



Gray Ghost Microfinance Fund

Ten Year Review

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Executive Summary and Conclusion

Highlights of Gray Ghost Microfinance Fund

- *Committed \$97mm through 23 MIVs between 2003 – 2008; created or co-founded eight and provided the critical capital to enable three more to launch.*
- *Funded vehicles raised \$760mm in total during this period – more than one quarter of average MIV AUM during the period.*
- *Funded vehicles raised \$480mm in capital from private sources.*
- *During its investment period, assessed over half of all MIVs and invested in over one quarter of the 80 MIVs in existence as of 2008.*
- *During 2006-2008, accounted for 10-20% of all reported PE transactions, and a much higher proportion of secondary markets purchases and sales.*
- *Operationalized the integration of a social value model into its investment process in 2004.*
- *On track to fully recover capital and register an annualized return of just under 5%. Over roughly the same period, the JPMorgan LIFI index shows a 23% annual increase, the Morgan Stanley EM Bank index shows a 15% annual increase, and the Morgan Stanley World Financials index is flat (0% annual increase).*
- *Gray Ghost promoted roughly half of the local management teams that had emerged as of 2011.*

The history of the Gray Ghost Microfinance Fund (Gray Ghost or GGMF) and now Gray Ghost Ventures (GGV) has been one of creation and calculated risk. Gray Ghost launched in 2003 on the leading edge of impact investment, a role GGV continues today through the GGV-Doen Fund, Village Capital, the Indian School Finance Company, and many other ventures.

Gray Ghost, as the first and largest of Bob Pattillo’s impact investment portfolios, provides experience and models which have helped shape Bob’s subsequent efforts and – as intended – those of other social investors that have followed: how to assess the need, focus resources, engage expertise and collaborators, learn from failures, and exit with grace.

Early on, Gray Ghost set five goals:

- Mobilizing social investors
- Generating liquidity
- Creating a financial track record
- Balancing social and financial returns
- Promoting local management capability

In pursuit of these goals Gray Ghost undertook an aggressive investment venture, closing a total of 23 investments in 2003 – 2008, and 15 in 2004 -2006 alone, a high level of productivity for a small staff. The use of the term “venture” is deliberate, as Gray Ghost’s role in creating this portfolio has gone well beyond choosing and monitoring investments: eight of the investments, or more than a third, were investments that Gray Ghost initiated alone or working with a small founding group.¹ In several other investments, Gray Ghost was an anchor investor, or filled a critical gap in the capital structure without which the initiative would have failed to proceed.² Thus Gray Ghost has played an essential role in the launch of 11 vehicles that together have redrawn the microfinance landscape in ways that helped achieve Gray Ghost’s primary goal of bringing private investors into microfinance in a substantial and influential way. This “catalytic” or “co-creation” role deliberately went beyond what more conventional investors might attempt, playing the role of path breaker, which continues to distinguish GGV from other investors to this day.

The GGMF portfolio is over half exited, and its history is sufficiently complete that the broad outlines of its accomplishments and performance are clear:

- Gray Ghost’s industry-wide influence was substantial, providing critical support to fledgling and established players alike: Deutsche Bank Global Social Investment Funds, Calvert Foundation, Developing World Markets, Blue Orchard, MicroVest, Caspian, and others.
- Gray Ghost succeeded in playing a catalytic role in the creation of a variety of different vehicles suited to various investor financial return requirements, risk appetites and social objectives and has illustrated the full range of risks, financial returns and social outputs available to investors in microfinance.
- Interpreting financial comparables in microfinance is not a straightforward exercise. What imperfect comps can be found suggest that Gray Ghost has achieved solid financial performance, especially in light of global financial markets during this period. The realized return to date on the Gray Ghost portfolio is 4.9% and this is expected to be maintained as the remaining assets are liquidated. This compares with a 23% annual increase in the LIFI index, a 15% annual increase in the Morgan Stanley EM Bank index, and flat (0% annual increase) performance for the Morgan Stanley World Financials index over the same period.
- Gray Ghost has leveraged its capital eight times, in many cases taking subordinated positions, or anchoring new investment vehicles which have since become industry models;
- Perhaps more significant, given Gray Ghost’s goals, its \$97 million in commitments was associated with nearly \$500 million in commitments from other private investors, representing well over half the total capitalization of the vehicles in which Gray Ghost invested.
- Gray Ghost was responsible for a significant proportion of secondary market activity at both the MIV and MFI levels, promoting liquidity and generating price data when the absence of both was impeding further engagement with broader capital markets;
- Gray Ghost has been on Boards and Investment Committees of nearly all its investments (19 of 23), influencing the strategies and performance of a significant swath of the total industry;

¹ STLF, Bellwether, Catalyst, Antares, LocFund, Prospero, IFIF and GMEF.

² MicroVest, BOMSI, GCMC.

- MIVs in the Gray Ghost portfolio had total AUM of \$900 million, representing a substantial proportion during a period when total MIV AUM grew from \$1.2 to \$4.9 billion.³

While these contributions to the microfinance sector are significant, Gray Ghost’s experience is also of broader relevance to the impact investment community more generally. Specifically, with microfinance often cited as the poster child and model for other emerging impact investment sectors, a number of lessons and observations are of relevance as efforts to engage investors more systematically in impact investing are worth highlighting:

- *As impact sectors engage new investors, careful and candid investor education will be crucial to building stable and reliable relationships, even if this process may slow the rate at which capital is engaged.*
- *There are far too few local equity managers with experience and a solid track record capable of building pipelines of investible MFIs and creating social and financial value.*
- *To the extent that the impact investing industry is successful in raising capital in excess of what existing managers can intermedicate, results are likely to disappoint and discourage continued capital flows to the sector. Developing fund managers at the local level can noticeably enhance prospects.*
- *The sector is highly dependent on “lead investors” like Gray Ghost who devote the time and incur the expense to develop relationships of trust and support with MIV and MFI managers. Gray Ghost invested as much as five years to launch some management teams, and has remained engaged for eight years and counting in others. While such lead investors play a crucial role, it is not one that can be justified on purely economic grounds as they are unable to capture much of the value they create.*

Overall, Gray Ghost has met its goals and played a significant contributing role in shaping today’s microfinance industry. But while the microfinance industry and Gray Ghost can take great satisfaction in all that has been accomplished in the past ten years, there are important qualifications to that success that suggest important shifts in emphasis going forward. Perhaps most important is the crucial role of investor education. As impact sectors engage new investors, careful and candid investor education will be crucial to building stable and reliable relationships, even if this process slows the rate at which capital is engaged. At the same time, committed and well prepared investors can bring more than money, enhancing the value proposition for investee partners. Among the questions and issues investors can consider before beginning an impact investment program are:

- *Are we fully aware of the particular reputational and political risks that may be associated with impact investing?*
- *Have we thought through our expectations and rationale for profitability? Are we prepared to persuasively advocate for high profits? Can we distinguish low profits associated with mission from inefficient operations that unnecessarily burden clients?*

³ Source: MicroRate 2012 MIV Survey: total MIV AUM 2004 -2008. MIV private capital excludes MIGROF.

- *Are our expectations with respect to mission well defined and aligned or at cross purposes with management and coinvestors?*
- *Are we prepared to commit the time and money required for active and engaged participation in governance, and take the sometimes difficult decisions that may be required with respect to leadership development and succession, exits and other often contentious issues?*
- *How do our impact assets fit with the rest of our portfolio? What are our financial expectations or requirements?*

Answering these questions and engaging investors with clear expectations is an important task for GGV, Grassroots and the entire impact investing community going forward.

Ultimately, Gray Ghost's goal was to make impact investing a more accessible component of everyone's financial and spiritual lives. While this is far from being achieved, the path to get there has been greatly illuminated by Gray Ghost's efforts and it counts many more collaborators working towards that common purpose than was the case when it was first conceived.

Introduction

The Gray Ghost Microfinance Fund LLC was created November 2003 and will reach the ten year mark this year. Reaching this milestone is a natural point at which to review Gray Ghost, its successes and failures, and extract what lessons can be learned from what was always envisioned most importantly as a demonstration project and a catalyst.

Gray Ghost was conceived by Bob Pattillo and his colleagues David Weitnauer and Genia Topple during 2003. Bob was a successful commercial real estate developer who was introduced to microfinance in the mid-1990s and began providing grants to sector initiatives in 1998 through his family foundation. Bob became increasingly impressed with microfinance and in particular its potential as an investment as well as a philanthropic engagement and an opportunity to combine his commercial talents and financial resources with his strong faith and values. The more Bob learned, the more he believed that microfinance offered an almost perfect model for realizing the impulse to constructively engage which could then proliferate into other social investment sectors. In the course of 2003 he took the extraordinary decision to devote the bulk of his financial resources and all his time to developing microfinance as a nexus between those with abundant resources and those in need.

Over the six years during which Gray Ghost was actively investing it reviewed nearly 50 opportunities in some detail and approved 24 of which 23 ultimately closed.⁴ Total commitments reached just short of \$100 million.⁵

⁴ A \$3 million investment in BOLD failed to close due to difficulties in arranging clearing accounts. The figures include a \$500,000 commitment to DB MDF that was never activated and do not include a warehoused investment in Africap.

⁵ This total includes total commitments of Antares and STLF/GROWTH which were essentially 100% owned by Gray Ghost.

Gray Ghost Microfinance Fund Commitments

USD Million		
Approved	GG Commitment	Total Capital Commitments
2003		
1 Deutsche Bank Microcredit Development Fund	0.50	4.00
2 Accion Investments in Microfinance (AIM)	1.00	20.00
2004		
3 MicroVest	4.20	47.80
4 CASA / The Positive Fund	0.30	NA
5 Blue Orchard Microfinance Securities I	2.50	82.50
6 Emergency Liquidity Facility	1.50	6.26
7 Short Term Liquidity Fund /GROWTH	15.40	15.40
8 Calvert Foundation	2.00	17.00
2005		
9 Bellwether Microfinance Fund	7.80	20.00
10 Global Commercial Microfinance Consortium	4.00	80.00
11 Catalyst Microfinance Investors	15.00	125.00
12 Balkan Financial Sector Equity Fund	4.60	61.79
2006		
13 Antares	6.90	6.90
14 AIM Secondary	3.90	<i>See above</i>
15 Solidus	2.00	17.40
16 Latin American Challenge Investment Fund	2.00	15.00
17 Centurion	2.00	4.00
2007		
18 LocFund	2.00	32.00
19 BANEX	3.90	N.A.
2008		
20 Prospero Microfinance Fund	0.50	23.00
21 India Financial Inclusion Fund	5.00	89.00
22 Global Microfinance Equity Fund	10.00	117.00
23 Microfinance Growth Fund	0.25	118.00
Total Committed	97.25	902.05

When the concept of Gray Ghost began to form, Bob had been active in providing grant support to microfinance for 5-6 years, supporting the MiX Market (www.mixmarket.org) and Sanabel (the regional association of MENA MFIs) among others, and was beginning to explore the possibility of microfinance as an investment, rather than strictly a philanthropic opportunity. In addition, two investments had already been committed before the formal launch of Gray Ghost: in the Deutsche Bank Microcredit Development Fund (DBMDF) and in Accion Investments in Microfinance (AIM).

In late 2003 Paul DiLeo was engaged to design a strategy for Gray Ghost and stayed on to implement the strategy and manage the Fund. Paul had a background in international finance with the US Treasury and Federal Reserve, and had helped launch a \$340 million US government “Enterprise Fund” for Russia in

the early 1990s. From there he had moved to reorganize and expand Shorebank's international management and advisory services, in the course of which he became increasingly engaged with microfinance. Other key members of the Gray Ghost investment team over the decade included Frank Brown, Catherine Burns and Anna Kanze. Paul and his colleagues at Grassroots Capital Management continue to manage Gray Ghost today.

As of December 31, 2012 the fund had \$34 million in 12 investments outstanding (at cost) and \$10 million of undrawn commitments in five of these investments. Cumulatively, Gray Ghost has committed \$97 million in 23 investments over the ten years. Ten investments have been liquidated to date and one written off. It is intended that the remaining portfolio will be managed over its scheduled life although Gray Ghost may consider early exit opportunities.

Part 1: Concept and Objectives

Gray Ghost Concept

From the outset, several features distinguished Gray Ghost within the first wave of microfinance funds⁶. First, Gray Ghost was capitalized by a single, extraordinary investor: Bob Pattillo. Aside from providing the vision, this unusual capitalization had a number of important practical consequences. As other managers can well appreciate, it meant that the manager of Gray Ghost did not have to devote time and resources to capital raising. It also meant that decision-making could be quite rapid and un-bureaucratic. Gray Ghost could move quickly and adapt its policies to the demands of a particular situation or broader shifts in the industry. Of course, there are downsides to a single dominant investor as well, in particular, the absence of the “ballast” and perspective that a diverse group of investors can provide and the risk of a flexible and agile approach becoming erratic and inconstant.

Second, an integral part of Bob’s vision was that social investment could be a transformative experience for the investor, and not simply a way of making some money while feeling morally superior or making more interesting small talk at cocktail parties:

“GG’s focus on the social investor reflects Bob Pattillo’s conviction that participants on both sides of the social investment transaction can benefit from the relationship. GG will implement its activities to maximize that benefit to both sides. Social investors can add unique skills, resources and perspective to the mix that is supporting the growth and evolution of MF globally, enhancing its impact and prospects for greater scale. But at the same time, social investors can benefit from an enhanced engagement with other communities, a direct involvement in the responsible stewardship of their material abundance, and creation of a lasting legacy.

