Unlocking Local Capital for Development: Shared Interest's Guarantee Fund for South Africa

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Introduction

As the world grapples with growing income disparities that leave more than three billion of the planet's people in poverty, and as the current recession shrinks the pool of public and private resources available to remedy the situation, investors and policymakers across the globe are seeking high-impact, cost-effective strategies and tools to reduce the cavernous income and wealth gap and create bridges out of poverty.[1]

South Africa is a stark case in point. In 1994, when the country replaced apartheid with majority rule and elected Nelson Mandela president, South Africa was one of the most unequal nations on earth, with the preponderance of the country's wealth concentrated in the hands of 9 percent of the population.[2] Eighty-four percent of that wealth was deposited in the country's four major banks, which by and large did not extend credit or most other banking services to blacks, who made up 80 percent of the population.[3]

That year, after the country transferred political power, but left economic power concentrated in the same minority hands, Shared Interest was launched to provide U.S. investors with a catalytic vehicle to help reverse apartheid's legacy of institutionalized race-based inequality. In creating a model that would respond to South Africa's particular conditions and needs, Shared Interest established a guarantee fund that moved highly capitalized South African banks to lend to community development financial institutions (CDFIs), cooperatives, and emerging enterprises that, in turn, have supplied credit, affordable homes, and jobs to more than one million low-income black (including mixed race) South Africans. In the process, it has forged a model applicable and replicable far beyond South Africa.

1 The World Bank Development Indicators for 2008 report that almost half of the world's population, more than 3 billion people, live on less than $2.50 a day.

2 Crait Schwabe, "Fact Sheet: Poverty in South Africa," South Africa: Human Sciences Research Council, Pretoria, July 26, 2004.

3 T.T. Mboweni, South African Reserve Bank; DI 900; "Banking Council Annual Report, 1999" cit. in, Penelope Hawkins, "South Africa's Financial Sector Ten Years On: The Performance of the Financial Sector Since Democracy," Cape Town: Development Policy Research Unit, School of Economics, University of Capetown, 2003: 16.

How Shared Interest Works

Shared Interest's fund guarantees South African bank loans to low-income black entrepreneurs, cooperatives, and the CDFIs (including microfinance institutions) that serve their communities.

Individuals and institutions (ranging from foundations to religious orders) currently invest between $3,000 and $1.5 million in Shared Interest for between three and five years, earning a rate of return that closely tracks that of U.S. Treasury notes. (Through an arrangement with MicroPlace, retail investors in most states can also lend as little as $20 online.) Shared Interest invests the funds it borrows from its investors in quality debt securities, primarily U.S. government Notes, which it deposits in a U.S. bank. The bank in turn uses these securities to back letters of credit to mainstream South African financial institutions. The letters of credit secure loans to South Africa's black entrepreneurial poor through CDFIs, cooperatives, and their own small and growing businesses. Through Shared Interest, U.S. investors become the functional cosigners for emerging entrepreneurs who would otherwise be considered "unbankable."

But they are doing much more. Because Shared Interest guarantees no more than 75 percent of any bank loan (and often covers less), it moves financial institutions to begin to underwrite and take their own risk in the majority market. Having brokered and guaranteed these new relationships, Shared Interest's objective over time is to reduce its coverage and ultimately withdraw from particular transactions, leaving banks and their new borrowers working together, as a matter of ordinary business.

As Shared Interest puts the securities it purchases to work, it manages default risk through its South African partner organization, the Thembani International Guarantee Fund, which it established with RAFAD, a Swiss nongovernmental organization (NGO), in 1995.[4] Thembani's wholly South African staff readies credit-worthy CDFIs, co-ops, and emerging enterprises to prepare their paperwork, apply for, and then negotiate what is usually their first commercial loan. With the added value of the guarantees it can provide, Thembani is also able to serve as a facilitator for its clients, brokering loans, and encouraging banks to lend at more favorable rates and terms than they would otherwise. Historically, Thembani has been able to lower interest rates to 1.5 percent above or below prime–the banks' rate for their best customers.

Once the loan proposals are submitted, Thembani frequently confers with the banks during the underwriting process and assists the borrowers in complying with the banks' and Thembani's reporting and other monitoring requirements once the loans are made. Finally, Thembani also serves as a trainer for bank lending officers, either by assisting them on a case-by-case basis throughout the transaction or, more recently, conducting classes to help them to better understand how to lend prudently to sectors they have previously shunned.

4 RAFAD (Recherches et Applications du Financement Alternatif au Développement) created the International Guarantee Fund in 1996. Since that time, the fund has managed RAFAD's guarantee portfolio, composed of 22 guarantees totaling 1,679,844 CHF in 2009.

