

FALL 2008

# The Community Lender

from FOSTRIAN | Business Capital Corporation

*Fostrian Business Capital is a commercial lender specializing in working capital loans to emerging companies through the factoring of their accounts receivable.*



*From Jeff:*

With the 2006 Nobel Peace prize going to microfinance pioneer Muhammad Yunas of Grameen Bank, and the United Nations having declared the year 2005 to be the “International Year of Microcredit,” microfinance has leaped onto the world’s radar. Because I believe in the mission of microfinance, and its effectiveness in fulfilling that mission, and because it is not too far from most of our respective wheelhouses, I thought microfinance would be a good subject to write about in Fostrian’s Fall 2008 issue of *The Community Lender*.

So enjoy....and let’s use these tough times to make ourselves, our companies and our country better and stronger than ever!

# MICROFINANCE...CHAMPION OF THE UNDERDOG!

Microfinance pioneer Muhammad Yunus of Grameen Bank wins the 2006 Nobel Peace Prize. The United Nations declares the year 2005 to be the "International Year of Microcredit." Microfinance company Banco Compartamos goes public in 2007 resulting in its stockholders realizing enormous profits.

All this is budding evidence that microfinance has become an effective tool for the impoverished to lift themselves up to a better life...and that those companies practicing microfinance can make a healthy profit while helping the world's underdogs.

## What is Microfinance?

Microfinance is defined as the extension to poor individuals of small loans (microcredit) to be used for income generating activities, and/or the extension to these same clients of other financial services including savings accounts, insurance products and money transfer services; the objective of which in providing these loans and other financial services is to improve the clients' living standards.

Some basic elements of microfinance:

- industry's primary focus is on the poor in the developing world, where it has a wide presence
- small loans... often as low as \$100 or less, uncollateralized, payback term less than a year
- high interest rates, generally 20 – 80% (a function of a very labor intensive loan granting and monitoring process), generally paired with the borrower earning huge returns on the loan proceeds (studies in Kenya, India & The Philippines show these returns range from 117% to 847%).
- repayment rates average 97%, with prompt repayment performance generally being rewarded with the granting of a new, larger loan
- most microfinance clients are women

## Historical Effectiveness of Microfinance

Microfinance essentially did not begin as an industry until the 1970s. Bangladeshi economist, Muhammad Yunus ("banker to the poor"), is generally given credit as the pioneer of microfinance and in 2008, as head of microfinance giant Grameen Bank, is still the main face of the industry.

There is a preponderance of evidence that microfinance has been effective in its mission to reach the poor, and help them to help themselves. In 2006 the industry reached the 52 million client mark and the industry pioneer won the Nobel Peace Prize. The industry's global loan portfolio grew 81% between 2004 and 2006. In 2007 alone the 10 largest microfinance organizations in Latin America increased lending by 36%. In India, microlending increased by 76% between March of 2006 and March of 2007. Studies in Kenya, India and the Philippines show that the returns earned by microcredit clients on the borrowed funds invested range between 117% and 847%. The experience in Bolivia has its microloan clients on average doubling their incomes in two years. An eight year World Bank study concluded that 48% of the poorest households in Bangladesh, with access to microcredit, rose above the poverty line.

The U.N.'s "Millennium Development Goals" include halving extreme poverty between the years 2000 and 2015. Microfinance is to play a large role in reaching this goal as is evidenced by The U.N. launching its "International Year of Microcredit 2005". The following quote by then U.N. Secretary-General Kofi Annan I think gets to the point:



*"The International Year of Microcredit 2005 underscores the importance of microfinance as an integral part of our collective effort to meet the Millennium Development Goals. Sustainable access to microfinance helps alleviate poverty by generating income, creating jobs, allowing children to go to school, enabling families to obtain health care, and empowering people to make the choices that best serve their needs."*

Microfinance has historically been practiced via non-profit organizations, though this is changing and for-profit entities are starting to make some strong forays into the microfinance world. And there is some recent impressive evidence that microfinance is an industry where a for-profit company can do some good **AND** make a healthy profit. Ninety-seven percent of loans made in the industry are paid back. Banco Compartamos, a Mexican for-profit microfinance firm, went public with an IPO in 2007 rewarding investors with extraordinary returns. Behemoths such as Citigroup, Deutsche Bank and ABN AMRO have entered the industry. Visa is doing its due diligence and will likely enter the fray. Standard & Poor's is looking to set-up an international rating standard for the microfinance industry which will create more transparency and attract even more capital.

## The Future Of Microfinance

Today, microfinance is reaching 52+ million clients while studies show there are 500 million "micro-entrepreneurs" without access to financial services, that could greatly benefit from having access to these services.

It seems apparent that for microfinance to not only sustain itself, but to propagate and serve the 450 million poor currently without access, the for-profit business model will need to be the model of the future. As profits are generated, competition and its capital will enter the market. Increased competition will breed greater expertise and efficiencies, and will drive down fees charged to the industry's clients. Success will attract more capital which will enable the industry to sustain itself, and grow in the proportions its clients' needs require of it.

There is controversy within the industry regarding the for-profit vs. not-for-profit business model. In this writer's opinion, history and the evidence here show that the profit motive, when imbued with a socially responsible mindset, is the best engine for getting big things done.

And helping the poor to lift themselves out of poverty is a big thing.

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