WSAS[sm] Wall's Street Advisor Services, LLC

From: Peter Wall, CEO WSAS
Re: Suggestions for Fixing the Microfinance Industry's Information Infrastructure

Summary
Microfinance as a global financial industry does not have today, and seems unlikely to have in the next decade, the critical mass of demand (as indicated by assets under management and fund flows) needed to make important information infrastructure services commercially sustainable, and donor subsidies are unreliable over the long term. The information service providers need new owners, ones with long-term commitment to fostering financial inclusion infrastructure and "deep pockets".

The Current Business Circumstances and Outlook
I recently read the Center for Financial Inclusion at Accion's excellent report, "The Microfinance Industry Needs an Infrastructure Fix: Summary of Findings and Recommendations", and would like to offer some alternative suggestions on how to 'fix' the operations of the infrastructure. The problems noted in the report are long-standing, and I believe new approaches are called for to finally resolve them.

First, as a former executive director at MIX (2005-2009) and an occasional user of its public platform, I concur with the report's comments on MIX's flaws (its very un-intuitive public websites, lagged MFI reporting), and the donor-funded free public/fee-based services conundrum it faces.

These are not new problems for MIX - in fact, apart from fixing its websites' functionality, I believe they are endemic. Much like securities, the value of financial information services to users is not "bought", it is "sold". MFI managements will need to be constantly chased by MIX to participate, and to be shown rewards for doing so (public global praise, investment flows), while researchers need to be convinced that MIX's scope of coverage, ease of use, and overall quality are value-added attributes worth paying for, for time-saving if nothing else. I agree with the report's conclusions that, for the foreseeable future at least, subscriber fees are unlikely to cover all MIX's costs and that MIX will require some substantial level of subsidy to continue to provide world-class services.

Similarly, the problems faced by Microfinance Transparency (MFT) during its short life and by the Microfinance Rating Agencies, in covering costs of global operations. are to be expected and are likely intractable, given the probable limited scale of commercial demand and the relatively short life-span of donor subsidies.

Information services about very niche markets take a long time to gain traction, and much depends on the growth of business interest in the niche market itself. Expanding interest in Impact Investing and its microfinance sub-category may represent a commercial tide the information infrastructure could ride - but profitability is probably quite far off.

In my own experience in developing an information service covering developing country stock markets for IFC, long-term financial commitment to the project's objective was crucial to its success. It took 18 years (and a lot of institutional vision and funding from IFC) to go from an annual research project to a world-class commercial information and benchmarking service used by international money managers.

I'll note that the emerging stock markets niche grew into a 'hot' topic over this period (assets under management in funds growing from about $500 million to $500 billion) and thus commercial service had a good tail-wind of demand. Meanwhile IFC could subsidize the stock market project because it brought collateral benefits - the project's benchmarks, the IFC Indexes, brought IFC much useful press attention. It also helped IFC establish a degree of international investor recognition that facilitated investment fund underwriting and placements that generated substantial fee income.

But, I'll also note that even at the time Standard & Poors bought it from IFC in 2000, the project's annual revenue had been only break-even on a fully-loaded overhead budget basis for a few prior years, when its client-base (international money managers) had over $200 billion under management, and average annual funds' inflows were $11 billion. Only with the sale to S&P did IFC recoup its 18 years of spending on the project, making a single-digit compound annual return considering both net sale proceeds and revenues from the project's 12 years of commercial operations.

All of which is to say, there is a long-term possibility, but not a surety, that microfinance information service providers can be profitable investments, and while the information infrastructure can contribute to the growth of the niche, it's the growth of the niche that will drive revenue to the information providers (assuming the information providers are seen by potential clients as providing value). With the 110 Microfinance Funds' assets under management today of just over $10 billion, the critical assets' mass and client diversity needed to provide information service providers with a good revenue base seems far off.

Suggestions for Fixing the Microfinance Information Infrastructure - New Owners
The microfinance industry's information infrastructure is asked to serve a very diverse set of clients, who naturally have very diverse sets of needs and varying capabilities or interest to pay for services. I believe the industry's needs are best served by the consolidation of the current infrastructure providers into the hands of institutions which have mandates to provide microfinance/financial inclusion infrastructure services, have deep pockets, and have long operational timeframes. Investment costs might be recouped from subscriber fees, but mostly when third-party commercial demand makes spin-outs or divestments feasible.

I would like to suggest that the functions of the MIX and MFT be incorporated into the World Bank proper, as part of its Financial Inclusion/BOP initiatives, or into another global development finance organization, such as the new Asian Infrastructure Investment Bank. {For simplicity's sake, I'll use the World Bank as a reference hereafter}.

The integration of MIX & MFT services/operations into the World Bank would have the following advantages for the principal parties concerned:

- These information services would have a clear owner who can provide prestige and a dedicated source of long-term funding, which would not be considerable amounts in a World Bank scale of things;
- They complement existing World Bank research and operational programs;
- They would benefit from having the prestige and extensive overseas office network of the World Bank associated with them, making partnering efforts far easier to arrange and sustain;
- The World Bank would gain the full benefit of ownership, in terms of publicity/goodwill generation, tangible demonstration of implementation of it missions, and reinforcement of its claim to be a global knowledge leader.

Considering the Rating Agencies, given the extensive investments of multilateral and bilateral development finance agencies in the microfinance investment industry and their respective missions, they should undertake the consolidation of the Raters into one global Microfinance Rater through buy-ups/buy-outs of the existing Raters, and rationalize their operations with a view to an eventual divestment. IFC and other DFIs already have made investments in national credit bureaus and rating agencies, and a consortium consolidating international Microfinance Rating Services into one apex global provider makes some business sense, from cost consolidation and future strategic sale aspects.

Closing Remarks

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Continuing its valuable work on the subject, The Center for Financial Inclusion at Accion could convene a meeting of leading organizations in microfinance to consider this proposal and if adopted, to take its recommendations to the relevant parties.

I have no illusions that the "new owners" concept will be an easy sell to prospective new owners, but I think they can be brought to see the value in the proposal.