Thembani also regularly monitors the risk of the outstanding guarantees and reports quarterly to its Credit Committee and to Shared Interest on the risk of the portfolio. This enables Shared Interest to assess the level of reserves to set aside in its Guarantee Loss Reserve Fund (GLRF) (built with its own net assets and donor capital) to protect its investors' capital from potential loss. Shared Interest's additional layer of subordinated debt and other credit enhancements includes a $3 million facility from the Overseas Private Investment Corporation (OPIC) to cushion lenders' capital from loss in the event that defaults on guaranteed loans in South Africa cause South African banks to call on Shared Interest's underlying securities and deplete its GLRF. Thembani's Credit Committee, which approves new initiatives, can only authorize the issuance of guarantees if sufficient reserves are available to cover any projected risk. (Shared Interest representatives must approve the guarantee issued with its capital.) Shared Interest pays Thembani to place and negotiate the guarantees and to provide the necessary technical support and monitoring.

At the same time as Thembani's hands-on assistance and the GLRF help to mitigate the risk that South African borrowers will default on their loans, the guarantee fund itself reduces currency risk. Shared Interest borrows in dollars, reinvests investors' funds in dollar-denominated securities, and uses these securities to back letters of credit issued in South African rand. It does not re-lend its funds to institutions operating in other currencies. Shared Interest only incurs currency risk in the event that loan defaults result in calls on its guarantees in South Africa. Should the rand appreciate against the dollar after the guarantee is issued, Shared Interest must supply more dollars than originally anticipated to cover the call. Shared Interest protects against such possibilities by using no more than 75 percent of its guarantee capital at any one time. Moreover, it invests its GLRF in rand-denominated securities so that the value of its reserves will rise and fall with the value of its guarantees.

Additional Models

Shared Interest's is not the only loan guarantee fund. In the United States, one of the oldest and best known models providing opportunities for retail investors is ACCION International's Bridge Fund, which extends facilities to institutions in the ACCION network.[5] Other development institutions, such as Grameen Foundation, use guarantees to enhance leverage and reduce credit risk for their own subsidiaries and network members.

Other models include large portfolio guarantees (such as those by USAID, which help to secure portfolios of loans issued by particular banks). They also include multi-country funds, such as the International Guarantee Fund (FIG), which manages the guarantee portfolio of the Swiss NGO RAFAD and operates with capital largely supplied by its member institutions in different countries.

5 ACCION reported in 2005 that its Bridge Fund borrowed from socially responsible investors who made loans beginning at $2,000 to ACCION at below market rates – and used these funds backed local currency loans from commercial banks to nonprofit microfinance institutions. Maria Otero, "The Power of Microfinance: The Experience of ACCION International," ACCION International, 2005: 7.

Another guarantee model, pioneered by MicroCredit Enterprises (MCE), uses pledges of investors' assets (without actually borrowing them) as guarantees to back loans issued by US banks to MCE which, in turn, lends the money to MFIs around the world (www.mcenterprises.org). In the event of a call, investors pay their proportional share of their losses to MCE as tax-deductible contributions.

The increasing international interest in guarantees reflects growing recognition that, when properly financed, managed, and supported by local know-how, such vehicles play an important and unique role in development finance. Leveraging local resources, guarantees can boost the sustainability and scale of CDFIs and emerging enterprises, mitigate risk, and link new borrowers to their own countries' commercial capital.

Multisector Approach

Numerous guarantee funds and other development finance vehicles specialize in one sector, such as microfinance or Small and Medium Enterprises (SMEs), also referred to as "small and growing businesses" (SGBs). However, from the outset, Shared Interest noted that apartheid created deep craters of poverty in a number of ways, ranging from forcibly relocating black families to the country's least productive land or ethnically designated "homelands," to concentrating industry in white areas, forcing rural blacks in search of jobs to migrate to townships on the outskirts of cities. In response, Shared Interest–recognizing that South Africa's diverse communities were already implementing a broad spectrum of effective strategies to create wealth and jobs, sustainable rural livelihoods and affordable housing–decided to support and learn from them by taking a multisector approach.

Microfinance institutions, small black-owned enterprises (which were illegal outside of the "homelands" during apartheid), and new black-owned cooperatives face a common barrier: access to capital and the capacity to put it to productive use. Cognizant of South Africa's numerous development needs and approaches, Shared Interest and Thembani together devised different development strategies to address poverty in rural, periurban, and urban areas. The partner organizations work to continue to unlock capital for low-income communities in three main sectors: microfinance, rural SGBs, and affordable housing. They also work with innovative institutions to bridge boundaries between sectors.

