
Event Report

“Microfinance—Reflections on a Changing Industry”: A Presentation by Chrysanthos Miliaras

FEBRUARY 5, 2009

On February 5, 2009, Microlumbia, Columbia Business School’s student-run microfinance fund, welcomed Chrysanthos Miliaras, director, Middle East Division, at Chemonics International, an international development consulting firm. Mr. Miliaras discussed the impact of the financial crisis on microfinance, the current state and the future of microfinance, and the new technology that could revolutionize doing business with the base of the pyramid.

Microfinance is seen as something newer than it actually is, according to Chrysanthos Miliaras who began his discussion by explaining the origin of microfinance. Microfinance dates back to 15th-century Italy, when the Monte di Pietà (“mount of pity”), or pawnbroker, was approved by the church to lend money to those in need to finance weddings, funerals, and other family matters. This same vision was carried out by A.P. Gianini, the founder of Bank of Italy (which later became Bank of America), who lent a small amount of money to the poor—including the victims of the San Francisco earthquake in 1906—when banks used to lend to the wealthy. Then, the founder of Grameen Bank, Muhammad Yunus, received the Nobel Peace Prize in 2006 “for [Grameen Bank’s] efforts to create economic and social development from below,” putting microfinance in the limelight. The underlying theme of microfinance, whether by the Monte di Pietà in 15th-century Italy or Grameen Bank in 21st-century Bangladesh, is scale, which is necessary to make the business financially sustainable.

Today microfinance institutions (MFIs) are estimated to have 152 million borrowers in the world. Loan volume increased from US\$4 billion in 2001 to \$25 billion 2006—an impressive sixfold growth in a mere five years. While US\$20 billion is predicted to flow into MFIs by 2010,

there is still a huge funding gap of US\$250 billion, considering the eight billion poor who still have no access to finance.

For MFIs to grow and continue to provide loans to those in need, commercialization is the key. Microfinance is a “business like any other business,” Mr. Miliaras said. Because it is a scale business, microfinance requires having a large member base and keeping unit cost as low as possible.

The 2007 IPO of Banco Compartamos, the leading MFI in Mexico, put microfinance on the map for global investors by drawing attention to microfinance as a viable asset class. But by having an internal rate of return of 100 percent for eight years, Compartamos also raised an interesting debate about whether private investors are being compensated at the expense of borrowers who are being charged an excessive interest rate.

Foreign capital going into microfinance has doubled to US\$4.4 billion since 2004. While this increase indicates the much-needed mainstreaming of microfinance, it also raises a concern regarding the impact of the current financial crisis as more and more MFIs raise capital from foreign investors. Traditionally, microfinance is viewed as being resilient in times of crisis, and on February 9, 2009, the *Edmonton Sun* published a story with the headline “Microcredit Presents Investment Option in Economic Downturn.” Unlike previous crises, such as the Asian financial crisis in 1997 and the Latin American debt crisis in the 1980’s, the current credit-driven financial crisis may have a different impact on microfinance. Now the investor community is looking at microfinance cautiously.

According to Mr. Miliaras, the potential short-term risk for MFIs includes credit risk and refinancing risk. Examples of credit risk are a decline in commodity prices, a slowdown in emerging markets and a fall in remittances. Refinancing risk includes difficulty in accessing future funding, foreign-exchange risk and uncertainty regarding the stability of deposits. There is an additional danger that regulators and politicians may overreact and introduce counter-market policies, such as subsidized credit schemes and debt forgiveness. Ultimately, Mr. Miliaras explained, it is the MFIs without deposits that are most likely to suffer, because they are forced to depend on outside funding. This further reinforces the importance of the commercialization of MFIs from nonprofit organizations (NGOs) to regulated banks in order to collect deposits.

The endgame of microfinance is advancing financial access for the world’s poor. For a sustainable growth of MFIs, Mr. Miliaras advocates the “financial systems approach”—building an inclusive financial system. The three pillars of such systems are legal and regulatory

environment, financial-sector infrastructure and financial institutions. Legal and regulatory environment refers to credit-information sharing through establishing a credit bureau, and contract enforcement for MFIs to recover delinquent loans. The second pillar, financial-sector infrastructure, helps implement and enforce the legal and regulatory framework—for example, such institutions as a judiciary system that could facilitate contract enforcement fall into this category. But the most important pillar is the financial institutions, as they are the core of any financial system. Building and managing sound financial institutions requires long-term commitment, management that can develop sound strategy, sufficient financial resources, strong management-information systems and good governance.

Meanwhile, there are exciting new developments surrounding mobile-phone technology, which, Mr. Miliaras said, has “revolutionized the way we do business with the base of the pyramid” by removing the middleman and making it more cost-effective for large businesses and affordable for the poor. He gave the example of M-PESA, a mobile payment service offered by the Kenyan mobile operator Safaricom. M-PESA addresses the risk of carrying physical money and reduces the time spent waiting in line by allowing customers to transfer money by using a mobile phone. The technology gained extraordinary popularity, and about four million people signed up in two years. While liquidity (availability of cash at Safaricom kiosks) can be a big challenge in the near term, Mr. Miliaras expects this technology to grow even more.

“Microfinance is not a magic solution but a workable solution [to poverty],” Mr. Miliaras said. It is a growing challenge for MFIs to scale up and increase access to finance for the poor. While some critics express concern regarding the commercialization of MFIs, the NGO model lacks scalability and does not guarantee better governance. As commercialization of MFIs accelerates, there needs to be a balance between shareholder value and social mission in order to avoid the exploitation of borrowers. Good regulations, governance and transparency can help achieve the double-bottom-line balance.

SAWA NAKAGAWA MBA/MIA '09

Columbia Business School

Columbia University School of International and Public Affairs