

Microfinance: Successes and Challenges

Jean-Philippe de Schrevel is CEO and co-Founder of BlueOrchard Investments, and also founder and CEO of Bamboo Finance and the Oasis Fund. His companies specialize in asset management and microfinance projects that target positive social impact and produce “market” returns -- 2% above LIBOR (the benchmark London Interbank Offered Rate) for the microfinance unit. In India, his organization backed a rural hospital group providing “no frills, high-quality care” to low-income patients. They have grown the profit-making company from four hospitals to 12, serving some 250,000 patients. He expects 50 hospitals and 1 million patients in two to three years. Schrevel also offers his views on the rising criticisms of microfinance, which include charges of exploitation of the poor.

An edited transcript of the interview is below.

Knowledge@Wharton: We’re meeting today with Jean-Phillipe de Schrevel, founder and CEO of BlueOrchard, a leading microfinance company, and founder and CEO of Bamboo Finance. Welcome to Knowledge@Wharton.

Jean-Philippe De Schrevel: Thank you very much.

Knowledge@Wharton: Would you offer a brief history of BlueOrchard, its mission, accomplishments and how you grew it into a \$1 billion fund over 10 years?

De Schrevel: Well, the original idea was to seek how to promote microfinance globally because we were convinced that microfinance, if properly done, can have a tremendous impact on poverty. What was attracting us as well to microfinance was the ability to have, in one go, an investment for social impact and financial returns, and this idea that you don’t have to trade social impact for financial returns and that you can actually achieve both at the same time. So that was very appealing to us, especially as Wharton grads.

And so the combination of wanting to do something good and using the traditional tools of main-stream finance was attractive. We were in Geneva, surrounded by private banks and wealthy family offices, and the idea very quickly emerged to create a for-profit management company to channel private investors’ money into microfinance and delivering for them financial and social returns.

So that was the beginning – that’s the DNA of the company. We called it BlueOrchard so that people would remember the name. We didn’t call it “Micro-Invest” or “Micro Something.” We started with very little seed money in our first fund, \$10 million, essentially given by a bank that took the risk of trusting us.

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And then, progressively, through our investments and discussions with investors, we attracted an increasing number of individual investors intrigued by the social impact, and essentially first investors, as they realized they were actually getting their capital back with some decent returns.

Knowledge@Wharton: Some market level returns?

De Schrevel: Well, I don't know if you would call it "market level returns." It all depends on your risk perception of microfinance. But we consider that, given the low default rates of microfinance portfolios over a long period of time, delivering a net LIBOR plus 2% in U.S. dollars in a very diverse debt portfolio of microfinance loans to microfinance companies was the market return. And actually I think institutional investors voted with their feet, because after four or five years of a track record of attracting wealthy individuals, we suddenly were able to talk to the Fund of Funds, pension funds and, even in the last two years, sovereign wealth funds. So we saw it as a gradual increase in our investment processes, but also as a demonstration that we could actually deliver the returns and be very effective investors in microfinance.

Now that was BlueOrchard from the start – very focused on fixed-income in microfinance. Around 2007 or 2008, we decided to go into private equity because it was a need of the sector, because we knew the sector quite well and were able to identify the good opportunities for investments. We created a second company called BlueOrchard Investments to do private equity investments in microfinance. At the same time we realized that, while financial inclusion's important, it's not the end of it -- it's just a little, piece of what low-income communities need to have access to.

They need access to health care, affordable housing, clean water and clean energy. And we had this intuition, and a lot of people have done it before as well, that there were probably social entrepreneurs out there, for-profit companies, trying to meet the needs of those low-income communities in those sectors. And so, we created another company called Bamboo Finance to do private equity investments in non-microfinance-related sectors. And we raised the fund, very much a pioneer fund, and we now have \$50 million under management in terms of investment activity -- attractive portfolio companies. The goal is the same – to demonstrate to mainstream finance that you can actually have social impact while doing what they do every day, which is investing money for financial returns. [After the interview, De Schrevel noted the following: "The Bamboo Microfinance BOPE Fund is our private equity fund for microfinance. Oasis Fund is the private equity fund for the other sectors -- health, energy, housing, etc. Bamboo Finance is the asset management company, managing the two funds.]