For example, two of Shared Interest's microfinance institution (MFI) beneficiaries make credit available for low-cost housing. The first, Kuyasa, promotes individual and group saving and lending to enable low-income (primarily township) families to build, expand, or improve their homes. The second MFI, Norufin, issues loans for housing construction and improvement to the residents of traditional communities that, by law, cannot put up communally owned land as collateral. Banks otherwise unwilling to lend to such rural homeowners have extended credit to the CDFI, which lends to current and future homeowners, with a Shared Interest guarantee.

Impact

By the end of 2010, the 41 guarantees that Shared Interest has issued have benefited 1,994,546 low-income, black South Africans. The finances have reached residents in each of the country's nine provinces. The financial leverage achieved by Shared Interest's guarantee model has helped millions more. Since its inception, Shared Interest guarantees have enabled more than 99,699 economically disenfranchised South Africans to launch or expand small and microenterprises; 120,223 to build or improve affordable homes; and 1,774,381 to obtain jobs.[6] Shared Interest's guarantees have ranged in size from $18,124 to $1,516,320. Their leverage has varied from a $17,189, guarantee resulting in loans of $32,740 to a $711,631 guarantee unlocking $66,000,000 in credit.

Together, Shared Interest's guarantees, totaling $14,938,657, have leveraged $94,504,524 in loans to organizations benefiting South Africa's entrepreneurial poor. That is, every dollar of guarantees issued has directly unlocked more than six dollars in credit. Moreover–and of particular interest today–during its 17 years of operation, Shared Interest has repaid all investors requesting repayment 100 percent of their principal and interest on time. Only six calls on its guarantees have been made as a result of full or partial borrower defaults in South Africa. However, owing to Shared Interest's risk mitigation and guarantee loss reserves, no investor has lost a penny of interest or principal.

Examples

Several exemplars showcase the benefits of guarantees as a catalyst for development. The Small Enterprise Foundation (SEF), one of South Africa's premiere microfinance institutions, is one. An early Shared Interest's client, SEF mobilizes savings and extends microloans (often beginning at less than $100 each) to women in groups of five who use them to launch or expand tiny businesses in the provinces of Limpopo, Mpumalanga, Gauteng and the Eastern Cape. During the early 2000s, SEF was unable to obtain a loan from Standard Bank, where it had kept its accounts for 12 years, or any other commercial bank. Seeking to diversify its sources of capital and scale up, SEF obtained a series of guarantees from Shared Interest. Over a six-year period, SEF used $1,854,397 in guarantees to unlock $2,601,752 in commercial credit from the Amalgamated Banks of South Africa (ABSA), one of the country's largest, and Teba (now renamed U-Bank), a second-tier bank that is half-owned by South Africa's National Union of Mineworkers. This leverage helped SEF expand from 22,110 clients to 68,578, while maintaining its borrowers' 99 percent repayment rate.

Most important, the loans to SEF built the physical capital of rural communities; enhanced social capital by helping to strengthen the survival, social cohesion, and organization of these communities; and empowered women to protect their rights and enhance

6 These jobs include both permanent jobs created by enterprises and temporary jobs related to housing construction. The South African government estimates that the construction of each new house creates an average of 15 jobs.

their families' well-being. A study of eight SEF village centers found that "among direct programme recipients, [the] 12 month experience of physical and/or sexual abuse was reduced by 55 percent."[7]

Shared Interest issued another guarantee to Siboshwa, a sugarcane cooperative in eastern Mpumalanga, three miles from the Mozambican border. Siboshwa's workers were forcibly removed from an area declared a "black spot" during apartheid, and trucked to inhospitable, undeveloped land, before the authorities shot their cattle. After apartheid, the democratically elected government gave Siboshwa initial financing and helped them form a cooperative, while TechnoServe provided technical assistance in growing cane, managing the business, and securing markets. Shared Interest provided an $80,496 guarantee, which unlocked a $107,328 loan from ABSA. This enabled the cooperative to expand its acres under cultivation, increase its yield, and prepare it for financial sustainability.

Key Features

The power of the guarantee model created by Shared Interest is enhanced by several factors, including its ability to leverage local capital, strengthen the capacity of local CDFIs and small black-owned enterprises, and alter banking practices and attitudes. We consider each of those factors below.

Leveraging Local Capital

In the wake of the 2008 global recession and the G-20's call for nations to reduce deficits by 50 percent by 2013, the role has only grown for development strategies that do not sink governments deeper into debt or exacerbate cross-border exposure.[8] Since the 1980s, many nations' debt traps have undermined their development efforts, as creditors such as the IMF and the World Bank have imposed rigorous "structural adjustment" (and "enhanced structural adjustment") and mandated austerity measures in exchange for debt forgiveness and/or access to future international investment. As a result, there is a growing interest in strategies that avoid ongoing dependency on overseas investors and markets, and instead elicit local private-sector participation to mobilize local capital for development.