“Finance is a means to a more fulfilling and rewarding life for ourselves, our families, and our communities. For GG, the personal commitment and relationship implicit in a broad conception of social investment is central, ensuring that MF will remain merely the means to an end, and that the financial accomplishments and management achievements of MF will not obscure or replace the ultimate goal of enriching lives, both financially and spiritually, on both sides of the investment transaction.” (GG Business Plan, April 2004, p3)

Third, an early decision was that Gray Ghost would be a fund of funds, with its target investments other funds that invested directly in MFIs. This decision reflected Gray Ghost’s core objective to engage other private investors. Since few private investors—individuals or institutions – could be expected to assemble and manage portfolios of direct investments in MFIs, it was decided to promote the proliferation of microfinance investment vehicles (MIVs) suitable for private investors. Gray Ghost would engage the interest of private investors by deploying its investment capital aggressively and creatively to both help create suitable vehicles and to build a track record of performance to enable private investors to determine which vehicles could best match their requirements. An additional consideration was Paul’s skepticism that much value could be added by investors lacking specialized expertise and more often than not based thousands of miles from the MFIs. Gray Ghost was sensitive to the fact that money

⁶ Strictly speaking, ProFund, launched in 1995 and wound up in 2005, constituted the first wave all by itself.

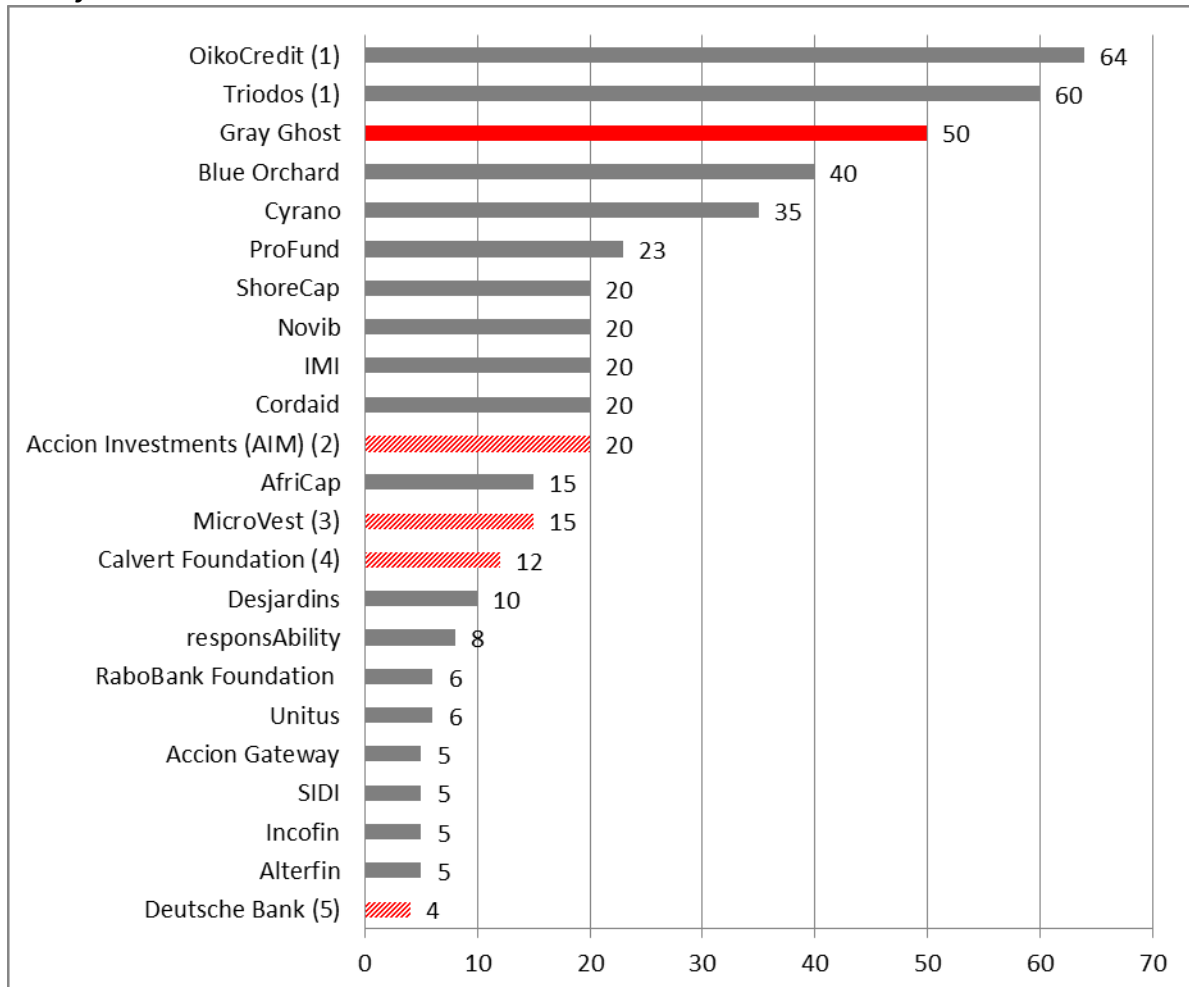
would not be enough to enable the sector to rapidly increase its positive impact on lives and that building an infrastructure of specialized investment managers close to the ground would be necessary as well.

With these fundamental strategic decisions taken and an initial capital commitment from Bob Pattillo of \$50 million, Gray Ghost was positioned to play a unique role during the 2004-2008 period when it was most actively building its portfolio. It reviewed essentially all the MIV opportunities during that period, and invested more equity in more vehicles than any other private investor. Gray Ghost created or was a founding or anchor investor in many of the funds and management teams that have shaped the industry as it is today, complementing, from a private perspective, the role of the DFIs.

The Microfinance Landscape in 2003

At the time of its launch, \$50 million in committed capital (subsequently increased to \$75 million) made Gray Ghost among the largest, if not the largest purely microfinance fund in existence. While Oikocredit and Triodos were well established as “impact managers”, as of late 2003 the other European managers that would come to be leaders of the sector like Blue Orchard and responsAbility were at a nascent stage, and others among today’s leaders, like Symbiotics and DWM, were just launching.

Microfinance Investment Funds in mid-2004



Source: Private estimates.

(1) Included non-microfinance investments

(2) Of which GGMF invested \$1 million

(3) Of which GGMF committed \$3.6 million

(4) Microfinance investments only; GGMF provided \$2 million guarantee.

(5) Of which GGMF invested \$0.5 million

In addition to sheer size, Gray Ghost was a prolific investor, actively engaged with many of the funds being launched during the 2004-2008 period when microfinance was most actively expanding the pool of investors from which it drew capital. In the aggregate, Gray Ghost’s 23 investments means that it invested in more than quarter of the 80 MIVs that Symbiotics found had been launched in total as of end-2008.

	2004	2005	2006	2007	2008
New funds launched⁷	5	12	12	17	10
Gray Ghost Investments⁸	6	4	3	1	4
GGMF Declined Investments	7	5	6	4	0

Gray Ghost’s size and agility carried risks, to which Bob was sensitive. In addition to engaging an experienced manager – Paul had been active in the sector since the late 1990s and had completed equity investments in BASIX (India) and BRAC Bank (Bangladesh) before launching Gary Ghost —Bob ensured that Gray Ghost’s objectives, strategies and tactics were vetted and refined through an extensive process of consultation, gathering input and guidance from numerous industry participants and observers. One source of input, particularly in 2004 and 2005, was the Microfinance Advisory Committee of Bob’s family foundation, consisting of Beth Rhyne, Asad Mahmood, Heather Clark, Mohammed Khaled and Roy Jacobowitz. A second outreach effort was specifically focused on the Gray Ghost business plan in early 2004, when Paul circulated several drafts to over 50 participants in the microfinance and social investment communities for comment.

Gray Ghost Objectives

Such input and extensive internal discussions over its first 18 months generated four primary goals for Gray Ghost:

1. Mobilizing social investors: A meeting of the Advisors’ Committee expressed the priority clearly: *“The Gray Ghost Microfinance Fund for Social Investment was created in 2003 with the goal of accelerating and deepening the engagement of private social investors in the microfinance industry, bringing their energy, perspective and capital to help move MF to its next stage of development. For MF to remain viable and grow, the profile of MFI funding must look substantially different five years from now than it does today. GG believes that private social investors (SI) must constitute a key element of this new funding mix. GG has tentatively set twin goals of generating a minimum of \$200 million in SI co-investment in MF and facilitating \$200 million in secondary market transactions by 2008.”*

2. Generating liquidity: As the passage above indicates, Gray Ghost believed that a key obstacle to greater private investor engagement was the lack of liquidity in microfinance assets. Gray Ghost

⁷ Symbiotics 2012 MIV Survey.

⁸ Excludes secondary market transactions.

aggressively sought out opportunities to promote liquidity in microfinance assets, beginning in its first few months with work on the “Roll Up Facility” which eventually took the form of the Antares Equity Participation Fund.

Advisory Committee Guidance: May 2004 / September 2005

Strategic Guidance

- Define “social investor” to include both institutions and individuals. Individuals can play an important role.
- There’s a knowledge gap: we don’t yet know what Social investors (SI) need to get involved.
- Jump in and don’t be afraid to fail.
- Bring SI along to invest. Be in a position to invest profitably.
- The issue of who should own MF is important to ponder. Developing local markets is crucial.
- Establish strong commercial principles while maintaining social focus.
- Are the current fund managers out there in the best position to make investment decisions or is a different kind of fund manager better suited, esp with early stage MFIs?
- Would local funds have a cost structure that lends itself to more efficient fund placement? We believe that the local fund model adds something that isn’t provided currently.
- Without liquidity, you blur the line between investment and charity. How can GG promote a secondary market?
- Investors looking for exit need data points.
- Put more effort into developing vehicles that work closer to the ground.
- Consider fund of funds concept to service the very large investors.
- Think about the challenge of promoting “our kind” of microfinance. The portfolio should represent our vision of mf.

Risks

- Set some boundaries so that you don’t end up traipsing off in too many directions.
- When you bring other investors in, they’re not necessarily going to share your opinions about the way to invest or the nature of the right outcomes. You’ll be introducing diversity and one result will be a lessening of your voice.
- The time horizon for capturing a return with these emerging MFIs is way outside commercial parameters.
- If commercial players come in only for profit, it is incumbent on those who are in it for social good to assert that distinctive character and find ways to preserve it.
- What happens in India will influence the industry.
- Troubles will exist. There may be a MF bubble, scandals, sub-prime lending. We should expect the same kind of banking abuses in MF that we’ve seen in commercial sector in the US.
- We should be more selective with our affiliations. Just like any industry, there will be good actors and bad actors. We need to find ways to make the distinction and to support the good.

Gray Ghost was also an early and active purchaser of assets including, in addition to nine purchases through Antares, the purchase of significant interests in LACIF from FOMIN and NorFund (2006), AIM from FOMIN (2006), and BANEX from FOMIN and DID (2007). Gray Ghost’s judgment of the importance of exits to the development of capital market access for microfinance received recent reconfirmation in JP Morgan’s Survey of Impact Investors (January 2013), which found that “difficulty exiting investments” was cited as the third most critical challenge facing the impact investing industry.

3. Creating a financial track record: Financial returns were not the primary motivation for Bob’s initial commitment to microfinance and indeed, documents from the early years make clear that aggressively

experimenting with unproven models—and consequently assuming a high risk of failure as well as uncertainty over the ultimate financial performance of even those initiatives that did “succeed”—were key features of the Gray Ghost investment program. The investment policy of April 2004 included as its fifth and final criterion that the portfolio was to preserve capital and earn moderate return, before expenses. Nevertheless, Gray Ghost was aware that while expectations for the portfolio could be modest, individual investments should demonstrate the full range of possible outcomes, including attractive financial returns, with or without high social content. This was reaffirmed in the revised Business Plan of April 2005, which stated that: *Overall, GG will seek preservation of its capital, although it is prepared to realize some overall losses when operating expenses, particularly those associated with nurturing the engagement of social investors as distinct from investments per se, are factored in. In its individual investments GG expects to realize a range of returns as a means of demonstrating the options available to SI: commercial and near commercial returns to low financial return high social value and public good returns...*

4. Balancing social and financial returns: The same version of the Business Plan also gave a prominent place to the need to preserve the double bottom line character of microfinance:

Private social investors can confirm the double bottom line character of MFIs once and for all. While the tension between commercial and development goals will not disappear at the operational level, social investors can be expected to carefully weigh the balance of social and financial value created and ensure that the character of MF maintains a core commitment to social innovation, outreach and impact. The financial implications of this balancing will be explicitly recognized and endorsed.

From this starting point, Gray Ghost’s view of how social and financial returns can interact evolved and developed. From the investor’s perspective, Gray Ghost’s performance early on demonstrated the compatibility of social and financial returns in many cases, and raised the possibility that an enterprise can provide both high impact and high return, promoting a model that by treating customers and management with compassion and respect, an investor could see social and financial objectives converge. Indeed, the possibility of such convergence was an important consideration in the Bob’s decision to increase his capital commitment from \$50 million to \$75 million in 2005.

