MAKING AN IMPACT

With impact investments ranking high on fund managers' and investors' agendas, **Anna Lyudvig** finds that Africa offers promising investment opportunities in the microfinance space

Microfinance offers investors an opportunity to achieve a 'double-bottom line', providing an attractive risk-return profile along with making a social impact. Although the microfinance sector in Africa is less mature than in other emerging and frontier markets, demographic trends and economic developments on the continent play in favour of microfinance investments.

Compared to the 1990s when many African countries were facing negative growth and huge economic problems, the investment sentiment nowadays is much more positive, says Jacco Minnaar, fund manager at Triodos Investment Management, which manages four financial inclusion funds with total assets under management in microfinance of more than €500m ($662.3m).

"We have been investing in Africa since 1994 and we see that investors' sentiment towards Africa has greatly improved," says Minnaar. "Between 2005 and 2009 there has been very large growth in terms of the number of funds focusing on inclusive finance, and it quickly went up to more than 100 specialised funds. Now we see that the market is growing 10-12% per annum."

Volumes in Africa are still smaller than in Latin America and Asia, where markets are more mature and as a result bigger ticket size deals are possible in those regions, he adds. "Our current microfinance portfolio in Africa [11% of the total portfolio] is still relatively small compared to Latin America and Asia, but it is growing quite quickly."

Maria Largey, microfinance investment manager at the UK's development finance institution CDC, agrees, saying that the African market is maturing, but it is a very different landscape from South-East Asia or Latin America. "There are stronger regulations that are coming into place, but it is a far less mature market and it is still far behind the other two regions. If you look at overall microfinance investment, Africa currently makes up the smallest percentage of exposure globally. However, it is the fastest growing region," she explains.

"Although the supply-demand gap for formal financial services in Africa is one of the most severe in the world, less than 20% of microfinance investors are going to the continent. There are as many kinds of 'off-the-shelf' investment opportunities especially in the fund arena on the continent," adds Largey.

Socially responsible investments

The diversity of microfinance investment vehicles (MIVs) – in terms of structure and objectives – allows investors to choose MIVs with portfolios that match their own investment philosophy. But whether it is an equity, debt or hybrid MIV, fund managers agree that social responsibility is the key theme for investors in microfinance.

Vincent Lehner, regional manager for Symbiotics in Africa, says: "You do not invest in microfinance if you do not believe in social impact. But investors have different profiles. You have development banks for which social impact is more important, whereas

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pension funds investing in microfinance want social impact as well as positive financial return."

Mariano Larena, fund manager of Regmifa, the biggest microfinance fund in Sub-Saharan Africa, says it is not only important that investors get reasonable return over time, but also that the investments made are socially responsible.

"In microfinance, you will not get a bombastic return for your investment, but you will have a constant and stable income on a regular basis. Also the social responsibility is there; investors know that the money will be used for meaningful purposes in economic development," he says.

"We think that we are offering our investors sustainability over time, but at the same time we do have a developmental impact on the markets we are entering into. We have calculated that our investments have reached out to 156,000 borrowers," he says.

Lehner agrees, saying that microfinance may not get you the same sort of returns you could get from other investment types, but investors in microfinance are committed to social impact.

For CDC's Largey, microfinance is a sector which is "commercially viable and financially sustainable". "Access to finance supports jobs, reduces vulnerability for families, and helps to build economic citizenship. There are benefits from both a social and a financial perspective," she says. Microfinance fits within the broader financial institution strategy and makes about 2-3% of the CDC's overall investment portfolio in terms of commitment. CDC's exposure to underlying microfinance institutions (MFIs) in Africa is about 30%. But as well as acting as a fund-of-funds investor, CDC provides debt and direct investment to businesses in these regions.

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While investment in microfinance is often described as a 'double-bottom line', some MIVs are trying to reach a 'triple-bottom line' objective. One of these funds is the €139m Triodos Microfinance Fund, which provides loans and equity to banks and MFIs and targets 6-9% IRR. But besides the financial return the fund focuses very strongly on realising impact. For the fund's manager Minnaar, a 'triple-bottom line' is 'People, Planet, Profit', meaning social impact, environmental impact and commercial return. "We never sell our funds just on the commercial side, we always target triple-bottom line investors. We aim for a balanced return, which includes a financial return, but has a social impact as well," he says.

In Africa, most countries are still underbanked with whole segments of society not having access to finance. The spectrum ranges from South Africa, which has relatively good financial inclusion, to countries like Congo, where even today only 2-3% of the population have a banking account. Minnaar says that people in Africa are generally confronted with barriers to access basic financial services such as credit, savings, insurance and payment services. "Overall, there is still a lack in financial services. Our primary goal has always been expanding access to affordable and responsible financial products and services to those traditionally excluded. We strongly believe that access to these basic financial services unlocks opportunities for people to improve their living conditions and to utilise their talents," he says.