Shared Interest's guarantee fund leverages local capital in several ways. First, it encourages mainstream South African financial institutions to extend credit to clients previously considered unbankable and to lend at least 33 percent more than the amount of the guarantee. (Over the years, guarantees have ranged from 19 percent to 75 percent, resulting in the extension of local loans at 1.3 to 6 times their value.) Second, CDFIs that receive commercial bank loans in turn lend the funds they borrow to previously neglected black clients. Small

7 Paul M. Pronyk et al., "Effect of a Structural Intervention for the Prevention of Intimate Partner Violence and HIV in Rural South Africa: Results of a Cluster Randomized Trial," The Lancet, 2006 Dec 2; 368(9551):1973-83.

8 In Toronto in 2010, the G-20 countries called for halving deficits by 2013, implying the possibility of imposing national austerity measures.

business borrowers may secure loans with less than 12-month terms, enabling community lenders like CDFIs to deploy the same funds more than once a year by relending the principal when loans are repaid. Many microfinance institutions make use of four-month repayment periods, which allows the institutions to recycle the funds to those businesses three times a year. The result is that local partners' capital and institutional support revolves funds and multiplies the value of the guarantees up to 12 times for microfinance institutions over a three-year period. (The bank lends 1.3 times the amount guaranteed, which revolves three times a year over a three-year period.)

Strengthening the Financial Skills of CDFIs and Emerging Black Enterprises

Shared Interest's guarantees enable CDFIs and emerging enterprises to receive, use, and repay loans they need to grow, reach more clients, achieve economies of scale, and become increasingly sustainable. Thembani's guidance and technical support throughout the process build skills in using financial tools such as guarantees for commercial expansion loans and help to enhance efficiencies and lessen dependency on grants.

When guarantee beneficiaries require assistance related to their particular industries, technologies, and markets, Thembani and Shared Interest often partner with specialized service providers. In the Western Cape, for example, Thembani worked closely with Stellenbosch University's aquaculture department to assist the Hands-On Fish Farming Cooperative (HOFFC). With the university's innovative trout farming methods and feed, and Shared Interest's guarantees, HOFFC enabled black farmworkers to launch a successful trout farming cooperative consisting of 35 projects on the white-owned farms where they live and work. In Mpumalanga Province, Thembani has partnered with TechnoServe to enhance the agricultural and management expertise of two sugar cane cooperatives that were able to borrow working capital with the help of Shared Interest guarantees.

The guarantees are designed to move borrowers to access commercial loans without guarantees. After utilizing Shared Interest guarantees for six years, growing and strengthening its balance sheet, SEF obtained its first unsecured loan from Standard Bank (the bank with which it has maintained an account for 18 years). After only one guarantee, the Siboshwa sugar cane cooperative was able to obtain a loan from TSB, the local sugar industry's largest financier, without a guarantee.

Finally, guarantees can be instrumental in bolstering financial intermediaries that build both social and financial capital. Guarantees to MFIs that use group or "solidarity" loans for development, for example, help to strengthen support systems that mobilize community members to back one another's loans and benefit their communities in additional ways. This system has enabled Tropical Mushrooms, a mushroom farming business in North West Province, to double its growing area, boost annual sales from R5.9 to R10.0 million, increase its workforce from 65 to 105, and create jobs to employ and encourage the careers of local youth.

Altering Banking Practices and Attitudes

More than unlocking credit for impoverished people and helping them build strong CDFIs, Shared Interest set out to promote institutional and attitudinal change to redress historical inequities in the banking system. It is far too soon to declare success with an effort that may take more than a generation. Nonetheless, the fact that Shared Interest has issued 41 guarantees and moved at least some bankers to lend to clients previously considered unbankable demonstrates the potential of the approach. Moreover, an evaluation conducted by the New School for Social Research in 2005 found that banks using Shared Interest guarantees demonstrated increased willingness to lend to emerging entrepreneurs and, over time, to consider taking a greater share of the risk.[9]

While the financial risk coverage serves as a catalyst for credit, Thembani's hands-on technical support fosters new capacity and policies. By sharing its own due diligence with mainstream financial institutions, Thembani assists the lenders in underwriting loans to the new market. In addition, during the fall of 2009, ABSA hired Thembani staff to help train 150 of its loan officers.

Such support continues throughout the life of the guarantee, particularly if credit issues arise that the bank and its guarantors must address together. When several small businesses encountered difficulties during the recession of 2008 and 2009, Thembani collaborated with the banks to avert liquidation and work out solutions to business challenges, including providing specialized consultants and identifying potential equity partners.

Challenges

Shared Interest's guarantee model faces several significant challenges to its success and growth. We outline the most prominent below.