5. Promote locally managed funds: In pursuing these four core goals, Gray Ghost took full advantage of its flexibility and quickly came to elaborate on its approach in one important respect. It realized that the key bottleneck in the microfinance sector was not money, nor operational capacity on the ground, nor regulatory regimes, nor political risk, but sufficient and relevant expertise at the investment management level. VC type managers with the capacity, presence and persistence to build MFI management teams, balance sheets and systems over a period of years were scarce, to say the least, which accounted for the astounding concentrations of capital which annual surveys of capital flows into the sector documented year after year. Thus Gray Ghost concluded that local investment management capacity in the target regions posed the binding constraint both to increasing the flow of capital to where it was most needed in the MF space *and* access to investment opportunities for social investors. In promoting and selecting investments, therefore, Gray Ghost came quickly to favor and devote substantial time and resources to “local funds” and this effectively became a fifth goal.

GGMF's concept in moving investment functions to the local level was initially demonstrated in its engagement with The Positive Fund and extending through Caspian to Catalyst and BIM⁹. Its goal was to both increase the efficiency and value added in the investment process, and as a first step towards engaging local business communities in direct support for MFIs in their own countries. The commitment to the "local fund" strategy guided much of GGMF's efforts and investments. In late 2003, GGMF delineated its "local fund" concept as follows:

- Principle 1: Local focus, commitment, knowledge, networks are desirable as a general matter.
- Principle 2: Local base has cost advantages that have implications for what a fund can do.
- Principle 3: Sufficient "south based" skill exists that dominance by northerners is hard to justify any more.
- Principle 4: MF can benefit by *combining* "finance" discipline and skills with "practitioner" insights and sensitivities.
- Conclusion 1: Focus (though not exclusive) on south based, south managed funds.
- Conclusion 2: Finance skills should be paired with practitioner skills.

Gray Ghost Performance

Assessing the successes and failures of Gray Ghost is not a simple matter, because its primary goals were to build the industry in various ways, and there is no way to attribute causality to Gray Ghost or determine how the industry would have developed in its absence. And even after ten years, it is clearly too soon to evaluate the ultimate performance of a number of Gray Ghost's investments; several are still in or just barely out of their investment periods, or just beginning to reinvest initial proceeds. Nevertheless, evidence can be assembled that reflects on whether Gray Ghost effectively pursued its stated goals; the reader can form his and her own views of whether effective pursuit of those goals was beneficial or not.

Goal 1: Mobilizing Social Investors

Gray Ghost's target on the investor side has always been the "private investor". It set various targets over the years of how much incremental private investment it aimed to leverage with its capital. In some cases it rationalized joining an otherwise predominately official investor group of development finance institutions (DFIs), as in the case of AIM or ELF, to provide a "private perspective" and help influence the initiative in a way that would attract or support private investors in the future, or at least avoid reinforcing any suspicions that MIVs were not suitable for private investors.

While causality is impossible to determine in many cases, the gross numbers can provide some crude evidence of Gray Ghost's success in mobilizing private investors. Looking solely at the amount of capital committed by other investors in MIVs in which Gray Ghost invested, and not at the ultimate capitalization of the MFIs in which these MIVs invested, Gray Ghost achieved "leverage" of eight times. In other words, Gray Ghost invested \$97 million in MIVs with total capitalization of nearly \$900 million. A somewhat more relevant measure would be the amount of other (non-Gray Ghost) private capital

⁹ See Section 2 for details on these initiatives.

associated with Gray Ghost’s investment. While the leverage drops somewhat, it remains quite significant at five to one.

Nevertheless, private investors are more tentative than expected at this stage. In part this may reflect the failure of us as managers to clearly define the range of investment propositions. But whatever the cause, the itinerary of private investment in microfinance with its milestones, setbacks and false starts can be examined for useful lessons for the broader impact investment sector, for which microfinance is often held up as a model and lodestone.

In addition to promoting new vehicles, Gray Ghost aggressively sought out other means of introducing and engaging private investors to microfinance. Bringing investors to these new MIVs was always a challenge. Over time, complementary initiatives led by a dedicated Gray Ghost “Relationship Manager”, Sam Moss, grew up around the GGMF investment management function and portfolio. The indefatigable Sam focused on outreach and education through every avenue conceivable: conferences, networking with associations of social investors, and institution and infrastructure building, such as the creation of IAMFI (the International Association of Microfinance Investors) and the launch of a microfinance fund ratings initiative together with MicroRate and the Gates Foundation in 2006. For the most part, these non-investment initiatives will not be addressed directly in this paper, although they complemented and greatly magnified the impact of GGMF’s investment activities.

Goal 2: Generating Liquidity

Gray Ghost devoted substantial and sustained effort to promoting liquidity in microfinance assets, beginning in early 2004 with its efforts to create a “Rollup Liquidity Facility” to unlock holdings of the first generation of MFI promoters, which ultimately emerged as the Antares-Equity Participation Fund in 2006, and continuing through its own direct secondary market purchases from IDB / MIF and DID. While there is a bit of an “apples and oranges” issue, since some of Gray Ghost’s secondary purchases and sales were of MIVs and some of MFIs, some sense of the significance of Gray Ghost’s secondary market engagement can be gleaned by comparing its activity to the total market activity as estimated by the JPMorgan / CGAP valuation surveys. During the years when it was active in the secondary market – 2006 through 2009 – Gray Ghost’s secondary purchases and sales were equivalent to 10-20% of the total number of transactions tabulated by JPMorgan. Gray Ghost’s activity by dollar value was generally even more significant: in its peak years –2006-2007 – Gray Ghost secondaries exceeded the total dollar value of secondaries reported to JP Morgan. Gray Ghost’s relatively high level of activity deserves some credit for accelerating the emergence of a more liquid market, providing evidence of liquidity and price data that in turn was the key to dismantling one of the primary obstacles to greater private investor engagement.

Gray Ghost Secondary Market Activity

	2005	2006	2007	2008	2009
MF PE Transactions (#)	28	37	37	63	32
Value of Secondary Transactions, USD million	93	8	7	46	173
Gray Ghost Secondaries ¹⁰	0	7	5	7	2
Value of GG Secondaries		7.7	12.8	4.7	1.1

Source: JP Morgan, Global Microfinance Equity Survey, May 2012

Goal 3: Financial Track Record

Because of Gray Ghost’s multiple, interacting objectives and heterogeneous portfolio, interpreting financial comparables is not a straightforward exercise. For example, at the Gray Ghost level the appropriate benchmark might be a frontier market fund of funds of the 2004-2006 vintage investing in both debt and equity, with some adjustment for Gray Ghost’s social and industry building value; obviously no such benchmark exists.¹¹

Data as of end 2012, which combines realized proceeds with FMV of the outstanding portfolio, indicates that to date Gray Ghost has preserved capital on a gross basis, which is one appropriate comparison for other MIV investors.¹² Given that a significant proportion of Gray Ghost’s remaining investments are still in or have recently completed their investment periods and thus show low FMVs, we have also estimated IRRs for their maturities and for GGMF as a whole. These estimates show GGMF maintaining the performance to date of realized investments with an IRR just under 5%.

Thus Gray Ghost appears likely to substantially surpass its original financial objective of preserving capital before expenses.

Summary of GGMF Returns

IRR Estimates for GGMF Portfolio	Realized	Unrealized (31-Dec-2012)		Realized & Unrealized (FMV as of Dec2012)	Realized & Unrealized (Forecasted FMV at exit)
		To Date	Forecasts		
All Investments	4.9%	-1.2%	4.9%	1.1%	4.8%
Debt	6.8%	3.6%	4.4%	5.7%	5.8%
Equity	-0.1%	-2.5%	5.0%	-2.0%	4.4%

¹⁰ Each Gray Ghost purchase and sale counted once.

¹¹ For its first five years, Gray Ghost was structured as an investment company that also undertook extensive industry building initiatives not directly related to management of the portfolio. It is therefore not possible to definitively calculate a comparable Total Expense Ratio (TER) for the fund.

¹² A net IRR, providing for fee and expense leakage, would only be an appropriate comp for investments in other funds of funds, of which there were none of comparable vintage.

As noted above, however, the Gray Ghost investor, Bob Pattillo, adjusted financial expectations upwards coincident with an increase in capital committed to \$75 million in 2005 and the spin out of the management team in 2006, at which time a hurdle of 6% was agreed.

Gray Ghost Gross Portfolio (USD Million, as of December 2012)

Total Committed	97.3
Total Cost of Investments	79.8
Total Realized Proceeds	46.5
Total Unrealized FMV	50.0
Total Estimated Proceeds	96.5
Estimated Gross IRR	4.9%

See Gray Ghost Microfinance Returns table below for more detail

While noted above it is difficult to identify genuine comparables at the level of the Gray Ghost portfolio in the aggregate, some general context can provide a sense of what returns might have been available to investors sharing some but not all of Gray Ghost’s investment objectives. For example, JP Morgan has created a LIFI (Low Income Financial Institutions) index, launched in November 2003, and so exactly coincident with Gray Ghost.¹³ There are also available for the same period MSCI indices for World Financials and for Emerging Market Banks. While none of these represent companies with a stated social mission¹⁴, they do reflect various combinations of emerging market, low income clients, and financial institutions exposures, which were the other characteristics of the Gray Ghost portfolio.

CAGR of Gray Ghost and Indices

Gray Ghost (gross IRR)	LIFI (1)	MSCI World Financials (2)	MSCI EM Banks (2)	S&P 500 Index (3)	US Treasury 10 year	JPMorgan (4)
5%	26%	0%	15%	5%	4%	9%

(1) Performance from Sep 2003 –Apr 2012, Source: JP Morgan, Global Microfinance Equity Survey, May 2012

(2) Financials Standard (Price) in USD for 10 Yr Annualized Historical as of December 31, 2012

(3) S&P 500 Index Trailing 10 Yr Avg Total Return as of December 31, 2012

(4) Annualized Total 10 Yr return ending December 31, 2012

By these comparisons, Gray Ghost significantly underperformed relative to the LIFI index, while showing a more mixed performance with regards to other portfolio comps.

At the level of the individual investments, Gray Ghost’s objective was to demonstrate the range of combinations of financial and social return that could be achieved. The performance of the individual assets can be placed in context by comparing the performance of the Gray Ghost portfolio funds against

¹³ The index includes eleven financial institutions focused on low income clients and has some limited overlap with major microfinance markets (India, Mexico) although more than half (6) of the component companies and over 80% of the weighting are in countries (South Africa, Indonesia, UK) which are not significantly represented in the Gray Ghost or other microfinance portfolios.

¹⁴ There are possibly exceptions in LIFI, depending on subjective determinations of the social value of Compartamos, SKS and Equity Bank but these carry very low weights in the index.

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the performance of assets that it chose not to invest in. While there were often non-financial considerations that drove Gray Ghost’s choices, this comparison at least provides closer apples-to-apples comparisons than mainstream market benchmarks. A listing of investments that were declined by Gray Ghost by year is included in the investments section below. Unfortunately, reliable data on the performance of declined investments is generally not available. Anecdotal reports considered reliable suggest that for equity, comparable vintage MF funds are showing returns ranging from 8-17%.¹⁵ In general, it appears that the GGMF equity portfolio is likely to end with most returning within this range, although several will likely fall short.

