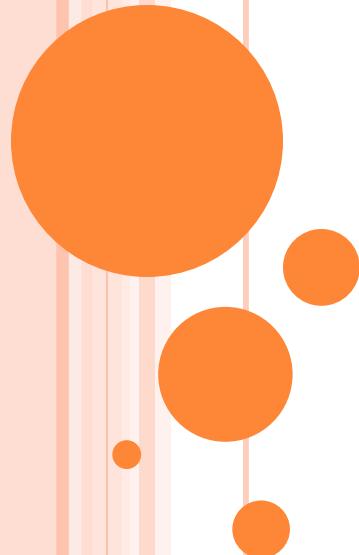


# PRIVATE, SOCIAL AND HYBRID OWNERSHIP AND FUNDING STRUCTURES IN MICROFINANCE



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# OUTLINE (AND WARNING)

- Not a Cuba specialist
- Microfinance around the world:  
Ownership and financing structures; behaviors
  - Academic theory
  - Competing visions of microfinance on the ground
  - Evidence
    - historically (e.g. 19<sup>th</sup> century Europe and USA)
    - today
- Ideas (and mostly questions) on relevance to Cuba
  - Cooperatives (and other non-state firms)
  - Financial intermediaries



# HOW ARE ENTERPRISES FINANCED?

- Inseparable question:  
How is enterprise owned, organized and controlled?
- Finance = resources today for IOUs or contingent promises to future property claims and control rights.
- Two ‘standard’ contract forms
  - **Debt:** claim to fixed rate of return.  
(no rights of control unless payment missed in which case right to foreclose on asset or force bankruptcy).
  - **Equity:** contingent claim to a share of profits or residuals.  
(shareholders exercise control via delegated board/manager)
- In practice richly differentiated contract forms tailored to context. Implicitly or explicitly specifying covenants, pecking orders, rights to sell to outsiders, etc). Competing/overlapping claims.



# WHAT KIND OF MICROFINANCE?

## TWO NARRATIVES

- **Welfarist approach**

- e.g. Grameen, BRAC, ASA.
- buzzwords: empowerment, self-help, social impacts, community control. Social businesses.
- critiques: not-sustainable, dependent on social investors, paternalistic, imposes costs on the poor.

- **Commercialization approach**

- e.g. Bancosol (Bolivia), Compartamos (Mexico), SKS Microfinance (India)
- buzzwords: hard budgets, professionalization, tap into commercial capital markets to achieve scale.
- critiques: high interest rates aggressive practices, overindebtedness, profiting from the poor, not targeting the poor. Recent AP crisis in India.



# MODERN THEORIES OF “CORPORATE FINANCE”

- Asymmetric information and costly enforcement (Stiglitz, Akerlof, Holmstrom, Tirole, Ostrom, others).
- Contracts, organization, property rights, incentives (very different from arms-length markets)
- Conflict, incentives and cooperation
  - Theories of rural organization and microfinance use same tools.
- Non-cooperative *and* cooperative game theory.  
Behavioral approaches.
  - Contract via intermediary or collective or directly with individual?
  - do contracts ‘crowd-in’ or ‘crowd-out’ cooperation?



# HOW ARE MICROFINANCE INTERMEDIARIES OWNED AND FINANCED?

- **Historically** (until early 20<sup>th</sup> century) financial services (savings, credit, insurance) for working families in Western Europe and USA:
  - Dominated by not-for profits, cooperatives, mutuals.
    - e.g. Raiffessen credit cooperatives in Germany, Netherlands (and similar in India). Thrifts and mutual in USA.
    - Equity capital from member contributions or philanthropic capital donations. Bottom up organizations.
- Investor-led (for-profit) firms were rare. Seemingly unable to compete against non-profits. Why?

Could not commit to not acting opportunistically (Hansmann: non-distribution constraint as commitment device in weakly regulated markets).
- Another reason...