Legacies of Apartheid Banking

Two key features of banking during the apartheid era continue to challenge South African financial institutions seeking to serve the majority market, even with internationally provided guarantees. The country's international financial isolation in the 1980s and 1990s curtailed bankers' interactions with international markets, and reduced their familiarity with mechanisms such as international letters of credit.[10] Meanwhile, deeply rooted discriminatory lending practices entrenched during colonial rule and perfected during apartheid shaped

9 Frank Brunetti et al., "An Evaluation of the Thembani International Guarantee Fund" (New York: The New School, Graduate Program in International Affairs, September 2005).

10 Banks' relationships with international markets were curtailed by financial sanctions and overseas banks' refusals to roll over their loans. Chase Manhattan's decision in 1985 not to renew its loan to South Africa led other international banks to follow suit. This left the country unable to repay its mountain of short-term debt, and moved the government to declare a moratorium on further repayments pending negotiations with international creditor banks. The move sharply reduced the flow of international credit to South Africa and further isolated the country's banks.

underwriting criteria, credit policies, and attitudes. Black entrepreneurs and communities were typically not perceived as "credit-worthy," particularly when they lacked traditional forms of collateral difficult for impoverished families to obtain, and had no formal borrowing histories, creating a vicious cycle of exclusion from credit.

Apartheid practices and perspectives further limited experience with community lending, which continues to undermine mainstream lenders' capacity to serve the low-income black majority. During the last five years, for example, Shared Interest has found that even banks with decades of experience lending to white-owned sugarcane cooperatives are reluctant to lend to black-owned sugarcane cooperatives, even those with solid financial records. Similarly, the banks are much faster to foreclose on black farmers in trouble than on similarly situated white farmers, who are more likely to be given time to work things out. By shutting down black-owned businesses, this disturbing pattern undoes the potential for positive community outcomes. Worse, it establishes negative precedents and expectations that black-owned businesses are likely to fail and are unworthy of credit.

Borrowers' Reluctance and Limited Capacity to Use Commercial Credit

A second challenge to continued growth is the fact that access to commercial credit is new for many in South Africa, and elsewhere. South Africa's CDFIs, cooperatives, and emerging enterprises have had little experience with formal-sector financial institutions, and are often reluctant and unprepared to seek commercial credit on their own. They require Thembani's technical and often moral support in applying for and negotiating loans from banks that have rejected them in the past–if they have the courage and opportunity to approach them at all.

Meanwhile, many of the newer emerging enterprises and agricultural cooperatives that have sought Shared Interest's assistance have required extensive work with technical partners to prepare them to put commercial credit to work. The HOFFC, for example, would not be bankable today without the strong technical support of the University of Stellenbosch's aquaculture department. Similarly, the Siboshwa cooperative would have been unable to launch or manage its profitable sugarcane business without TechnoServe's expertise in crop production, management, and marketing. This inexperience and continued reliance on outside advice can place significant demand on supporting organizations. It elevates the time and expense of providing these services, which are critical for bringing banks and emerging entrepreneurs and communities together to "make the market." This means that at least during the short- and medium-term, intermediaries like Shared Interest and Thembani that provide technical assistance to new market entrants are unlikely to be able to cover the cost of their non-financial services with revenues earned from their guarantee funds. As a result, for the foreseeable future, they are likely to require fees from those clients who can afford them pay for them–and subsidies for those who cannot.

Sustainability and Scale

To succeed and grow, development finance organizations such as Shared Interest require a firm foundation of "equity" or net assets. Yet building this equity is not easy if the institution is not well capitalized at the outset and must scale up loan by loan, grant by grant. For these organizations, long-term and major support is often needed to ensure their staying power and anchor their growth.[11] Yet such support is often very difficult to find. With limited equity or net assets, such organizations may experience difficulty in obtaining loans from larger and more mainstream investors which, in turn, is an important step toward protecting the funds they borrow and increasing their scale of operations.

Building the guarantee portfolio is further challenged by the interest Shared Interest is able to pay its lenders. The rates are capped by the gross interest the organization earns on its investments in high-quality but low-return securities (particularly in the current market). Consequently, it is not yet possible for Shared Interest to pay investors an entirely risk-adjusted return. Moreover, the lack of a market for Shared Interest notes presents an obstacle for those mainstream investors seeking enhanced liquidity, and a constraint on the organization's potential growth.

Replicability

Going to scale with any successful venture can be difficult. As Shared Interest prepares to scale up and extend its work to other countries in Southern Africa, it confronts several obstacles. The first is that guarantees presuppose a sufficiently developed banking system that is capable of extending loans and working with international letters of credit. Unfortunately, a number of countries in the region still lack such a robust system. This means that guarantees for developmental domestic bank lending may take more time and work to establish, and are likely to be less supported by sound credit policies and lending practices.