And the reason why we're so focused on this combination of social and financial returns is that, although we admire philanthropy and charity, we believe that it will never be sufficient to tackle the size, the magnitude of the problem of poverty in the world. And therefore, private capital and main street – those huge pools of private capital waiting to be deployed – should be deployed to solve the most critical issues of the world today. So that's what we're after. Our success is important, but beyond our own little personal success, what we're really after is demonstration, replication -- and as we've seen in microfinance. Ten years ago, when we launched the Dexia

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Micro-credit Fund with BlueOrchard, we had \$10 million and we were probably one of the two funds out there in the market. Today, if you look at the World Bank website -- I think you have a hundred microfinance investment vehicles channeling collectively something like \$6 to \$8 billion to the microfinance industry. That's in the space of 10 years. The idea with Bamboo Finance today and our private equity business is to, hopefully, do the same and then be competed against, replicated, copied and progressively to [have the whole effort] called a "sector." Because if you're by yourself, you are not a sector and you're not an asset class

Knowledge@Wharton: You're a pioneer.

De Schrevel: You're a pioneer. You try to open paths and show what people could do. But then when you start talking about \$5 billion, \$6 billion, \$8 billion, \$10 billion, [you get] a multitude of practitioners. And those practitioners start talking in networks, and start organizing themselves and start discussing: how do you rate a microfinance company, how do you assess your social impact? You develop a common vocabulary, a common language that is recognized by mainstream investors. Then your progress will be becoming an impact investing sector. I don't think we're there yet. But we're progressively going there.

Knowledge@Wharton: How big is Bamboo Finance?

De Schrevel: Together, Bamboo Finance is a 25 person team managing \$250 million through two private equity funds. We're close to full investment and are about to launch second generation funds.

Knowledge@Wharton: So you raided \$250 million in four or five years?

De Schrevel: In four or five years, exactly. And people were amazed that we could raise this amount of money in a new field, in what is a difficult financial situation worldwide. I mean, 2008, 2009 were not precisely the best years to raise money.

We are very happy about that. The mix of investors that we have in our funds is also quite interesting. We have, obviously, high net-worth individuals -- family offices -- but also, significantly, microfinance pension funds, European pension funds. We were very proud of being able to convince an Abu Dhabi-based sovereign wealth fund to test microfinance and impact-investing in Bamboo. So that makes for a very interesting key investor group.

Knowledge@Wharton: So they're investing also in the Bamboo private equity fund -- in both funds.

De Schrevel: Exactly.

Knowledge@Wharton: Bamboo operates globally also then?

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De Schrevel: Yes. We now have offices Bogotá and in Singapore. We're looking at opening in East Africa, which is a very active region for social investing. We have a smaller office in San Francisco and of course our bases in Luxemburg, Geneva and Zurich. And the idea is to progress most of our investment management capacity in the regions.

Knowledge@Wharton: As a private equity firm, you are then investing in companies around the world? Tell me what kinds of companies you look for – a particular size, a particular stage of development – and, of course, I'm assuming in a particular sector, because they're aimed at some kind of a social-impact result.

De Schrevel: Typically we invest in private equity growth stage – growth stage today in impact investing means tickets of about \$3 million to \$7 million. We are investing and looking essentially for the first fund at all kinds of sectors and companies. We wanted this first fund to be fully diversified by sectors and by geographies.

But we quickly realized that a few sectors are emerging in terms of social incapacity and impact. One is health care. Another would be affordable housing. A third would be energy. Those are clearly the three prominent sectors of investment for us. We'd love to do some educational deals. We have found two so far that were, in our opinion, worthy of investments. And so "growth stage" means that those companies for us have a proven track record, have tested their business models in the market, and have a beginning of a revenue stream. They don't need to be totally break-even yet. But they need to have a very defined and aggressive growth plan, and capacity to deploy the equity that we're investing.