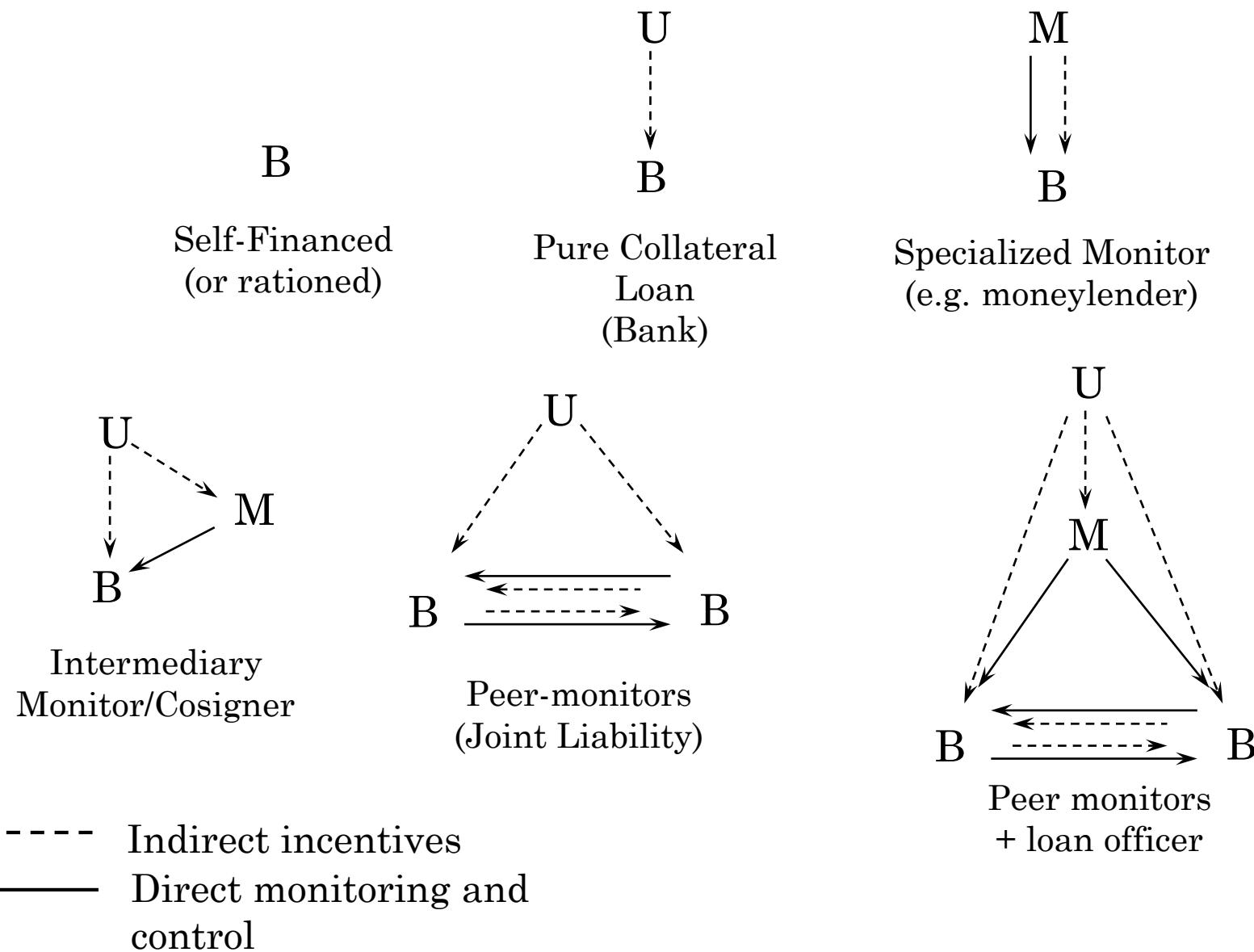


# WHAT MAKES MICROFINANCE DIFFERENT?

- Its **monitoring-intensive lending**. Costly screening/monitoring to substitute for missing collateral or pledgeable income.
- Need motivated local intermediaries and new contract structures to harness local knowledge and enforcement mechanisms.
  - Banks: (uninformed) collateral-based lending.
  - A good intermediary has advantages in monitoring and enforcing financial contracts and (in order to attract outside funds) incentive to do so.
    - Enough of own money at stake. Collateral-poor borrower → more intense the monitoring. Outside creditors will insist on local intermediary capital, which is scarce.
    - Dedication to mission/community. But won't want to be expropriated by a for-profit.
  - Non-profits more likely to serve the poor using donated philanthropic capital.