The second obstacle is the frequent lack of a political and regulatory environment conducive to these kinds of development initiatives. South Africa is moving in the direction of fostering such an environment. Even though it lacks legislation resembling the U.S. Community Reinvestment Act, South Africa has made reducing inequality a priority and has established a series of industry-specific black economic empowerment charters, including the Financial Sector Charter (FSC). The FSC sets benchmarks for banks and a reporting system to hold them publicly accountable. Although momentum for the FSC progress has slowed during the past two years, it has had a significant impact by ensuring that the industry sets, and in most cases exceeds, transformation benchmarks, including lending to low-income black South Africans.[12] Although this is not a prerequisite for moving mainstream banks to lend

11 Nonprofit Finance Fund, "NFF Capital Partners 2009 Portfolio Performance Report" (New York: Nonprofit Finance Fund, 2010).

12 Banking Association of South Africa, Financial Sector Charter 2008 Annual Report on the Transformation of the Financial Sector of South Africa (Marshalltown: Banking Association of South Africa, January 1, 2010).

to the majority market, and its impact has varied within the context of other political pressures, it has provided strong incentives that do not exist in many other emerging economies. Without even these legal measures, there may be less incentive for banks in other countries to overcome their own barriers and inertia, and to extend credit to underserved communities.

Myopia about Microfinance

The buzz surrounding microfinance risks diverting attention from its original aims. Recently, the discovery by international capital markets that microfinance can be extremely lucrative has created both momentum and confusion. It has also contributed to over-concentration, escalating interest rates and defaults in some markets. While impressive microfinance returns have driven $30 billion into the sector, they have also blurred the boundaries of a field whose original focus was developmental. In some countries, South Africa included, the term "microfinance" now applies to institutions such as "reckless lenders," "payday lenders" and "loan sharks" that the government is attempting to regulate in the interest of consumers. Such inclusive terminology has blurred the perceptual lines between the categories and their basic purposes.

Moreover, by focusing investment on the more profitable microfinance institutions–primarily those top-tier MFIs already operating at substantial scale and equipped to connect to capital markets–the field is contributing to its own concentration in a subset of MFIs that compete with each other in some saturated markets, as numerous investors compete to invest in the same established MFIs. Such concentration exerts pressures on MFIs to raise their interest rates and grow quickly to meet the return expectations of investors. In the process they fuel client over-indebtedness and, in countries like India, have contributed to a backlash of consumers refusing to repay their loans.

At the same time, such top-tier MFI investment concentration is failing to support the growth of smaller and younger developmental MFIs that need capital to mature and enhance their self-sufficiency.[13] Failing to seed the next generation of MFIs is short-sighted on the part of the investment community. Investors totally driven by profit are failing to expand the field to serve the estimated 270 million impoverished people still waiting for credit, as well as to meet MFI investors' own need for new investment opportunities.[14] The trend challenges Shared Interest to distinguish its own work with smaller institutions and its particular developmental impact in order to compete with investments offering higher financial returns.

13 In discussing Microfinance Investment Vehicles (MIVs), Reille and Sansanikone report that "The MIV market is concentrated in many respects. The top 10 MIVs account for 67 percent of the aggregate portfolio. A quarter of MIV investments are concentrated in just 10 MFIs. That said, MIV funds are invested in a larger pool of MFIs than IFIs are. In terms of instruments, MIVs are primarily invested in fixed income, of which 70 percent is hard currency. Recently, mainstream financial structures, such as securitizations, collateralized debt obligations, and credit wraps, are being adopted for microfinance investors. Finally, there is regional concentration, with 81 percent of MIVs in Eastern Europe, Central Asia, and Latin America." From Xavier Reille and Ousa Sananikone, "Microfinance Investment Vehicles" Washington DC: CGAP Brief, April 2007.

14 In 2008, CGAP reported $30 billion of international investment in microfinance, out of an estimated $300 billion in funding needed to extend financial services to the planet's unbanked poor. See Joan Trant, "Microfinance Investing with an Impact" (New York City: International Association of Microfinance Investors, 2009).