Another active MIV is AfriCap, a $42m private equity fund which also invests with a triple bottom line objective. One of its founding investors is Accion, a world pioneer in microfinance which helped recapitalise this MIV through its $150m Gateway Fund in 2001. Accion's experience of investing in microfinance has emerged from Latin America and successful exits from MFIs in Latin America have been redeployed into Africa, India and China, says CIO John Fischer.

Accion, which invests in common shares, quasi-equity, preferred shares and subordinated debt, sees its role as "building the base of the institutions in which it invests". Fischer says that Accion is very much about "bringing commercial money to the problem of microfinance". "When we look at microfinance in Africa, we see such a need for credit, insurance and other financial products. As much as we are proud of the size of our fund, we recognise that it is a drop in the ocean compared to the need for equity capital," he says.

Opportunities and risks

Historically, investments in microfinance have provided low correlation to the other asset classes and stable returns while providing a socially beneficial service to the end borrowers. Lehner says microfinance is not correlated to other global markets and in the last ten years it has remained "relatively stable compared to other markets with high fluctuations". "We tend to believe that there is a decorrelation with the other markets. However, we are influenced by the financial markets, so if you have volatile currency, that will have an impact on the microfinance sectors," he says.

In terms of risks, Triodos's Minnaar says that investing in Africa is slightly more challenging than in other emerging markets because of the country risks. "We invest in countries which politically and economically may not be as stable as developed countries. We want to invest in MFIs and banks with strong management and very good governance. And we see that Africa is making a lot of progress in that respect. I think in Africa the market provides ample opportunities, but the biggest challenge is to find the right institutions to partner with."

In the meantime, Accion's Fischer is less concerned with country risks, saying that "the secret is to build a very robust business model that can withstand the potential shocks of the country". "We do invest very much at the level of each MFI and usually take a stake of between 20% and 40%. We like to be a very significant shareholder and play a significant role in the share structure and the governance of the companies in which we invest," he says.

The main risk for Regmifa's Larena is that the investees will not pay back at the maturity. "When we access an investment we take into account all the MFI specific considerations, such as governance, structure of the MFI, and its ability of managing financial risks," he says.

In Africa, there are a lot of countries where microfinance is growing and developing, but each country's profile differs from one to another. There are regional differences, with East Africa being quite well developed in terms of its financial and microfinance sectors. The region is well regulated and has a favourable climate for doing business, according to Minnaar.

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Triodos's exposure in Africa is spread over 25 microfinance institutions and banks in 12 countries with the biggest exposure in Uganda, followed by Kenya and Tanzania. The investment manager also sees opportunities in other parts of Africa and has investments in South Africa, Angola, Zambia, Malawi, Ghana, Nigeria, Benin, Madagascar and Senegal. "We are open for business opportunities in every single Sub-Saharan African country, but obviously we have a strategy, where we focus more on a selection of specific countries. We are looking at an investment in Congo and we are hoping to close it by the end of the year," adds Minnaar.

Accion, which has about $10m invested in Africa across four institutions in Nigeria, Tanzania, Ghana and Cameroon, is also "closely looking at East Africa and is very interested in Kenya", according to Fischer. "We feel that we can have a greater impact in larger countries and we do look very carefully at the regulatory environment. We think that Kenya is more developed than some other countries and we are very intrigued by the possibilities that riding on the rails of M-pesa could provide to financial services entities in terms of financial innovation. And I think the potential future of a more integrated East Africa is very intriguing as well. We have been also looking at Francophone Africa and we feel there are a number of countries there which we would like to examine more," he explains.

In the meantime, Regmifa, a Luxembourg-based MIV managed by Symbiotics SA, works with 30 institutions, distributed along 13 countries in Sub-Saharan Africa with the highest exposure to Nigeria (30%), Ghana (15%) and Uganda (14%) due to the size of the population and an overall stability, but also targets Senegal, Tanzania and Kenya.

Going forward, it is clear that there are a lot of opportunities in microfinance space. "Africa will continue to be a focus for us in microfinance and it is a strategic part of our strategy going forward. As we look at making investments over the next four to five years, we would expect about 40-50% of our new investments to be in Africa," says Largey.

Over the last five to six years a number of really strong fund managers have emerged on the continent, who have a really long-term view in terms of developing microfinance market in Africa. "I think that the market will still grow, but there will be some consolidation and probably the number of funds will slightly go down, because they were not able to deliver what they have promised to investors," concludes Minnaar. ■