichter, director of Business Development at Acumen Fund, a New York-based non-profit global venture fund that uses business techniques to tackle poverty. "We are giving people the choice to make their own decisions."

One reason microfinance has taken off is because it can be so spectacularly effective. ABN Amro India commissioned an impact assessment of one of its microfinance partners in the country. "The results showed that four years of access to microfinance helped 58% of the households experience a significant reduction in poverty, while 41% of households came out of poverty," says Sanyal.

And it is this aspect of microfinance that makes it an ideal vehicle for individual investors or family offices, explains Graham Harvey at business strategy consulting firm Scorpio Partnership. "One of the key drivers is that they want to see tangible impacts from their investment and they do not necessarily want to be locked in for a long period." This is a reflection on the rise of high net worth individuals who have made their money recently in private business. "It is only natural for them to look at this from a business perspective. While their investments in this area are not profit motivated, they often expect them to become self-sustaining. They don't want to just throw money at issues."

One way people can help microfinance institutions (MFIs) is by acting as guarantors for the organisations' lending activities, according to Bob Annibale, global director of microfinance for Citi, which arranged a Donor Guarantor Programme in association with Grameen Foundation. Rather than give their money, donors use their assets to establish a pool of guarantees in the form of standby letters of credit. "Donor guarantors will continue to hold their assets and realise returns on their portfolio while MFIs gain access to increased financial resources," says Annibale.

While there are moves to establish a profit-based microfinance industry because of the high rates of interest and high repayment rates, "most of the people we see generally have double bottom line objectives" and apply social as well as financial criteria to any investment in microfinance, Annibale adds.

Indeed, it can be hard to judge MFIs on purely financial terms because they offer other services such as savings schemes, business education, healthcare or money management advice along with the cash they loan out.

A purely financial focus leads to the danger of "mission drift", says Maya Prabhu from Coutts Bank. "If you are too focused on the returns, you might end up not helping people," she points out. "Our role is to help clients that are interested in investing in this area to understand what it is about." Private wealth can really help because individuals are prepared to take risks that commercial institutions will not, she adds. "If private philanthropy can advance a project to the stage where institutions are starting to get involved, that is great."

Nonetheless, she urges caution. "There is a lot of money going into this area, with many people thinking it is the next big thing. But it is important to remember that at the other end of this are some genuinely poor people who could get burnt if it goes wrong. We need people to really understand what they are doing before they get involved."



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Acumen Fund's Dichter says investing in microfinance or in venture approaches can be important components of a philanthropic portfolio, but these should not be seen as purely financial investments. "You have to be wary about thinking you can solve poverty and get a decent financial return at the same time," he says. "We are looking to maximise social returns while getting a return of our capital. Microfinance and venture investing have the power to unlock untapped growth and have a real impact on poverty."

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Campden Research launches global philanthropy study

Campden Research has embarked on a project to analyse the opinions and attitudes of wealthy global families towards philanthropy. The study is designed to help families understand a range of their philanthropic concerns.

Philanthropy website hits €1.9 billion funds in postings

A new website (www.thebiggive.org.uk) aimed at bringing ultra high net worth philanthropists and worthy causes together has hit €1.9 billion funds in postings since launching nine months ago.

Kuok family teams with San Miguel to aid food crisis

Malaysian business tycoon and philanthropist Robert Kuok has joined forces with the San Miguel Corporation to help the Philippines boost food production and curb the country's growing food crisis.