Government Policy

Policy tools that spur international lending to combat poverty are scarce. In the United States, several policy initiatives create incentives for domestic financial institutions to supply loans and grants to low-income communities. The Community Reinvestment Act (CRA), where enforced, can penalize those that do not do so. Further, the Obama administration recently approved the largest funding allocation to the CDFI Fund in its history. The fund channels government grants directly to CDFIs. However, in the international arena, no legislation provides incentives for the private sector and nonprofit financial intermediaries to combat global poverty by advancing international community lending.[15] With the exception of grants through USAID, and OPIC, U.S. policy has yet to reward bank and corporate support for organizations that unlock private-sector finance for low-income communities overseas, in the way that CRA-motivated banks and CDFIs are doing at home. While U.S. policymakers articulate commitments to reducing poverty, and stabilizing and building markets overseas, their available remedies are also constrained by the volume of tax-levy dollars available to donate to international development initiatives. In this context, the government could do more to mobilize and reward private-sector loans and contributions to intermediaries fostering public-private partnerships and investment in disadvantaged communities overseas. This would be a cost-effective tool to enhance the success and leverage the results of its other international development strategies.

Lessons Learned

We can mine Shared Interest's 17 years of experience for a variety of lessons for making capital more accessible to low-income people and the small and micro-enterprises they establish and run. The first lesson is the most humbling: there is no silver bullet for eradicating poverty. Unlocking the power and potential of marginalized communities will require multiple strategies and partnerships. Shared Interest's work with MFIs, cooperatives, and other emerging enterprises has helped to leverage financial and human capital for a range of complementary approaches to combating poverty. Nonetheless, many other public- and private-sector initiatives are required to reverse centuries of exploitation and build a more equitable economy.

Mobilizing Local Capital

Despite the enormity of the task, eradicating poverty is not impossible, and mobilizing local capital lies at the heart of one of the most promising strategies for doing so. Numerous

15 In President Obama's inauguration speech, he underscored that the United States "can no longer afford indifference to the suffering outside our borders." See "President Barack Obama's Inaugural Address," (The White House, January 21, 2009, available at www.WhiteHouse.gov.) Moreover, his administration has allocated $246.75 million during 2010 alone to the CDFI Fund. "Statement by CDFI Fund Director Gambrell on President's Signing of the FY 2010 Appropriations Bill," U.S. Department of the Treasury, Dec. 17, 2009.

international agencies will, and must, continue to invest their own funds, often in their own currencies, in development across the globe. However, it is also essential that emerging communities and nations themselves raise local capital and invest it in their own development. Clearly, guarantee funds are one mechanism to mobilize local currency resources for these purposes. The guarantees also reduce currency risk to both local beneficiaries and international investors. As noted, Shared Interest and Thembani plan to secure capital to back guarantees from South African investors, a move that will further leverage U.S. resources and enable Thembani to finance its own guarantees. The devastating lessons of dependency, distorted development, and structural adjustment have been driven home again. The recent international financial debacle planted a new red flag signaling the dangers of the kind of development that "giveth and taketh away."

Local Partners

Local partners are another local resource that is critical to sustained success. Indeed, an important lesson that Shared Interest has learned in the process of seeding development is the invaluable role that these local partners play in a range of functions. Shared Interest's ability to place quality guarantees, monitor and mitigate risk, measure impact, and build the skills and relationships of beneficiaries and banks would not be possible without a strong local partner. In this case, Thembani ensures that Shared Interest's investors' capital achieves its intended purpose with a minimum of risk, while building the field of development finance in South Africa. As Thembani collaborates in turn with additional technical assistance and mentoring organizations in South Africa, it further roots the work in local knowledge and institutions, and helps local institutions learn from each other's experiences. These mechanisms are essential not only to implementation and mitigating risk, but to ensuring that development becomes a tool of the communities it seeks to serve.

Social Capital

The elusive, but critical "social capital" is yet another element in the sustained success of development efforts.[16] Social capital takes its name from financial capital, and its importance is on par with that of finance. But it is neither quantifiable like money nor measurable like poverty. Social capital is the glue that binds communities together–the networks that connect ideas and people; the trust that springs from working together; the nonmonetary aspects that make life easier for community members and increase their collective ability to accomplish their own goals. Indeed, building social capital is as important as leveraging financial capital. Shared Interest's most successful partners have not only developed strong

16 Harvard University professor Robert Putnam, one of the scholars best known for his pioneering work on social capital, defines the concept as "features of social organizations, such as networks, norms, and trust, that facilitate action and cooperation for mutual benefit." Robert D. Putnam, "The Prosperous Community: Social Capital and Public Life," The American Prospect, Vol. 4, No.13, March 21, 1993, pp. 35-36.

management systems and delivery models, and enhanced their scale, but have also enhanced their clients' skills, social support systems, organization, and a belief in themselves. Ultimately social capital can not only magnify the impact of development finance strategies such as group microfinance and loans for cooperatives, but also complement them with other strategies that enhance their beneficiaries' ability to meet their basic needs. SEF clients, for example, have mobilized through their savings-and-borrowing village centers to reduce violence against women and other behavior that had threatened their safety and health, and to make community clinics more responsive to their members. In so doing they enhanced their communities' interrelated physical and economic survival and well-being.