Gray Ghost Microfinance Fund Returns

Amounts in USD Million	Type of Vehicle	GGMF Commitment Amount	Total Capital Commitments	Commitment Date	Disposal Date	Holding Period (Months)	Cost	Proceeds ⁽¹⁾	Realized Gains/ (Losses)	Multiple to Cost	Gross IRR ⁽²⁾	Exit Method	
REALIZED INVESTMENTS													
1	Acción Investment Management	Equity Fund	4.90	20.00	20-Jan-04	18-Apr-07	39	4.86	6.28	1.42	1.29	29.5%	Sale to Co-investor
2	Africap	Equity Fund	NA	NA	25-Jan-08	10-Jun-08	5	0.90	0.94	0.03	1.03	26.6%	Warehousing complete
3	Antares / Equity Participation Fund	Equity Fund	6.90	6.90	9-Dec-05	31-Jan-12	75	6.89	9.32	2.43	1.35	13.6%	Various
4	BICC	Holding Co	3.90	NA	29-May-09	31-Dec-10	19	3.88	-	(3.88)	-	-100.0%	Write-off
5	Blue Orchard Microfinance Securities	Debt Fund	2.50	82.50	16-Jul-04	31-Jul-11	86	2.50	3.30	0.80	1.32	5.2%	Fund Liquidated
6	Calvert	Debt Fund	2.00	17.00	1-Jan-05	1-Jan-08	37	-	0.08	0.08	NA	NA	Guarantee Expired
7	DB Global Commercial Microfinance Consortium	Debt Fund	4.00	80.00	29-Mar-06	4-Nov-10	56	4.00	4.30	0.30	1.08	7.0%	Fund Liquidated
8	Emergency Liquidity Fund LOC	Debt Fund	1.30	6.26	30-Jun-05	21-Apr-06	10	1.30	1.32	0.02	1.02	14.6%	Commitment Expired
9	LACIF	Debt Fund	2.00	15.00	28-Jun-06	24-Dec-08	30	1.98	2.23	0.25	1.13	5.2%	Fund Liquidated
10	MicroVest I Bridge Loan	Debt Fund	3.70	47.80	5-Mar-04	15-Feb-07	36	1.60	1.75	0.15	1.09	6.6%	Commitment Expired
11	MicroVest I LP units (3)	Debt Fund	0.50	See above	23-Feb-04	31-Oct-11	94	0.50	0.77	0.27	1.54	7.7%	Sale to new fund
12	Short-Term Liquidity Fund	Debt Fund	15.40	15.40	28-Jan-05	2-Feb-11	73	15.38	16.24	0.86	1.06	8.5%	Fund Liquidated
Sub-total Realized Investments			47.10	290.86				43.80	46.53	2.73	1.06	4.9%	
Amounts in USD Million	Type of Vehicle	GGMF Commitment Amount	Total Capital Commitments	Commitment Date	Est. Disposal Year	Est. Holding Period (Months)	Est. Investment Cost	Est. Proceeds ⁽¹⁾	Est. Gains/ (Losses)	Est. Multiple to Cost	Est. Gross IRR ⁽²⁾		
UNREALIZED INVESTMENTS (4)													
1	Bellwether Microfinance Fund (5)	Equity Fund	7.80	20.00	9-May-05	2017	144	7.78					
2	India Financial Inclusion Fund	Equity Fund	5.00	89.00	19-Feb-09	2017	96	4.55					
3	Catalyst Microfinance Investments	Equity Fund	15.00	125.00	1-Aug-05	2015	120	8.87					
4	Global Microfinance Equity Fund	Equity Fund	10.00	117.00	9-May-08	2018	120	4.55					
5	Balkans Fin'l Sector Equity Fund	Equity Fund	4.60	61.79	22-Nov-05	2017	144	4.23					
6	Prospero Microfinanzas Fund	Equity Fund	0.50	23.00	2-Jul-10	2018	96	0.39					
7	Centurion Capital	Debt Fund	2.00	4.00	7-Nov-05	2014	108	1.25					
8	Solidus	Debt Fund	2.00	17.40	25-May-06	2014	96	1.60					
9	LocFund	Debt Fund	2.00	32.00	31-Oct-06	2014	96	2.00					
10	Emergency Liquidity Facility	Debt Fund	0.20	See above	11-Aug-04	2014	120	0.20					
11	Credito Amigo (CASA/Positive Fund)	MFI	0.30	NA	22-Apr-04	2014	120	0.30					
12	Microfinance Growth Fund	Debt Fund	0.25	118.00	22-Mar-10	2014	48	0.25					
Sub-total Unrealized Investments			49.65	607.19			35.97	49.99	14.02	1.39	4.9%		
TOTAL PORTFOLIO			96.75	898.05			79.77	96.52	16.75	1.21	4.9%		

ESTIMATED INDIVIDUAL PROCEEDS AND EXIT TARGETS FOR UNREALIZED ASSETS ARE UNDISCLOSED

(1) Includes Interest, Fees & Dividends

(2) Before fees and expenses at GGMF level

(3) Roughly half of Microvest I (MVI) assets were sold to Microvest Plus (MV+).

Of the remainder, 25% have been distributed to investors leaving approximately \$84,000 of Gray Ghost’s capital held in an illiquid investment in a Trust.

Timing for disposition is estimated over the next 18-24 months.

(4) Results for Unrealized Investments are based on expected cash flows, including additional capital called for fees and expenses, as of projected dates of exit (which vary by individual investment)

(5) Bellwether Microfinance Fund includes investment in Caspian Impact Investments (CII)

The table above does not include a \$500,000 revolving credit line committed to DB MDF in 2005 which was never activated.

For debt funds, there is ample return information available on the publically distributed funds, for example the respA and Dexia funds, which generally have registered returns in the low single digits. But these are not directly comparable, both because they offer liquidity, which the Gray Ghost investments

¹⁵ ProFund, of an earlier (1995) vintage returned 4-6%.

generally did not, and because in many cases the Gray Ghost investment was leveraged, and so premia reflecting subordination would have to be estimated. While the Gray Ghost senior debt returns have been satisfactory in the context of rates available on more conventional alternatives, it is not clear that these returns would generally be perceived as attractive once emerging market risks and subordination are factored in.

Overall, Gray Ghost cannot yet claim to have built a compelling case for investment in microfinance purely or largely motivated by financial considerations, although a final judgment awaits the liquidation of Gray Ghost’s remaining investments, particularly the equity funds. Even if preliminary, however, Gray Ghost has generated a data set providing investors with actuals and FMV estimates that enable a more systematic determination of what financial return may be expected from such investments, and how important a factor expected social value creation must be in the investment decision.

In assessing the Gray Ghost results it is important to bear in mind what it illustrates. As a fund of funds, the Gray Ghost experience is essentially a sample of the results available to microfinance investors of this vintage. One can argue that the sample is not representative; that, for example, Gray Ghost placed a greater or lesser emphasis on financial or social return than other investors might have done. With the benefit of hindsight, it is easy to construct alternative portfolios that would more successfully achieve one or the other of these objectives. For example, a fairer comparison might drop the more innovative and presumably high risk investments from the Gray Ghost portfolio, and create a Gray Ghost portfolio that would more closely mirror the motivations of a “typical” private investor. Surprisingly though – or maybe not – some of Gray Ghost’s better performing investments from a financial standpoint, like STLF and Antares, were among the more innovative, while others that seemed lower risk and were driven by more of a financial motivation, like Solidus and BFSF, were disappointing. This would seem to strengthen the conclusion that Gray Ghost’s overall results from a highly diversified portfolio are indeed representative of double bottom line microfinance assets.

The breadth of Gray Ghost’s investments, and the participation of nearly every other significant microfinance investor of the period in its portfolio funds and companies suggests that Gray Ghost’s results are quite robust: while it can be argued that the environment facing microfinance investors today is different for better and worse than that facing investors in 2004-2008, Gray Ghost’s results for that period are representative of that vintage and most likely current vintages as well. In that respect, Gray Ghost achieved its demonstration goal and the simplest interpretation of its performance is that double bottom line investors should expect modestly more than a return of principal from a diversified portfolio of microfinance assets. Whether this outcome over or under performs “the market” will depend on which comparables are selected, which is to say that there is not yet a clear cut case for or against microfinance purely on financial grounds.

Goal 4: Balancing Social and Financial Performance

Along with many other managers and investors, Gray Ghost struggled with how to analyze and balance the fundamental social objectives that gave microfinance its essential character with the financial requirements of the new investors that the industry aimed to engage. Gray Ghost’s approach, as a fund

of funds, was to develop a range of options that would enable investors to locate themselves most comfortably along the social –financial spectrum.

In 2004 in an effort to standardize how it incorporated social performance into its evaluation of prospective investments, Gray Ghost developed a simple model based on a set of indicators on MFI and MIV performance. Gray Ghost examined four broad dimensions of social value: innovation, impact, outreach, and funding, with the aim of using 3 to 4 “relatively available, relatively measurable, and relatively consistently defined” indicators to score each dimension.¹⁶ The model weighted each dimension equally and (arbitrarily) valued a perfect score at 600 b.p. Thus, in Gray Ghost’s internal assessment, an investment with an expected financial return of 12% with no social value was equivalent to an investment with a financial return of 6% and a perfect score for social value, “worth” 600 b.p.

The results of this analysis tended to be somewhat erratic, and bunched around 200-300 b.p., making the model less useful for differentiating high social value and lower social value investments. The four dimensions used were also not relevant to some idiosyncratic initiatives, like ELF or Antares, which addressed specific industry features but didn’t fit comfortably within a social value context as generally understood. Nevertheless, Gray Ghost used versions of this approach internally to help guide its investment deliberations during 2004-2007 and it did provide a structured, systematic approach to considering social value alongside financial value in the investment process.¹⁷

While Gray Ghost made some efforts to publicize and disseminate its approach, these were not especially vigorous. In retrospect, this was a mistake. While obviously flawed and arbitrary, the Gray Ghost approach did explicitly recognize that financial and social characteristics of each investment needed to be carefully and separately assessed. Consistent with the financial results summarized in the previous section, it is not yet clear that all or most microfinance investments are likely to be attractive on purely financial grounds.

In failing to more effectively promote its approach, and dropping it altogether in 2008, Gray Ghost collaborated in a general trend in microfinance as it more aggressively courted commercial and particularly institutional capital to downplay social-financial tradeoffs. While this approach did arguably succeed in engaging new investors, there is some evidence that their commitment has been short-lived, and that their entry and in some cases precipitous exit have been disruptive.¹⁸ As microfinance and other impact sectors continue to build their investor bases, this experience highlights how important careful and candid investor education is, even if it may slow the rate at which capital is engaged.

¹⁶ A more detailed review of Gray Ghost’s approach to social value measurement is included in the Appendix.

¹⁷ During 2008 use of the model was discontinued as Gray Ghost tried to shift to utilizing and supporting industry conventions and approaches to social performance assessment.

¹⁸ See discussion of GMEF in Section 2, below. Over the past two years, Grassroots has attempted to make amends for this failure by pushing a more open discussion among managers about investment priorities, and designing investment structures that could concretely distinguish investments with social or financial priorities.

Goal 5: Local Funds

Gray Ghost’s results in promoting more local capacity have been mixed, with a number of clear successes and some disappointments. Of the 10 local manager capabilities GGMF has supported or established, a few have not managed to create a permanent equity intermediation capability (AfriCap, LAC HC/BANEX, DFE Partners). But in several cases, Gray Ghost played a leading role in promoting new capability (Caspian, Catalyst, Centurion and BIM) or extending the reach of an existing manager (Omtrix).

However, while the GG experience has confirmed how difficult it is to create robust local teams, the industry at large has largely adopted the view that locally based teams are essential for effective successful investment, lowering costs, and identifying investment pipeline, particularly for equity. By now most of the global managers have moved to establish locally based teams, albeit usually with staff moved from headquarters rather than locally recruited (noteworthy contrarians include Triodos, DWM and MicroVest). And indigenous management teams are forming to focus on home countries or regions.

Nevertheless, even today most equity funds are managed from Europe or North America. Of the 15 microfinance equity funds that participated in Symbiotics 2012 MIV survey, only five could be said to be largely or entirely managed locally: two of these are Gray Ghost funds and two are Goodwell funds. While the survey overlooked a number of funds and managers (Catalyst, Prospero, Lok Capital) it is probably an accurate rough estimate of the continued bias towards north-based management and confirms Gray Ghost’s exceptionalism in devoting such efforts to promoting local funds. Filling in the gaps in the Symbiotics survey, it seems that Gray Ghost promoted half of all the local equity management teams currently operating.

While creating local management capabilities was a high priority, this should not obscure the important role that north-based managers played in the evolution of the industry over the past ten years. Gray Ghost can claim some successes in supporting such north based managers as MicroVest and DWM. The table below provides a summary of Gray Ghost’s engagement with the various management teams represented in its portfolio and their key features.

Gray Ghost MIVs and Funds	Outcomes
Caspian Advisors: Bellwether and IFIF	Leading Indian impact manager
Catalyst: ASAI International	Collaborative effort created strong SSA and SA owner /operator
DWM: BOMS I	Launched CDO model and engaged new investor base, helped launch DWM, now the leading US based manager
MicroVest	Leading intermediary for US private investors
BIM Funds: LocFund and Prospero	Established new LAC MF manager with deep regional capital markets experience
Omtrix Funds: Antares, STLF and ELF	Engaged ProFund expertise to creatively respond to LAC opportunities and challenges
Deutsche Bank: MDF and GCMC	Brought mainstream credibility to task of engaging new investors

Gray Ghost MIVs and Funds	Outcomes
TPF / CASA	Instability in investor and management groups, but laid the groundwork for Catalyst / ASA International
DFE Partners: BFSF	Initial management team unable to gain traction in light of limited regional presence and adverse regional developments
Cyrano Funds: Solidus	Hoped for engagement with private investors and capability in equity investing failed to materialize
LAC HoldCo: BANEX	HC failed to gain traction; anchor MFI a casualty of Nicaragua’s “No Pago” movement, among other factors
Centurion	Well established niche operator in a challenging operating environment
GMEF	Failed management partnership; incoherent investor group

Gray Ghost’s experience with local funds and MIV management teams overall speaks to an important feature of the impact investing landscape: there are far too few managers with experience and a solid track record capable of generating meaningful pipelines and creating social and financial value. To the extent that the impact investing industry is successful in raising capital in excess of what existing managers can intermediate, results are likely to disappoint and discourage continued capital flows to the sector.

Part 2: MIV Investment Highlights

Gray Ghost undertook an aggressive investment program, closing a total of 23 investments in 2003 – 2008, and 15 in 2004 -2006 alone, a solid level of productivity for a small staff.¹⁹ Perhaps of more significance is that of the closed investments, eight, or more than a third, were investments that Gray Ghost initiated alone or as part of a small founding group, in most cases with gestation periods of 2-3 years.²⁰ In several other investments, Gray Ghost was an anchor investor, or filled a critical gap in the capital structure without which the initiative would have failed to proceed.²¹ Thus Gray Ghost can claim to have played an essential role in the launch of 11 vehicles several of which helped redraw the microfinance landscape in ways that helped achieve Gray Ghost’s primary goal of bringing private investors into microfinance in a substantial and influential way. Among these were: MicroVest, DWM’s BOMS I, Bellwether, Catalyst, LocFund, Prospero, Antares and the Short Term Liquidity Facility. Gray Ghost’s productivity, agility and responsiveness reflect the combination of Bob Pattillo’s willingness to move first and take substantial risk combined with Paul DiLeo’s knowledge of and networks within the sector. Bob has replicated this model drawing on expertise in other sectors as he has extended GGV’s influence beyond microfinance in recent years.