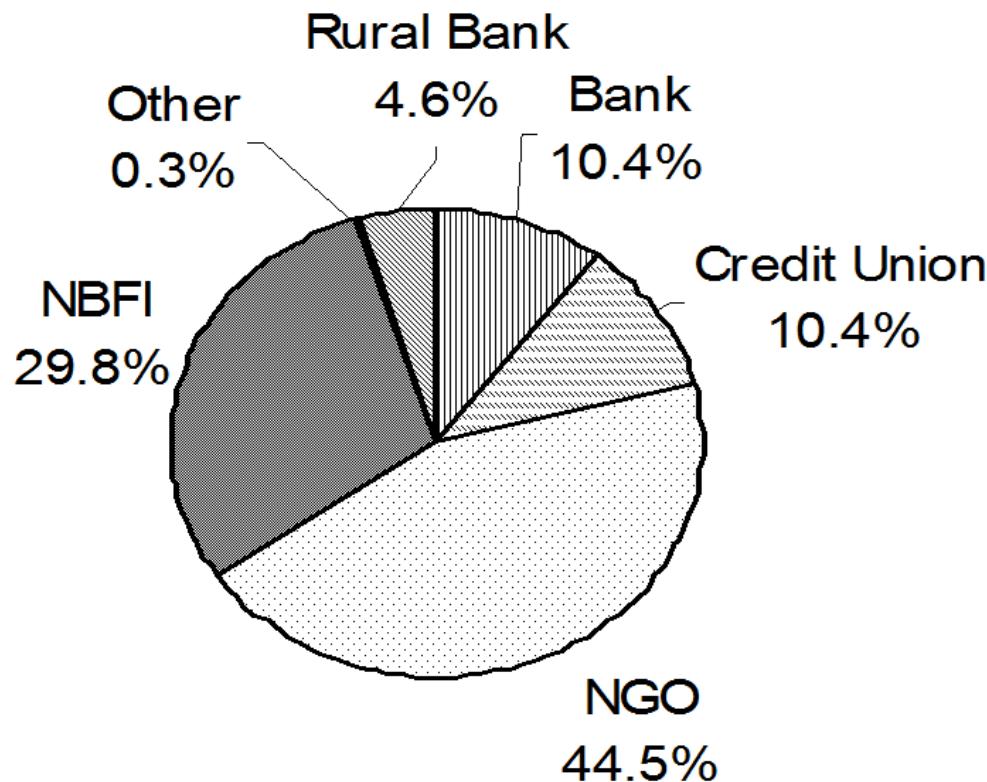
# FINANCIAL INTERMEDIARY STRUCTURES



# WHAT TYPE OF MICROFINANCE INTERMEDIARIES DOMINATE TODAY AND HOW ARE THEY OWNED AND FINANCED?

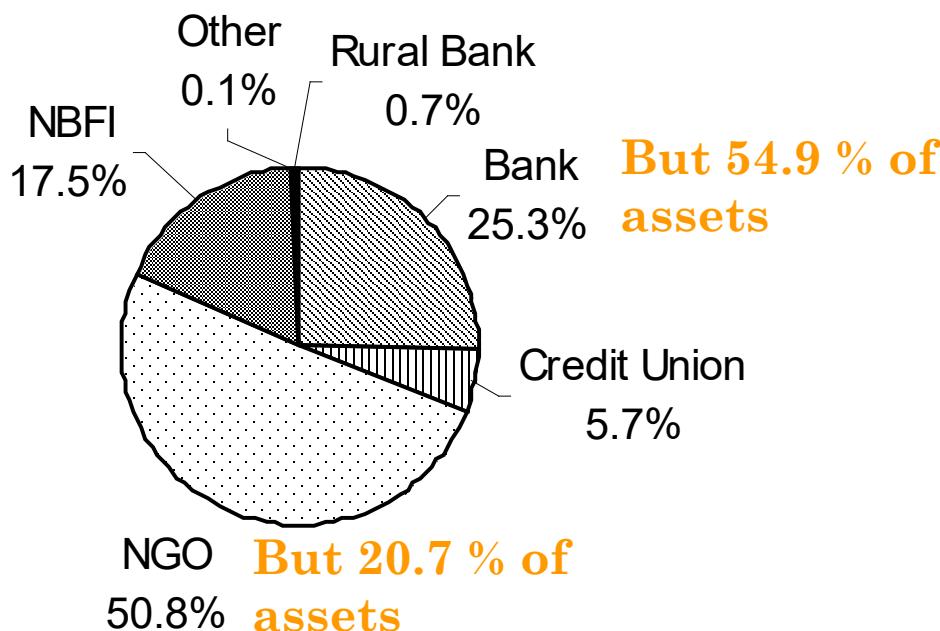
- Large heterogeneity of corporation forms: Banks, Rural Banks, Non-bank financial intermediaries, NGOs, Credit unions, etc.

**MICROFINANCE INSTITUTIONS**  
OF 346 TOTAL ANALYZED IN CONNING AND MORDUCH (2008)



# BORROWERS

(17.6 MILLION TOTAL; 346 OBSERVATIONS)



# HOW ARE MFIs OWNED AND FINANCED?

- Commercialization: Fraction of for-profits up over time.
  - Yet most ‘for-profit’ MFIs are ‘hybrid’: mostly or entirely owned by not-for profits and social investors.
  - and most for-profits are subsidized
- Owners and investors
  - Governments and state banks
  - Clients
  - Social investors
    - DFIs
    - Philanthropies
    - Individuals
  - Commercial investors
- Many creditors hold quasi-equity
- Increasingly importance of investment funds; social venture capitalists and structured finance.



# THE FINANCING AND TRANSFORMATION OF MICROFINANCE

- Philanthropic Capital
  - Philanthropists (e.g. Ford, Gates and Omidyar) increasingly make Program Related Investments (PRIs) rather than grants.
    - Earlier era of Philanthropists in finance (e.g. Russell Sage in early 20<sup>th</sup> century NYC Pawnshops) made similar investments in financial institutions for the poor.
- Philanthropists as venture capitalists?
  - “The modern philanthropist dislikes the term *charity*, preferring to speak about his *social investments*. His language is entrepreneurial, sprinkled with references to metrics, scalability, leverage, and venture philanthropy.”

Jacob Weisberg, “The Philanthropist's Handbook:  
How billionaires give their money away.” *Slate* Nov. 15, 2006

Multilateral and bilaterals: World Bank, KfW, GTZ, USAID, Dutch Microfinance Platform,etc.