Systems Change: More Than Moving Money

Financial models that use a systems approach can be particularly effective catalysts for social change. By impacting the behavior of major institutions (such as banks) and their relationships to other market participants (such as emerging entrepreneurs), development finance institutions can achieve far greater and more enduring results than those they could produce with their own resources and episodic interventions alone. Guarantee funds with a hands-on catalytic and capacity-building component can have a profound impact on private-sector institutions and practices. Specifically they can help emerging nations mobilize their own institutions and resources to lay the foundations for increasingly equitable development on an ongoing basis. While it is much too early to declare "victory" in moving banks to lend to low-income communities, Shared Interest has demonstrated the credit-worthiness of many of its guarantee beneficiaries, and begun to move some bankers and banks to extend credit to borrowers they would have previously considered "unbankable."

Appeal of the Model

What makes stakeholders invest in tools like guarantees? What is the appeal to investors of models such as Shared Interest's? In reality, a number of factors motivate stakeholders, some tangible, some less so. Banks that use the guarantees in South Africa, for example, have enhanced their reputations as institutions contributing to "broad-based black economic empowerment" (BBBEE), a goal of the South African government and those who elected it. Loans to low-income black borrowers enhance a lending institution's "scorecard," the instrument that measures its social performance according to the standards of the country's Financial Sector Charter. In this context, Shared Interest and Thembani help move banks to issue loans that benefit both their balance sheets and their public profile.[17]

As banks move beyond their traditional comfort zones, they benefit from a low-risk introduction to a significant new market–the majority of the population. Through Shared

17 South African banks have received more than a nudge in this direction by the Financial Sector Charter. While the charter does not carry penalties like those of the U.S. Community Reinvestment Act, it does demand disclosure and creates an environment of public and governmental expectations, even without sanctions.

Interest's guarantees and Thembani's technical support, they not only mitigate their risk, they also enhance their understanding of the black, low-income market, as well as their skills in underwriting and monitoring loans to CDFIs and emerging entrepreneurs.

Shared Interest's investors, in turn, are motivated by the high social return on their investment. Many are driven by their commitment to help South Africans build an equitable economy after apartheid. Others value the financial leverage of the guarantee model and its ability to mobilize local capital for the country's unbanked majority, and particularly its women. While financial returns have tended to be lower than those of corporate and government fixed-income securities (with the exception of years such as 2009 and 2010, when U.S. government Treasury and Agency interest rates plummeted), they are commensurate with those of many other community investments.

In addition, investing in Shared Interest (and other CDFIs) provides a hedge against movements of a market with which it is only tangentially correlated. Because Shared Interest's operations do not depend on mainstream financial markets, the organization provides an opportunity for portfolio diversification. At the same time, it strengthens the most powerful economy on the African continent—an engine for growth badly needed as U.S. and European economies falter.[18]

Shared Interest's investors and donors, in addition to placing high priority on the social return on their contributions, are compelled by the knowledge that they are building an increasingly sustainable institution that is enhancing the capacity of South African entrepreneurs, families, and communities to support themselves. They are further motivated to support Shared Interest's strategy to alter South Africa's financial ecosystem—by moving banks to lend to their country's own majority market—ultimately without the support of guarantees. Finally they support Shared Interest's current strategy to expand its operations to reach the next 500,000 black South Africans, and to ensure its own sustainability and that of Thembani for the long haul.

Conclusion

Although South Africa is exceptional, in many ways it is not an exception. Discriminatory lending practices are not unique to South Africa. They have been entrenched across the globe, leaving diverse and exploited populations struggling to direct their own development. Such lending practices are more the norm than the exception. South Africa is like many other countries with histories of colonial rule, economic exploitation and institutionalized racial discrimination, only more so.

18 In June, McKinsey & Company issued a report entitled "Lions on the Move," which marked Africa's compound annual growth in real GDP for 2008 at 4.9 percent. This is higher than the rates for developed economies (2.0 percent), all countries reporting such data (3.0 percent), Latin America (4.0 percent), and Central and Eastern Europe (4.8 percent). It follows Emerging Asia (8.3 percent) and the Middle East (5.2 percent). Celia W. Dugger, "Report Offers Optimistic View of Africa's Economies," *New York Times*, June 24, 2010, p. A8.

Guarantees have an important role to play in building a new financial ecosystem that reduces economic disparities, roots development finance in emerging communities, and moves them forward on their own developmental paths, while providing a role for international partners without creating detrimental dependency. As Shared Interest works to further test and develop its model, and explores opportunities to extend its work beyond South Africa, it is looking to other countries in Southern Africa. With sufficient public and private support at home and abroad, its model can be replicated well beyond the region.

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