Investee	Performance Against Gray Ghost Goals					Social Return at Investment ⁽¹⁾
	Mobilizing social investors	Liquidity	Creating financial track record	Balancing social and financial returns	Promoting local management capability	
1 Deutsche Bank Microcredit Development Fund (2003)						
2 AIM (2003)						
3 MicroVest I (2004)	Excellent		Good	Good		1.30%
4 CASA / Paititi / The Positive Fund (2004)	Poor			Poor	Good	N.A.
5 Blue Orchard Microfinance Securities I (2004)	Excellent		Good	Good		2.90%
6 Emergency Liquidity Facility (2004)	Okay		Good	Okay	Good	0.40%
7 Short Term Liquidity Facility (2004)	Poor		Excellent		Good	0.80%
8 Calvert Foundation (2004)	Excellent		Excellent	Excellent		1.70%
9 Bellwether Microfinance Fund (2005)	Poor		Excellent	Excellent	Excellent	2.50%
10 GCMC (2005)	Excellent		Good	Good		2.10%
11 Catalyst (2005)	Excellent		Good	Good	Good	2.00%

¹⁹ An investment in BOLD was approved in 2006, but never closed due to difficulty setting up appropriate accounts.

²⁰ STLF, Bellwether, Catalyst, Antares, LocFund, Prospero, IFIF and GMEF.

²¹ MicroVest, BOMSI, GCMC.

Investee	Performance Against Gray Ghost Goals					Social Return at Investment ⁽¹⁾
	Mobilizing social investors	Liquidity	Creating financial track record	Balancing social and financial returns	Promoting local management capability	
12 BFSE (2005)	Good		Poor	Poor	Poor	2.60%
13 Antares (2006)	Poor	Excellent	Excellent		Good	1.00%
14 AIM Secondary purchase (2006)	Good	Excellent	Excellent	Good	Good	2.60%
15 Solidus (2006)	Poor		Poor		Poor	1.90%
16 Centurion (2006)	Poor		Good	Good	Good	2.50%
17 Latin American Challenge Investment Fund (2006)	Poor		Good		Okay	
18 LocFund (2007)			Excellent	Good	Excellent	
19 India Financial Inclusion Fund (2008)	Good		Excellent	Good	Excellent	
20 Findesa / BANEX / LAC Holding Company (2008)	Poor	Poor	Poor	Okay	Poor	
21 Gray Ghost 2 / GMEF (2008)	Poor		Poor	Poor	Good	
22 Prospero Microfinanzas (2008)	Okay		TBD	Good	Excellent	
23 Microfinance Growth Facility						

(1) Max = 600bps; based on analysis at time of investment of four broad dimensions of social value: innovation, impact, outreach, and funding

Two investments were made before Gray Ghost was formally launched and Paul DiLeo was engaged. These investments were pivotal in helping identify the opportunity and refine the initial concept for Gray Ghost.

1. Deutsche Bank Microcredit Development Fund (2003)

DBMDF was launched in 1998 by DB's Community Development Group, absorbing a fund originated by Bankers Trust. The MDF was capitalized by donations from Deutsche Bank Private Banking Clients, other wealthy clients and DB Americas Foundation. The MDF offered donors and social investors an opportunity to utilize their wealth to invest in sustainable social change and act as a catalyst to help leverage additional resources.

DBMDF's primary product was hard currency loans that were structured as subordinated, non-amortizing financing to MFIs with maturities from 3 to 8 years and a concessional interest rate in the neighborhood of 2%. The hard currency loans were deposited into a local commercial bank account and used as a guarantee for local currency loans from the local bank back to the MFI; thus unlike the case with most foreign lenders, the MFI bore no FX risk. The MDF loan would be leveraged at a minimum ratio of 2:1. The goal was to help MFIs which were reaching sustainability develop access to local funding, and to introduce local banks to MFIs. Originally loans were capped at \$150,000, raised to

\$250,000 in 2004; the average as of 2004 was about \$75,000

The Rockdale Foundation provided a \$500,000 PRI (program related investment) to MDF in August 2003, at which time MDF had roughly \$2.5 million in capital from other sources. The interest rate was 1% and the term was six years. Bob Pattillo joined the MDF board and stepped off in 2006, and was ultimately replaced by Paul DiLeo who remained on the Board through 2012.

The MDF targeted many emerging MFIs and was one of the earliest foreign sources of financing to recognize and address both the preeminent role that local funding must play and the importance of helping MFIs avoid large foreign currency exposures. At the same time, MDF's total portfolio was small and the highly concessional rate limited its potential scale. Based on its experience with MDF, the DB Community Development Group explored how to translate the MDF's approach to larger scale and innovative initiatives with the greater sustainability that comes from investors rather than periodic donors. This effort resulted in the Global Commercial Microfinance Consortium, launched in 2005 (see below).

Various discussions were held with MDF management in 2004 and 2005 to find ways in which GGMF could supplement MDF liquidity. Agreement in principle was reached on a \$500,000 revolving credit line in 2005 to enable MDF to finance more established and mature MFIs, but the facility was never activated.

The Rockdale PRI terminated as scheduled in 2009. MDF continues to operate today, with committed capital of roughly \$5.5 million and a focus on MFIs that are in early-mid stage development, operating in more underserved markets, or navigating turn-arounds from various crises.

2. Accion Investments in Microfinance (AIM, 2003)

In educating themselves about microfinance and taking the initial steps towards investment, Bob, David and Genia leaned heavily on Accion, one of the originators of microfinance which under Michael Chu and Maria Otero had led the drive towards "commercializing" the industry and engaging mainstream capital. In 2000 several efforts got underway to launch investment funds with traditional capital market LP structures to pick up where ProFund had left off and provide vehicles for capital flows from new types of investors, in particular private individuals and institutions. Among these initiatives were AfriCap, promoted by the Calmeadow Foundation of Canada, ShoreCap International, promoted by the Shorebank Corporation of Chicago, and Accion Investments in Microfinance.

During 2001 there was a brief effort to merge the three initiatives, coincidentally led by Paul DiLeo, then at Shorebank, and Alex Silva, manager of ProFund and representing Calmeadow. At the time there was a rough geographical differentiation with Accion strong in Latin America, Calmeadow focused on Africa, and Shorebank already committed to two investments in Asia. After several months of discussions, DiLeo and Silva concluded that building the industry and the particular goals of each of the three organizations would be better served by continuing with the separate initiatives rather than the single "Global Fund" briefly envisioned.

Accion's goal for AIM was to raise roughly \$20 million to be deployed roughly 2/3s in Latin America, where Accion International (AI) historically had a strong presence and numerous relationships, and one third in Africa, where Accion International was building its knowledge and networks, in part by absorbing a MFI technical assistance and capacity building effort in the region which had been up until

then undertaken by Calmeadow.²² The management team, the core of which was Enrique Ferraro and John Fisher, was employed by AI, but was to be answerable to the LPs, and the Board of AIM was to be chaired by Maria Otero, President of AI, features that were to figure in the subsequent evolution of Gray Ghost’s investment in AIM (see below).

While Accion’s goal, and indeed the goal of all three of the investment fund initiatives launching more or less in parallel, was to bring new investors into microfinance, private investment remained more the exception than the rule. The bulk of AIM’s capital came from DFIs already active in the sector, but aware that testing newer, market accessible vehicles was an important step towards broadening and deepening the capital pool. Nearly all the private investors in AIM were individuals, like Bob, with an existing philanthropic relationship with AI. Of these, Bob’s commitment of \$1 million was the largest, as part of a closing of AIM at \$20 million in early 2003.

Gray Ghost’s subsequent investment in AIM is treated below.

3. MicroVest I (2004)

Gray Ghost invested \$500,000 in Limited Partnership interests at end-2004, and also made available a short term line of credit of up to \$4 million due in June 2005 to enable MicroVest I to meet its December 31, 2003 deadline, of which Microvest activated \$3.6 million to meet its \$15 milli

on closing minimum. Thus, of a total of \$12.5 million in cash commitments for MicroVest’s first close, Gray Ghost was directly responsible for \$4.1 million, nearly one third of the total and significantly larger than the next largest cash commitment (one investor committed \$3 million cash and another a total of \$4.5 million of which \$2.5 million was in kind). In addition, Gray Ghost directly recruited four LPs who committed \$350,000.

The Gray Ghost line was structured flexibly so as to both meet MicroVest’s immediate required closing commitment minimum, but also during its early years to meet its liquidity requirements without accelerating its scheduled draws from LPs. Microvest drew \$1.6 million on the Gray Ghost line in November and December 2004. Discussions were held to extend the line beyond its original due date, but Gray Ghost was ambivalent, preferring that MicroVest remain focused on expanding its private investor base and MicroVest ultimately preferring to seek lower cost funding.

Gray Ghost’s determination that MicroVest see the light of day reflected its view that MicroVest, and its indefatigable manager, Gil Crawford, could lead the introduction of microfinance to a broader range of North American private investors. This confidence was well placed: MicroVest I received commitments from more than 60 LPs, the vast majority individuals committing \$100,000 or less and new to microfinance. Gil and his team were succeeding in one of GG’s priority areas: connecting private investors to microfinance and social investment.

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On the asset side, MicroVest I had a satisfactory record. It focused on the better known MFIs with mostly short and medium term loans. In doing so, MicroVest illustrated one of the trade offs facing

Gray Ghost Goals	Priority	Performance
Mobilizing social investors	1	Excellent
Liquidity	n.a.	
Creating financial track record	2	Good
Balancing social and financial returns	3	Good
Promoting local management capability	n.a.	

²² In principle AIM was also expected to move into Asia, and particular India, and in the event did invest in one MIV there but while AI has built an active presence there, it never became a real focus for AIM.

managers: they could either expand the range of investors or expand the range of investees, but generally not both. Investors new to microfinance and social investment were looking for relatively low risk, predictable performance, and the manager’s ability to raise future funds depended on his or her ability to deliver on those expectations.

It is also worth noting that MicroVest both as funds and as a manager, positioned itself consistently and explicitly in the “financial first” category: MicroVest has always positioned itself as a “market rate” lender, while it viewed most of its competitors as more “social”, investing at below or near market rates. In its view of the market, MicroVest saw itself offering commercial returns and making commercial investments, while it saw most of its competitors as offering various combinations including social returns and/or social investments.

MicroVest has established itself as a mid size manager with a respectable track record, and currently manages five funds with a combined \$200 million AUM.

4. CASA / Paititi / The Positive Fund (2004)

In early 2004, Gray Ghost was introduced to The Positive Fund (TPF), a Swiss-led initiative that had raised about \$12 million from 18 individual investors and was attempting to launch as an umbrella structure to promote regional funds managed by MFI practitioners. TPF had been in discussions with MicroVest and others as far back as late 2002 / early 2003.

Gray Ghost Goals	Priority	Performance
Mobilizing social investors	3	Poor
Liquidity	n.a.	
Creating financial track record	n.a.	
Balancing social and financial returns	2	Poor
Promoting local management capability	1	Good

Shortly after GG’s initial engagement with TPF leadership, the initiative began to come unglued, apparently due to disagreements among the initial investor group and management. A short-lived attempt to salvage the concept by delegating investment management to Blue Orchard and retaining the local fund promotion and TA function in the “Positive Investment Initiative” did not gain traction. Meanwhile, TPF had assembled several prospective local fund managers, one each in LAC, South Asia, Africa and Indonesia. The LAC manager was Pancho Otero who was attempting with TPF support to launch the Paititi Fund.

Consistent with the TPF concept, Paititi represented an attempt to (1) move the MFI investment sourcing, due diligence and management / oversight closer to the MFIs, making investments in less prominent, emerging MFIs possible and cost effective; and (2) test the proposition that giving the lead in the investment process to MFI practitioners rather than the investment professionals that funds had typically engaged would result in more and better investment portfolios and greater positive impact on MFIs and their clients.

The basic structure of Paititi was based within the framework of the Positive Fund, whereby fundraising would be led by TPF: TPF would provide initial capital (30%) for Paititi. Paititi and TPF together would then be responsible for raising additional capital for Paititi as well as enlisting coinvestors in individual MFI investments as necessary. Paititi planned its first closing for mid 2004 with \$8 million, and hoped to raise a total of about \$20 million by end 2006.

Among the initial capital contributions to Paititi were to be Otero’s holdings in CASA, a Bolivian MFI promoted by Otero. TPF also held a stake in CASA, initially worth \$1.5 million, and CASA had loans from

Novib, Triodos, Cordaid and DB MDF among others. CASA was created in 1999 as a pilot program called Emprender in a peri-urban zone of La Paz. Its goal was to focus on smaller clients suitable for group loans, a market that at the time most of the established MFIs in Bolivia were in the process of de-emphasizing in favor of somewhat larger, individual loans. In January 2003, the NGO was converted into a for profit company and as of early 2004 operated through 18 branches situated mostly on the outskirts of metropolitan areas. As it awaited the planned capital infusion from TPF, CASA found itself severely undercapitalized and registering significant monthly losses due, at least in part, to its inability to supply its expanded branch network with adequate funding.