## ONE EXAMPLE



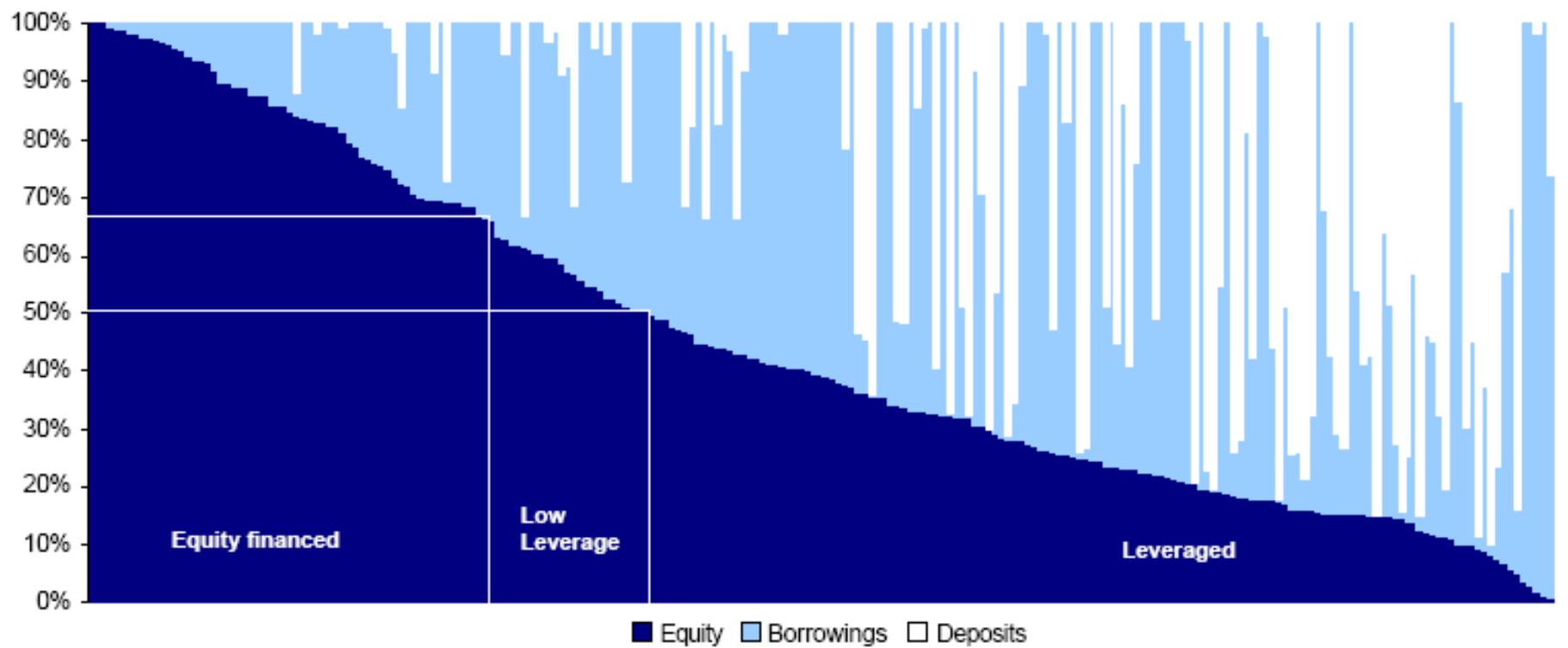
US\$20 million investment firm providing “**debt and equity capital...**

“**...to help the poor** and provide investors with current income and long term capital gains, **maximize shareholder return**, promote development of MFIs.”

Founded and entirely owned by three non-profit institutions:  
CARE, an international non-profit humanitarian organization,  
MEDA, a US and Canadian Christian business and professional association  
Seed Capital Development Fund, a US non-profit organization.