We will never take majority stakes. The objective for us is not to own or control. It's to be one of the partners of this group of initial promoters. We take a very active relationship to the portfolio companies. We are sitting on the boards – that's a condition sine qua non. And then we very actively engage on a monthly basis -- our investment managers have a limited set of portfolio companies, three to four portfolio companies maximum, that they're monitoring and always [monitoring]. And they bring very significant value added I believe in terms of organization of governance, in terms of definition of business plan and in terms of financial management operation. So far the feedback from the portfolio companies was very positive in terms of our engagement.

Knowledge@Wharton: Do you help them to find new personnel and talent as they grow?

De Schrevel: Absolutely. As a matter of fact, on our web site we post their job postings. We help them look for key personnel, obviously – CFO level, CEO -- in the organizations. For some we even help in fund raising, seek investors, introduce them to our network.

Knowledge@Wharton: Could you give some examples of the kinds of projects that you've done so far?

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De Schrevel: One example that we are very proud of is an investment we made in India, in a chain of rural hospitals. The problem in India -- 80% of the health care sector is urban, when the needs are rural. Eighty percent of the health care sector is tertiary care when most of the needs are primary and secondary. We met a group of doctors who had started their hospitals, no frills, high-quality, 50-bed hospitals in one state -- in Karnataka. They had four hospitals. Two of them break even, two of them on the way to break-even. And they had this grandiose plan of going to 50 hospitals, serving a million low-income people. Well today, two years after our investment, they have 12 hospitals. They serve 250,000 patients from low-income communities in Karnataka. They're entering a second state. And they just closed an additional round of fundraising, attracting a much larger private equity fund than ours, which we see as a success. I think they'll be on track to getting their 50 hospitals in two to three years, and serving these one million clients or patient base. And then this is just a beginning. Because if they have proven this business model, imagine how many states you have in India and how many low-income [people] you have.

Knowledge@Wharton It's just the beginning of your defining a sector there?

De Schrevel: Absolutely. And it signals too much larger private equity funds that there is a sustainable, financially attractive business model, but with huge social impact.

And the fact that we have -- or we will be proving hopefully -- that the intrinsic part of the business model is helping low-income communities get access to primary health care, will, so we hope, prevent follow-on investors [from diverting] the mission of the company. Because, in itself, serving low-income in rural areas will be proven very profitable. So that's at least the theory. That's what we hope for. We have not made any exit yet on the impact investing. The jury's still out in terms of how we'll fare for our investors. But we believe that we have a strong case.

Knowledge@Wharton: You mean when it comes to an exit?

De Schrevel: When it comes to exiting our private equity investments, obviously. That's one example. Another example that I find very attractive, again in India, is one of electrification of villages in Bihar, which is one of the poorest states in India. I'm not an engineer, but essentially, the rice husks of the rice production are then burned, from bio mass, to produce electricity through gasifiers that they can install in villages. Again, knowing that we'll be investing a couple million dollars alongside others in this company -- helping them electrify the whole of Bihar, villages that have never seen the light in their history -- I think is a fascinating story as well -- and again, on track to having being a solid financial investment, but with tremendous social impact.

Another example -- access to education -- to higher, university education in Mexico. There are hundreds of thousands of poor students with no access to a university and with the capacity to do it -- with skills, intelligence.

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We've been invested for two years in a company lending money to very poor people to get access to universities. Thinking that we'll hopefully ... be able to send the students to universities is going to be very rewarding, socially for the people and financially for [our] investors. But also, think about the human capital of the country that you're building for generations and for the very long term. That's also very satisfactory. Those are three examples, but there are many more.

Knowledge@Wharton: Tell me how you see Bamboo evolving over the next three to five years?