In TPF struggled to regain its footing, Otero approached Gray Ghost to help meet CASA’s liquidity needs arising from delays in the launch of Paititi and the promised infusion of funds from TPF. CASA was in the process of approaching a number of creditors, some existing CASA lenders and some new, for \$1.5 million of new loans to compensate for the TPF shortfall, with hopes of disbursements in the summer of 2004. Of the \$600,000 bridge agreed, Gray Ghost disbursed \$300,000 in April and May. By June it was clear, however, that CASA’s funding scenario would not be realized, due in part to creditor concerns over the inability of management to rein in costs in the face of a significantly smaller portfolio due to the funding shortfall. Gray Ghost consequently suspended disbursements. By late 2004 creditors had moved to replace management and negotiated a restructuring that ultimately resulted in GGMF writing off \$140,000 of its \$300,000 loan. CASA has subsequently met the terms of the restructured loan scheduled to be fully repaid by December 2014.

5. Blue Orchard Microfinance Securities I (2004)

What became BOMSI was originated in early 2002 by Blue Orchard as the Microfinance Loan Obligation Project as a collaboration with S & P and the Open Society Institute. Two years later, as Gray Ghost was beginning to build its portfolio, Blue Orchard had engaged Developing World Markets, in its first foray into microfinance, to help in fundraising, and Gray Ghost was contacted in late 2003.

Gray Ghost Goals	Priority	Performance
Mobilizing social investors	1	Excellent
Liquidity	n.a.	
Creating financial track record	2	Good
Balancing social and financial returns	3	Good
Promoting local management capability	n.a.	

Gray Ghost had a number of concerns about the transaction, both from the standpoint of developing the MF industry and engaging social investors. On the MF side, while the attraction of medium term – seven year loans with average maturity of 5 ¼ years – was clear, the dollar denomination seemed problematic. And while Blue Orchard at that point was well on its way to establishing itself as one of the leading specialized debt providers, its value added was unclear: it limited itself to the most mature, established MFIs, relied heavily on third party raters in its credit decisions, and had limited engagement with the MFIs beyond standardized reporting. On the social investor side, it was not clear how the transaction was broadening the universe of investors. The equity and subordinated tranches were expected to rely heavily on foundations while the senior tranche was fully guaranteed by OPIC (actually, investors bought OPIC Certificates of Participation) and thus were indifferent to, if even aware of, their microfinance exposure.

However, Gray Ghost also recognized that the transaction could represent a milestone in the evolution of the relationship of microfinance with the capital markets. While the likely investors did not seem to include many of the new, private investors Gray Ghost was targeting, the structure was something the

mainstream markets was familiar with and if it appeared successful, had the potential to serve as a model for future outreach to new investors. Nevertheless, at year end 2003 Gray Ghost was leaning against participation, preferring to focus on initiatives that promised to more immediately and directly engage new investors.

The approach to Gray Ghost took on greater urgency a few months later after one of the key subordinated lenders, a foundation, backed away when it became clear that they could not be granted a put to exercise in the event the facility appeared to violate their requirements for PRIs. In the intervening months, Gray Ghost had also come more to the view that the transaction could well prove a major stepping stone towards engaging more private investors.

The transaction ultimately closed in mid July, 2004 with \$40 million. Of this, the two most subordinated tranches plus equity and the initial cash reserve totaled \$9.5 million of which Gray Ghost committed more than one quarter: \$2.5 million; Gray Ghost represented more than one third of the two tranches in which it participated. The OPIC tranche represented 77% of the total.

Gray Ghost's hopes for BOMSI's potential to expand MF access to capital markets were borne out relatively quickly. The facility raised a second round of capital in mid-2005, raising the total facility to \$87 million and this time the pattern of investment was quite different. OPIC's share dropped to 60% and the greatest shift was towards the next most senior tranche, purchased almost entirely by Gray Ghost's target social investors, which increased from 6% to 26% of the total. The facility truly proved to be path breaking and established these "CDOs" as an important component of funding mature MFIs from 2005 until the onset of the financial crisis in 2008.

BOMSI also played a major role in bringing DWM into microfinance, first as a placement agent and eventually as the largest US based MF fund manager, although DWM has sourced much of its capital under management outside the US.

Despite these accomplishments, however, the transaction raised some second order concerns that affected Gray Ghost's future strategy. While Gray Ghost was able to negotiate a slight premium on its return in recognition of the size and importance of its commitment, it remained concerned that the rate, a weighted average of about 7.7%, did not adequately compensate for risk. And indeed, one of the Gray Ghost tranches was impaired by losses and Gray Ghost's ultimate return is in the neighborhood of 5%. Perhaps more important, however, was Gray Ghost's growing conviction that equity was likely to have greater impact in promoting microfinance's scale and scope, while debt, particularly debt provided through facilities like BOMSI, was more likely to cement the position of the industry's most established, if not always most innovative or effective, MFIs.

6. Emergency Liquidity Facility (2004)

The ELF was conceived to provide a “lender of last resort” function for the Latin American microfinance industry. It originated in the observation that in times of stress in the economies and financial sectors, or more limited liquidity crises affecting just one or a few institutions, the supervisory authorities could not be counted on to provide the liquidity support to microfinance institutions that they would be expected to extend to commercial banks. In part this reflected the

Gray Ghost Goals	Priority	Performance
Mobilizing social investors	1	Okay
Liquidity	n.a.	
Creating financial track record	4	Good
Balancing social and financial returns	3	Okay
Promoting local management capability	2	Good

relatively small size, in terms of total system assets, represented by microfinance institutions as well as the fact that they were almost never significant participants in the payments system. Taken together, this led the authorities to conclude that liquidity support to microfinance was not necessary from the standpoint of safeguarding systemic integrity, their primary focus, and might even have some adverse repercussions in terms of moral hazard.

Of course, the perspective from the microfinance industry and its clients looked quite different. For MFIs, their clients and their investors and partners, the costs of a liquidity crisis generated by external factors having little or no relationship to their institution can be enormous.²³ Because microfinance is characterized by relatively short term assets, liquidity constraints arising from a buildup in delinquencies or a surge in demand for credit due to natural disaster or other sharp economic disruption, threatens to force the MFI to break the implicit contract with its borrowers that is an important element of maintaining the quality of unsecured portfolios: that good borrowers will be rewarded with new loans of the same amount or larger. It was widely believed that the nature of many microbusinesses is such that, once word that new loans are not forthcoming spreads, MFI portfolio quality could deteriorate very rapidly and abruptly, turning a liquidity crisis into an insolvency and threatening the continued viability of the MFI.²⁴

Designed to address this situation, the ELF represented the quintessential “public good”, which is typically provided by the monetary authorities. As a private initiative, however, it presented an odd profile. In the extreme case, if it were very successful from a systemic and industry standpoint, it would never be drawn upon, because MFIs’ normal lenders, commercial banks for example, would extend the necessary liquidity knowing that the ELF stood ready ultimately to ensure liquidity. This success, however, would translate into a facility that was never drawn, therefore earning no income to cover costs and remunerate investors.

A more likely scenario, because the ELF imposes neither punitive interest rates, nor moral sanction, was that the ELF would be drawn during times of crisis. Nevertheless, since it planned to charge “pre crisis” interest rates, it could not be expected to generate a significant return.

Indirectly, however, Gray Ghost believed that the ELF could generate substantial returns to the

²³ The other liquidity scenario which can affect commercial banks, an institution specific run occasioned by a loss of confidence, is less likely for MFIs which tend to be less dependent on public deposits and whose deposits are more concentrated in time deposits.

²⁴ More recent experience suggests that it is possible to manage a period of no growth or shrinkage without a deterioration in portfolio quality.

microfinance industry and its stakeholders, including investors and clients, in two ways: first, by reducing the overall MFI risk premium attributable to the risk that liquidity events will turn into solvency events; second, by avoiding substantial losses to investors in specific cases where emergency liquidity could arrest deterioration. ELF was, therefore, a facility that deserved the support of all significant investors in the MF sector as a form of insurance. The alternative, as was documented in a 2001 assessment of ProFund's experience by DiLeo, was that conventional investors would inevitably find themselves forced to serve as lenders of last resort, a function for which they were ill equipped, both financially and in terms of information, preparation and human resources. Similarly, ELF management anticipated that in the event of a major emergency along the lines of Hurricane Mitch or the Salvadorean earthquake of 2001, other institutions like USAID or the IDB would wish to use the ELF infrastructure as a channel for their own assistance.

In addition to its liquidity support, the ELF also undertook an ongoing program of crisis planning with MFIs through companion Technical Services Facilities, helping MFIs build their capacity to manage crises.

The ELF presented a variety of issues for a private investor like Gray Ghost. Besides free-riding, ELF also exposed the type of tensions that could arise between public and private investors. Public investors and management were inclined to set interest rates at the pre crisis average rate prevailing in the affected country, and were extremely anxious to avoid any appearance of "predatory" lending. Gray Ghost urged that there was room between predatory rates and rates that reflected the fact that the ELF faced greater risk than "pre crisis" and that specific institutional risk profiles should be reflected in rates, rather than applying a country average.

A number of founding investors, including the MIF and the Swiss, were anxious that private investors play the leading role in the ELF. But ultimately, the ELF was only suited for investors who were willing to forgo returns in the interest of building the MF industry, were significant investors in their own right, and had a sophisticated and long term perspective on the MF industry.

ELF is now set to wind up in 2014 and barring some major emergency that would greatly boost utilization over the next 12 months, will more or less return investor equity. In 2012, the Board approved an expansion of ELF activity to include an institution specific "bridge" facility, both to fill the void created by the closing of the STLF (see below) by GG and to boost revenue to avoid an erosion of equity as the facility approached its wind up.

Two external appraisals in 2010 and 2011 (DAI and H. Martin) suggest that ELF had achieved its goals. Specifically, the appraisals found that:

- a. ELF met its objective of being a "lender of last resort" for the Microfinance Industry in the region: 50+ MFIs registered for the program, are being periodically monitored and 34 loans for a total of US\$34 million had been disbursed and fully recovered in accordance with approved terms. In addition, four loans have been extended under the Bridge Facility approved in 2012.
- b. Not only has financial backing for MFIs in distress been there as needed, but the Facility has also provided needed Technical Assistance so as to better prepare its client MFIs for External Shocks. Beyond the initial TAF program and its extension (Second Phase TA), the Caribbean TA program (CTSF), as well as the Haitian Emergency Liquidity Program (HELP) have also been implemented.
- c. As a result of securing adequate leverage (loans) at the lowest possible cost, maintaining operating expenses at a very low level for a Facility its size and complexity (2.1% on average) and having a perfect collection record, the Facility so far has managed to operate close to break-even and

preserve its Equity Capital. This, despite having stayed true to its mandate of not “overcharging” and/or not extending the term of its loans to MFIs beyond the initial emergency period and required renewals.

7. Short Term Liquidity Facility (2004)

Gray Ghost created the Short-Term Liquidity Facility (STLF) as a complement to the ELF, providing short term liquidity support in cases where the liquidity pressure was institution specific, due to delays in funding, unanticipated growth or seasonal requirements, rather than systemic crises. The STLF was formally launched in November 2004, with \$5 million in capital from Gray Ghost, and funded its first loan in January 2005.

Gray Ghost Goals	Priority	Performance
Mobilizing social investors	1	Poor
Liquidity	n.a.	
Creating financial track record	2	Excellent
Balancing social and financial returns	n.a.	
Promoting local management capability	3	Good

Gray Ghost conceived of the STLF as filling a market gap in a way that would provide high value to MFIs and premium returns combined with good liquidity for investors. Omrix, SA. (manager of ProFund and the ELF) was engaged as manager.

The Portfolio Growth Facility (PGF or GROWTH) was created in August 2006 as a complement to the STLF. Omrix had argued that nearly all STLF borrowers sought to have the loans extended once the immediate bridging need was satisfied. The STLF borrowers tended to be rapidly growing institutions, and thus there was a lost opportunity to extend medium term loans to these institutions with which STLF had already initiated a relationship. Omrix estimated in early 2006 that such a facility could easily place \$8-10 million. GG was concerned that moving into medium exposure with the very streamlined due diligence and documentation used for the STLF would expose GG to excessive risk, so it was agreed that PGF loans would be structured as 12-13 month loans which could be repeatedly extended at GG’s option.

Somewhat surprisingly, utilization of the STLF, and then the combined STLF (\$5 million) and GROWTH facilities (\$5 million) never exceeded 60%, and generally fluctuated between 20-40%, averaging about 33%. Utilization did not increase during the financial crisis; while a greater number of loan requests were received in Q4 2008, they were concentrated in Ecuador and Nicaragua and most could not be fulfilled due to exposure limits. Demand from other countries was unchanged. This appeared to reflect the ample liquidity available, and the willingness of highly liquid funds to provide liquidity to MFIs with which they had a pre-existing relationship, as well as to the slow down in portfolio growth during the financial crisis.

By the time the facilities were terminated by Gray Ghost in 2010, they had delivered returns of 8.5%, better than on any other Gray Ghost debt vehicle, on a portfolio of short term, senior loans.