# HOW ARE MFIs FUNDED?

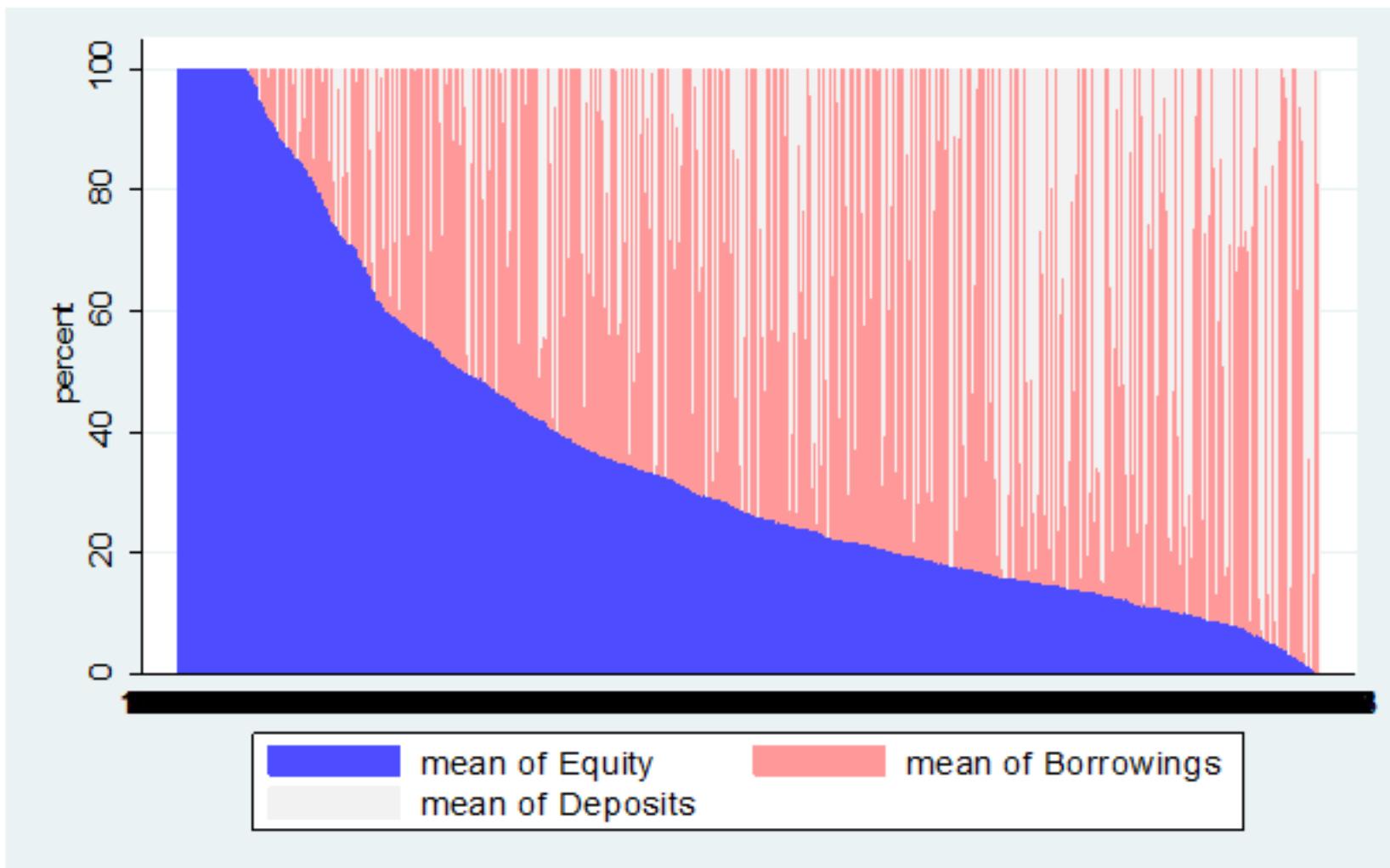


Source: MBB 11 Data. Decapitalized (negative equity) MFIs have been excluded from these figures. Data points represent actual observed financial structure broken into equity, borrowings and deposits. Observations are arranged from left to right in increasing level of debt-to-equity.