De Schrevel: One thing I've learned over the last 10 years is that, even though you grow fast, you don't have to rush it. Again, in the spirit of being able to demonstrate something, better to build your case steadily and deliver results to your first set of investors and then build from there, and send a very positive signal. So today, we manage \$250 million. We're 25 people working from three regional offices. My goal for the next two years is probably to double that with economies of scale -- so probably less staff [relatively speaking].... That's one set of foundations that's very selfish. [We also hope to have] exited a few investments and proven to our initial investors that they were right to trust us and prove to other would-be investors that they should come into the sector. And then hopefully we contribute the learning of the industry and the creation of the sector by sharing best practices and examples, and returning to Knowledge@Wharton in five years to tell you about great stories and exits that we will have realized.

Knowledge@Wharton There's been a lot of publicity when it comes to microfinance over the last several months. Some microfinance companies have had problems. There've been more defaults than there had been originally. As it got so successful, that success saw some non-profits develop a profit-making arm. And then some commercial banks moved into this space. And so there's this perception of – the phrase is “bleeding the poor.” What is your view of that? How extensive is the problem?

De Schrevel It's a difficult question and one that calls for a balanced answer. I do think that problems are still limited to a few geographies and what I would call saturated markets. I think they usually are triggered by a combination of causes, some internal, some external. The first thing I would say is that to me, and to Bamboo and BlueOrchard, it doesn't put into question the role of microfinance fundamentally and the objective of financial inclusion for the so-called unbankable people. So let's not throw out the baby with the bathwater. That would be the first answer. So, yes, financial inclusion is important. Yes, micro-financing's important. And that's why I said at the beginning, if you do it properly microfinance works anywhere. Now where do you see the problems -- with fast and exponential growth at some companies – usually uncontrolled, with weak management, with weak monitoring, with weak management information systems. [They are] essentially problems that have been building and are factually hidden by the sheer growth of the portfolio, right? That could be one [problem]. The other: probably an excess of competition in some saturated markets – in urban markets in Central America where you have 15 microfinance companies chasing the same low-income communities

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in the same slums or in the same suburbs. Of course, it leads to over indebtedness of clients. Some lenders or microfinance operators are less regarding than others when it comes to credit-worthiness and checking the credit quality of the would-be borrower -- so [there is] probably over-heating or over competition in those urban centers.

And then probably some mea culpa [is warranted] from the microfinance investment vehicles where, at the beginning, as I say, we were by ourselves and the world was ours. When suddenly you have a hundred funds chasing the same 200 microfinance companies waiting to lend to those microfinance companies, then suddenly the same thing happens. Just as microfinance banks become a bit softer, or less regarding, when it comes to the credit quality of their own borrowers, some microfinance vehicles may have done the same thing with microfinance banks. So that's unfortunately a negative consequence of success, if you like.

Now to the opposite, you have some geographies where you have a huge need of resources. You have [few] microfinance operators because they're operating in difficult legal environments or political environments in some parts of Africa that do not get access to finance. So is there a need for finance, and should this finance be channeled where it's really needed? Absolutely. But, again, it doesn't put into question the need for microfinance.

[Another issue is] what has been termed the "commercialization of microfinance." When we started -- and I started more than 12 years ago -- we looked at microfinance programs on microfinance operations -- first of all it was called "micro-credit" not microfinance. And it was usually credit-only institutions ... that were lending to small entrepreneurs. But the idea's always been -- at least for us and a few players in the industry -- to actually, progressively specialize, grow, professionalize those credit-only companies into progressively full-fledged banks. Because what poor people really need is not so much credit, in fact, it's savings.

The first financial need that a poor person will tell you is actually be able to put to work the money that he has saved in some safe place, convenient location and getting him some return on his money instead of putting it under the mattress. That's the first need. And you only get that if you have a regulated commercial bank. So to me the term "commercialization" is very positive. The fact that you have specialized, very professional, commercial microfinance banks able to offer saving services, different kinds of credit services, but also now wiring transfers, and even some insurance, is a very positive trend that I hope will not be put into question right now. But obviously, as always, when you have fast growth and some saturation, and high competition and excitement, you have some players that believe that they can take advantage of an attractive environment and business development, and then sometimes essentially spoil the market for everybody. So I really think that that's what happened.

Knowledge@Wharton: Thank you, and thanks very much for joining us today.

De Schrevel: My pleasure. Thank you very much.

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