8. Calvert Foundation (2004)

In late 2004, Calvert Foundation proposed that GG provide a \$2 million guarantee to enable it to expand what was then an \$11.5 million portfolio of investments in MFIs and MF intermediaries. Calvert would offer a guarantee fee 100 basis points and the funds would not be drawn unless the guarantee needed to be called. The guarantee was to support a 6:1 increase in MF financing, doubling Calvert’s portfolio in microfinance.

Gray Ghost Goals	Priority	Performance
Mobilizing social investors	1	Excellent
Liquidity	n.a.	
Creating financial track record	2	Excellent
Balancing social and financial returns	3	Excellent
Promoting local management capability	n.a.	

Calvert Foundation was then and remains the U.S. leader in connecting smaller investors to microfinance investments. It issues a Community Investment (CI) Note that meets federal and state registration requirements. At the time the guarantee was provided, Calvert was in the final stages of arranging for its CI Notes to be traded electronically through the DTC, substantially reducing the barriers to purchase and sale of the note, and Calvert expected that this will substantially increase its ability to sell CI Notes, if the level of equity and other enhancements can be maintained at the 6:1 ratio expected by investors and state-level securities officials. Calvert was also willing to put the CI Note to the service of other MF intermediaries, offering branded notes of FINCA and MicroVest, among others.

As with other funds that aimed to attract first time investors to social investing, Calvert placed a premium on safeguarding investor funds and meeting its return targets, and its international investment philosophy was overall quite conservative, sticking for the most part to well established mature MFIs or intermediaries. It also added little value in sourcing investments: it conducted no on-site due diligence or monitoring, piggybacking on other investors, networks or ratings. Calvert did try to support innovations in the field when it could do so in a risk averse way, however, and invested in ProFund, ELF, the Blue Orchard Securitization, and MicroVest.

Calvert represented perhaps the best existing platform for popularizing social investing in the US, and GG’s guarantee, tied to a 6:1 increase in its MF portfolio, promised to expose these investors to microfinance. Calvert had done unique and path-breaking work in developing a retail market instrument that allowed US individuals, including small scale social investors, to invest in microfinance, and it remains today the only such instrument available to retail investors in all 50 states. Calvert saw its goal as “popularizing community investment as an asset class”, which coincided closely with GG’s goal as well. At the time of the GG investment, Calvert had roughly 2000 investors only 200 of which – HNWI and family foundations -- had invested more than \$50,000 each.

While the guarantee fee was nominal-- \$20,000 p.a. or 100bp – it was a very low risk source of revenue during a period (three years) when GG was not facing capital constraint. It is also worth noting that while the fee was quite low, it did exceed the hurdle rate generated by GG’s return model. GG did discuss the possibility of expanding and /or extending the guarantee, but ultimately determined that it had played its role in helping Calvert expand its activity in microfinance, and the guarantee expired on schedule.

9. Bellwether Microfinance Fund (2005)

The Bellwether concept had already been gestating for two years when it was first brought to Gray Ghost in late 2004. Initially it had emerged from discussions between Viswanatha Prasad, General Manager of BSFL, Vijay Mahajan, Chair of BASIX and BSFL, Bas Rekvelt, Triodos nominee to the BSFL Board, and Paul DiLeo, at the time, the Shorebank nominee to the BSFL board. The original concept was to launch the fund as an initiative to be sponsored by BASIX -- one of 2-3 top Indian MFIs at the time and arguably the most innovative and financially sophisticated – which evolved into a stand-alone effort with looser and ultimately no ties to BASIX. A large number of other India funds were also on the drawing board along with Bellwether, but for the most part were stymied by the legal and regulatory hurdles posed by the Indian operating environment.

Gray Ghost Goals	Priority	Performance
Mobilizing social investors	4	Poor
Liquidity	n.a.	
Creating financial track record	3	Excellent
Balancing social and financial returns	2	Excellent
Promoting local management capability	1	Excellent

Bellwether seemed to offer both the most promising vehicle for foreign investors to enter the Indian MF market, as well as the possibility of jumpstarting investment in Indian MF more generally, by relieving several critical bottlenecks that had impeded both foreign and Indian investment in MF: the lack of shareholder MFIs (there were only four at the time of Bellwether’s launch); the requirement for Indian equity (Bellwether initially qualified as Indian equity); and the need for ongoing and in many cases intensive support and guidance to MFI promoters.

In the context of the potential demand for MF services in India there was essentially no foreign debt or equity flowing to the sector, the required domestic equity (for companies with less than \$50 million in equity) was non-existent, and even domestic debt was limited. This dramatic imbalance between supply and demand reflected the extreme regulatory complexity and government domination of the financial sector. At the time, considering the size of the potential market – 700 – 800 million poor, most in rural areas – the Indian MF sector was tiny. To a large extent this reflected the dominance of massive government sponsored initiatives, which were by and large poor performers. In addition, however, it reflected a number of key constraints, many a by-product of Indian’s culture of heavy and overlapping regulations, which created legal and regulatory hurdles that few MFIs or investors were able to surmount.

Despite the opportunity, creation of Bellwether was not easy or straightforward, however, and required Gray Ghost and Triodos, its co-promoter, to accommodate many peculiarities unlikely to be palatable to more conventional investors. Rather than an off-shore fund, Bellwether was to be an Indian company, a non-bank financial company (NBFC). The capital structure relied heavily on preference shares rather than common in order to navigate complex Indian regulatory requirements. The management company purchased approximately 15% of common shares at a preferential price with a loan from the NBFC, in lieu of a more traditional carried interest. Other Indian investors, intended to be venture capital specialists and/or microfinance experts such as BASIX, were expected to take up 10% intended to incentivize their non-financial contribution to the fund, in the form of otherwise unremunerated guidance and shared expertise. All the initial capital of \$5 million would be paid in at launch, again to meet Indian requirements.

Beyond the complexities facing both Triodos and Gray Ghost in the capital structure, the complexity of

the transaction, and the obstacles to getting the fund and management company launched required extraordinary efforts by the founding investors. In some cases, Gray Ghost had to act alone, taking advantage of its flexibility and risk tolerance:

1. GG and Triodos cofinanced a market study / due diligence by Caspian, the prospective manager, sharing equally the cost. This expense was capitalized when Bellwether closed.
2. The plan to purchase an existing Non Bank Financial Company (NBFC), required a 10% (roughly \$10,000) good faith payment. In addition, Caspian had assembled its initial staff of three. Gray Ghost arranged a collateralized LOC to enable Caspian to meet these start up expenses during its initial few months of operation starting in December 2004 and to finance the purchase of the NBFC.
3. Simultaneous with closing, the investors in Bellwether signed a Management Agreement with Caspian, including retroactive management fees. Caspian used these fees along with reimbursement for expenses associated with purchase of the NBFC, to repay its start-up loan.

Bellwether offered its investors a unique and valuable package of strengths and assets:

- Very strong management, with extensive contacts throughout the sector and a solid reputation among players.
- A creative but mostly solid legal and regulatory structure, which enabled it to effectively begin operation with weeks of investment approval.
- Close connections with and offers of collaboration from most of the prominent Indian MF supporting institutions.
- A fully funded capability for a 2-3 year initial phase.
- In Prasad, Rekvelt and DiLeo, a core founding group that had already worked closely together for 3-6 years and shared an understanding and vision for the sector.
- Bellwether's main shortcoming was a lack of mainstream venture capital or private equity experience in the management company, but it was agreed that this would be addressed by engaging a VC / PE specialist to join the Board / Investment Committee and, if possible, make an investment in the Indian share of common equity, which was done.

While the potential impact and financial performance were in principle attractive, there were structural features, such as the need to fully fund the initial \$5 million capital requirement and a double layer of tax, that would erode returns. In addition, the necessary conditions for realization of the market potential – particularly favorable evolution of the Indian regulatory regime – were far from assured. GG therefore entered the investment viewing it as a low return, illiquid investment.

The Bellwether Fund was formally launched by Caspian, Triodos (HTF and TDF) and Gray Ghost in May 2005 as an open-ended investment company, funded primarily by 15 year preference shares. FMO and several individuals joined the initial group of investors in 2006. As an Indian corporation (a non-bank finance company – NBFC) Bellwether had no liquidation date and according to the original documentation, investors who wished to exit would generally be expected to do so by the sale of shares to new investors. The initial plan was for a portfolio of primarily equity investments to be assembled, liquidated in years 5-8, and for investors and management to then take a decision whether *“to initiate a second portfolio, recycling capital recovered from the initial portfolio supplemented by new investment in the Fund.”*

As of mid-2013 Bellwether is well along in liquidating its initial portfolio. Out of a cumulative 70 debt and 12 equity investments, all debt and all but three equity investments have been exited or are under

contract and the remaining portfolio will be exited over 18-24 months. Gross rupee IRR to date is in excess of 10%. Conservative assumptions for taxes and the exchange rate, and the effects of cash drag generate a projected net USD IRR for the original investors of about 1%. While modest, this return obscures the fact that portfolio investments performed strongly, notwithstanding the AP²⁵ crisis. IRRs on four of the nine equity investments range from 20% to more than 30%. Two others were written off or suffered a loss due to the AP crisis, while two others were written off or suffered a loss for unrelated reasons. The final investment in a technology company is carried near cost. Thus the overall IRR on Bellwether is satisfactory in light of Bellwether’s primary objective of demonstrating the viability of equity investment in Indian MFIs at a very early stage in the development of that market, and in light of the features that while necessary to enable Bellwether to launch and function, served as a drag on Bellwether returns.

In mid-2012, management submitted a proposal to investors to recycle Rs 50 crores (roughly \$10 million) of proceeds to capitalize a new debt portfolio housed within the Bellwether NBFC, with the balance to be distributed to investors. Caspian Impact Investments (CII) was launched in March 2013 and extends debt to impact intermediaries in four sectors initially: microfinance, SME, low income housing and sustainable agriculture.

10. Deutsche Bank Global Commercial Microfinance Consortium (2005)

In the course of 2004 it became clear rather quickly that private investors – individuals and institutions – were rapidly becoming receptive to microfinance as an investment, particularly a debt investment (equity remained a hard sell). The Deutsche Bank Community Development group, which had been active with the small, philanthropic Microcredit Development Fund for many years saw an opportunity to use Deutsche Bank’s name, credibility and connections to support and accelerate this trend.

Gray Ghost Goals	Priority	Performance
Mobilizing social investors	1	Excellent
Liquidity	n.a.	
Creating financial track record	2	Good
Balancing social and financial returns	3	Good
Promoting local management capability	n.a.	

The irrepressible Asad Mahmood, leading the initiative, creatively and opportunistically assembled a complex tiered structure pairing the traditional, official supporters of microfinance with the more risk adverse, newer private entrants. Official participants including DFID which provided a \$1,5 million grant, and AFD, the French development agency, which participated in an equity tranche. Gray Ghost and AFD provided the bulk of the equity tranches with commitments of \$4 million each contributing about 1/3 of total equity tranches. Gray Ghost’s commitment exceeded the total of all other private investors in the equity tranches.

A wide range of US and European private investors provided the senior capital, which benefited from a partial USAID guarantee. In total, the facility raised \$80.6 million. Even for Asad, a structure of this complexity was, as he put it, “no cakewalk in the park”.

²⁵ In October 2010, the state government of Andhra Pradesh passed an ordinance to regulate microfinance institutions which froze lending by MFIs in the state and had serious repercussions for the industry across the country.

Asad’s goal with GCMC was to both expand the pool of microfinance investors but also, unlike BOMSI for example, to engage them actively, hoping in this way that the learning curve would be steepened and these new investors would more rapidly increase their engagement with the sector and serve as emissaries to the larger private investor community. To this end GCMC enlisted a Board of over 25 members and organized well attended Board meetings in places where loans were being made, such as Managua and Sarajevo.

In negotiating its investment, Gray Ghost focused on the staffing of the team and the composition of the ICOM, to ensure that the Consortium’s educational and publicity goals did not interfere with its ability to professionally and effectively manage the portfolio.

In the event, the facility matured on schedule in 2011, returning the 7% base return to Gary Ghost’s equity tranche but, due to several non performing loans, none of the hoped for kicker.

11. Catalyst (2005)

With the collapse of The Positive Fund (TPF) in March 2004, Gray Ghost began what would be a five year long effort to salvage the concept of marrying MFI practitioner experience with investment experience to better serve MFIs and ultimately investors. With the exit of TPF management and most, though not all, of its investors, Gray Ghost stepped in to work with the four local managers that had been engaged to find a new structure that could improve on the TPF concept.

Gray Ghost Goals	Priority	Performance
Mobilizing social investors	2	Excellent
Liquidity	n.a.	
Creating financial track record	4	Good
Balancing social and financial returns	3	Good
Promoting local management capability	1	Good

Initially, Gray Ghost worked with the former TPF promoter to reconstitute the TPF concept as the “Practitioner Umbrella Fund”. In this formulation the goal remained to engage the efforts and expertise of experienced MFI founders and managers in the selection and nurturing of high potential MFIs by enlisting them as managers of MFI investment funds in their regions of expertise. Gray Ghost saw such funds as key players in helping to create a new generation of innovative and dynamic MFIs and as key partners for funds managed by more traditional, often north-based, finance professionals. In each case, the intention was to complement the practitioner expertise with senior level investment and finance experience, although the source of this expertise had not been identified.