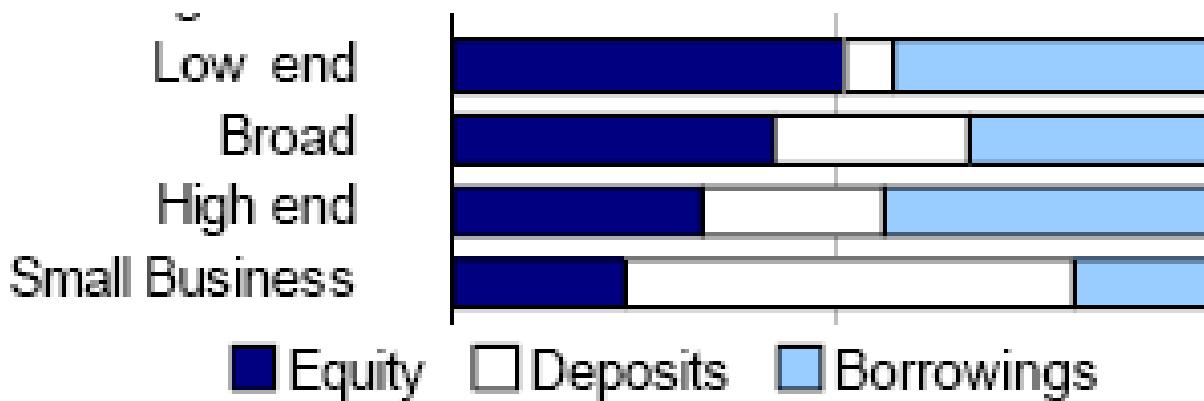
2003 data for 231 MFIs as reported in MBB 2005 by Blaine Stephens.

## HOW MFI'S ARE FUNDED

Year 2011    **Equity / (Equity+ Deposits+ Borrowings)**



# HOW DOES LEVERAGE VARY BY TARGET MARKET?



Source: In Blaine Stephens, MBB, Sept 2005. 231 MFIs.

# MISSIONS AND TARGET GROUPS: NGOs VS. BANKS

	NGOs		Banks
	Median	Median if profitable	Median
	(2)	(4)	(6)
Percent women	85	86	52
Average loan size/income at 20 <sup>th</sup> percentile (%)	48	60	224
Age	9	9.5	10.5
Assets (\$PPP million)	6.0	12.2	30.4
Active borrowers	7,416	11,115	20,262



# ‘PROFITABILITY’ OF INSTITUTIONS AND BORROWERS.

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	Institutions		Active Borrowers	
	Number in sample	Percent Profitable	Number (millions)	Percent served by profitable institutions
<b><i>Institution type</i></b>				
Bank	30	73%	4.1	92% <b>3.7m</b>
Credit union	30	53%	0.5	57%
NBFI	94	60%	2.6	75%
NGO	148	54%	8.9	91% <b>8 m</b>
<b>Total</b>	<b>315</b>	<b>57%</b>	<b>16.1</b>	<b>87%</b>

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# IN CUBA

- New law on cooperatives
  - New enterprises and incentives; mobilize equity capital.
  - But how autonomous?
    - if require govt. approval;
    - if asset ownership limited to ‘usufruct rights’.
    - if only source of funding is from state banks?
    - Incomplete property bundles. Delays, hold up, ‘tragedy of anti-commons’.
- New credit policy 2011
  - Promised new resources for private businesses.
  - But new intermediaries and intermediary structures to do the type of microfinance that need?
    - Traditional, collateral based lending by bank officials.
    - Why should it be above pitfalls of other Latin American state lenders? (e.g. slow/bureaucratic; high default; politically directed).
- New private financial service providers (cooperative, non-profit, social investors including foreign)?

# CONTRASTING TRANSFORMATION MODELS

- Russia/Ukraine: Top-down privatization
  - Kolkhozes not autonomous self-managed cooperatives. Sudden land privatization with no supporting local institutions. Result: oligarchs' and super-large agribusiness holding companies, market power distortions; now difficult/impossible for small & medium private and cooperative operators to compete.
- China
  - Town Village Enterprises. Locally empowered government as intermediary/partner/buffer.
  - Open to creative financing and ownership arrangements including outside investors.
  - Not free of abuses and problems but better outcomes.
- Cuba?
  - Solid base for successful re-invention but only if innovate