In July, 2004 the original TPF promoter convened a meeting in Romainmotier Switzerland to consider yet another incarnation of the concept: the “Microcredit Catalyst Fund” or C-Fund. In attendance were the four regional fund promoters, the remaining TPF investors, and Gray Ghost. Also in attendance were Elizabeth and Dirk Brouwer of the Netherlands. Their family had learned about microfinance during an extended visit to various developing countries and Elizabeth was determined to continue and deepen their involvement with the sector.

In the aftermath of that meeting Gray Ghost and the Brouwers took the lead in moving the initiative forward. Two of the original four practitioners –representing Latin America and Indonesia – dropped out as their energies were diverted to troubled institutions with which they were associated. The two remaining –Kimanthe Mutua of K Rep and Shafiq Choudhury of ASA – teamed with Dirk Brouwer to form

a management team. In mid 2005 agreement was reached to launch Catalyst Microfinance Investors and a closing took place in August with committed capital of \$2.7 million, of which Gray Ghost provided \$2 million with the balance committed by one of the TPF investors and the management team and their respective institutions. The initiative was conceived as a pilot to test the team and provide some track record to serve as the basis to raise additional capital. As stated in the initial agreement:

“The objective of the Fund is to play a catalyst role in the development of microcredit by helping a new generation of MFIs finance their growth and create value for their shareholders, their clients and their staff.

“The Fund intends to take minority or majority equity participations, including various forms of hybrid equity, and may offer loans to promising MFIs at various stages of development ranging from start-up, expansion, to turn-around situations.

“The Fund plans to play an active role in creating value through intensive guidance and supervision of the MFIs it invests in.

“The Fund plans to focus its initial investments on the Asia Pacific region and Africa.

“A major objective of the Fund is to realize its investments over time at a profit and thereby help create a new asset class for sustainable investing in the developing world.”

Through mid 2006 the team identified a number of investments, and the ICOM, on which Gray Ghost held an affirmative vote, approved four, in India and the Philippines, none of which ultimately closed. Meanwhile fundraising was underway with a target of raising another \$10-15 million to be invested in 20-30 MFIs spread over 10-15 countries in Asia and Africa. By late 2006, it was clear that the strategy was in trouble: the pipeline in Africa was not developing and while investments were being approved in Asia, they were not being closed. By year end, a substantial overhaul of the strategy and structure was underway. By mid 2007 K Rep stepped out of the management team, conceding that it did not have the bandwidth. The strategy was modified to incorporate a holding company of multiple ASA replicators, launched by ASA staff seconded from Bangladesh. The fund raising target was increased to \$50-75 million.

Catalyst’s fund raising timing was impeccable. The revised strategy and structure struck a chord with investors whose appetite and enthusiasm for microfinance was growing wildly. As new investors signed on, Gray Ghost’s influence declined. In preparation for a July 2007 close, Gray Ghost was prepared to commit up to \$35 million of a target of \$50 million if certain conditions were met. While Gray Ghost fully endorsed the shift in strategy towards the ASA holding company model, it sought to preserve significant investor control over key decisions. But as investor interest grew rapidly through the second half of 2007, Gray Ghost sought vainly to cap the fund at no more than \$100 million. In December 2007 the fund closed with committed capital at \$125 million, of which \$35 million from two pension funds and another \$15 million from a DFI. Gray Ghost committed \$25 million, of which \$10 million was warehoused for Gray Ghost 2, aka GMEF.

CMI’s performance has been impressive in the subsequent five years. It has concentrated almost entirely on the greenfield ASA replicator strategy, creating a holding company called ASA International (ASAI). It has created greenfields in five countries and absorbed an existing MFI in a sixth. There have been bumps on the road, with more or less severe setbacks in nearly every country. . However, the consolidated ASAI is profitable and the recent valuations place CMI as a whole above breakeven, a notable achievement given that the expected lead subsidiary in India has been crippled by the

repercussions of the AP crisis.

The core premise seems to have been validated: the combination of practitioner expertise with mainstream investment and finance experience has created a successful odd couple. Significant challenges remain as ASAI becomes increasingly independent of ASA, but there seems little doubt now that ASAI will be a major force in microfinance in Asia and Africa going forward.

12. Balkans Financial Sector Equity Fund (2005)

In early 2005, efforts began to launch a new regional equity fund covering 10 countries in the Balkan region. The initiative promised to fill the regional void created when Soros OSI abandoned its SEEMIC (Southeast Europe Microfinance Investment Company, Ltd) initiative in late 2004. The new fund was promoted by Opportunity International (OI) and OikoCredit, and assembled a management team comprising a UK based private equity manager and a Swiss based

Gray Ghost Goals	Priority	Performance
Mobilizing social investors	3	Good
Liquidity	n.a.	
Creating financial track record	2	Poor
Balancing social and financial returns	4	Poor
Promoting local management capability	1	Poor

former Citibanker who had provided TA to a number of OI MFIs in the region. A senior OI manager was also a principal in the management company, and OI planned an in kind investment.

Both Opportunity International (OI) and Oiko had substantial experience and exposure in the region and were looking for a way to increase equity engagement (Oiko) and begin to recycle resources out of three existing bank investments and four non bank partners in the region into initiatives more directly targeted on the poor (OI). They believed that the timing for a fund in the region was favorable, as many countries, including Romania with nearly half the population, seem poised for something of a take-off with respect to economic and financial sector growth as they positioned for EC accession over the coming 4-5 years. The sponsors saw the micro and small business sectors as a backbone of these economies, but one which most commercial banks, with the exception of IPC (ProCredit) banks were poorly equipped to serve.

At the time Gray Ghost entered the discussions the fund had received commitments totaling Euro 10 million from sponsors and two official entities (KfW and SECO). It was seeking a minimum of €5 million more to complete an initial close at €15 million, and ultimately targeted €25 million to be deployed in about eight investments in small business and micro banks and non-banks. The preference of the sponsors was that a significant portion of the remaining capital be raised from private investors, and DWM was engaged to help. GGMF indicated a willingness to work with the sponsors and DWM to explore ways that some or all of its investment could take the form of enhancements for other private investors. GGMF felt that a straight equity investment offered GGMF only limited opportunities to leverage its investment with other private capital by attracting co-investors. However, GGMF leverage could be increased by utilizing some or all of its investment as enhancements to other private investors.

GGMF's most important role appeared to be in the fundraising stage. Once the fund was up and running, it was not clear that GGMF would add a great deal to the Board or ICOM, although it would be important that private investors be significantly represented. In this light, Gray Ghost communicated that it wanted to see at least one third of the fund raised from private, non-sponsor investors, and offered its help in achieving this goal.

In the event, BFSE was launched in Nov 2005 and raised an initial €27million and more than achieved Gray Ghost’s goal for private sector participation, with significant commitments from Omidyar Network, two HNWI, the Calvert Funds (not Foundation) group; roughly half the first close commitments were from unrelated private investors. Private participation grew further in subsequent closings, with more than €30 million of the €47 million final total from unrelated private investors, including dedicated microfinance investors like OTMF, MicroVest and Respa as well as a regional bank. While Gray Ghost cannot take direct credit for this achievement, it was one of the first private investors to commit.

Notwithstanding the success of the fundraising effort, the fund faced asset side challenges from the start. The first investment was not closed until early 2007 and by late 2008 as the international financial system came unglued, the Balkans region began to feel the fallout of stress in Europe. But the challenges were internal as well. The five portfolio companies all were more challenging than management had anticipated, requiring significant work to create and realize value. While new hires strengthened the mid-management level of the team, the team continued to struggle with the mounting challenges. In the context, Gray Ghost decided not to increase its investment to an initially planned €5 million and remained at €3.4 million and dropped off the ICOM.

While external developments played a major role in BFSE’s difficulties, these were compounded by weakness in the management team and the fact that Gray Ghost had compromised its “local fund” requirements to accommodate the BFSE team. While the team was regionally focused and had significant local experience, it was not locally based—the two lead managers lived in London and Geneva—and it was not fully equipped to navigate the particular and complex politics and economies of the region.

In the course of 2011-2013 a number of significant changes were implemented to respond to the disappointing performance. The portfolio was split, with a new “holding company” strategy adopted for a number of the portfolio companies and a new team with banking operating experience in the region engaged to head this effort (NOA). One of the two managers left and the third member of the original management group, from OI, stepped down as fund chair and significantly reduced his involvement. The fund, which was to have been liquidated in 2011 has been extended 2015 and investors are currently awaiting a management proposal on how liquidity will be generated.

13. Antares (2006)

The Antares – Equity Participation Fund was originally conceived as an initiative of the Gray Ghost Fund in 2004 to address several interrelated problems in the microfinance space observed at that time: the difficulty of providing adequate compensation and a path to exit / succession for promoters of MFIs; the difficulty of facilitating consolidations among MFIs; and the lack of secondary market activity in MFI equity, which Gray Ghost saw as a primary obstacle to mobilizing investments by private investors in MF equity.

Gray Ghost Goals	Priority	Performance
Mobilizing social investors	3	Poor
Liquidity	1	Excellent
Creating financial track record	2	Excellent
Balancing social and financial returns	n.a.	
Promoting local management capability	4	Good

In response, Gray Ghost convened a series of meetings and consultations among a wide range of industry participants beginning in March 2004 to design an intervention that could address the common

element shared by these problems: lack of anything resembling liquidity in MFI equity.

The result of these consultations was a decision by Gray Ghost to create a separate Limited Partnership under independent management to make financial investments in MFIs and sell the holdings after a relatively short holding. The goals were to (1) allow existing shareholders in mature MFIs to realize partial liquidity and to diversify their risk; (2) establish valuations for equity tendered to the Fund in exchange for cash and potentially an interest in the Fund in order to facilitate further secondary market transactions; (3) raise cash both to partially purchase secondary shares in mature MFIs; (4) provide expert management of investments in MFIs on behalf of both secondary and primary investors; (5) realize exits at attractive valuations in order to provide market rates of return for investors.

The Limited Partnership was created by Gray Ghost as General Partner in 2005 and Omtrix was engaged as the manager in April 2006. Thus, the initiative took roughly 24 months from initial conception to launch, a time lapse which resulting in some modifications in the original expectations for Antares - EPF.

Antares set about acquiring, holding and selling microfinance shares in the secondary market in 2006. While some of the original formulations had envisioned “rolling up” holdings into a diversified portfolio and selling participations in that portfolio to further generate liquidity, the final form of the initiative was more modest, albeit still unique and path-breaking at the time. The fund aimed to jump-start the secondary market for microfinance shares, thereby producing benchmarks, transparency and strengthening the ability for MFIs to access international capital markets, and capturing the illiquidity discount that came from an untapped market.

The fund was structured as a Delaware LP in order to facilitate entry of other investors in addition to Gray Ghost. In the event, GG’s initial €5 million commitment proved to be sufficient for the opportunities that were encountered. In large part, this smaller than expected volume reflected the timing of its launch: while earlier in the decade many MFI promoters and initial investors were searching for liquidity at any price that covered cost or provided some modest monetization of sweat equity, by 2007 sentiment was changing. The entry of more private investors into the microfinance sector since 2004 created expectations of significant profits to be made. Book multiples were rising. In this context, equity holders who had expressed interest in selling 1-2 years before now preferred to hold their positions to see where prices might go.

Antares did not reach the volume of transactions originally expected but most of its investments were sufficiently profitable to demonstrate that liquidity and a solid two way market in MFI equity was emerging. Antares invested in eight MFIs with an aggregate portfolio cost of \$5.3 million. In a number of these MFIs, Antares made multiple purchases and sales. Returns after fees and expenses were quite satisfactory, at just over 14%.

In a somewhat ironic twist, given that one of Antares’ original objectives was to help promoters exit their holdings, Antares also developed a sub-specialty in helping to fund creation of ESOP-like pools. As many employees of MFIs could not afford to buy the stock outright, Antares set up a payment plan by which employees would normally put 20% down on the stock and complete ownership of the rest of the stock over a 4-5 year horizon (normally funded at least partially by dividend payout). Though in some cases shareholders did not agree to the programs, four out of the eight institutions in which Antares acquired shares participated in the ESOPs.

The positive return generated by Antares helped demonstrate that reasonable profits were available in the secondary market for MFI shares. “Though Antares was not the only investor into this secondary market at the outset of the fund, it was certainly in the forefront of such investments and would not be

wrong in claiming, to some degree, a hand in the strengthening of the now vibrant secondary market for microfinance shares.”²⁶

14. AIM Secondary purchase (2006)

In late 2005, discussions began among shareholders and management about the possibility of a recap of AIM that would provide an opportunity for the replacement of some portion of the public funding by private investors and a simplification of the structure by eliminating segregated Africa and Latin American portfolios.

Gray Ghost Goals	Priority	Performance
Mobilizing social investors	3	Good
Liquidity	1	Excellent
Creating financial track record	2	Excellent
Balancing social and financial returns	5	Good
Promoting local management capability	4	Good

Gray Ghost strategic rationale was to help make the fund better positioned to appeal to market-oriented private investors, and to help official development agencies recycle their capital as a means to facilitate greater private investor participation – this situation was perfect for that. But equally important, Gray Ghost perceived a major impediment to private investor participation as the absence of exits via secondary market sales – and this looked to be a sizeable, high-profile transaction with which to demonstrate a secondary market transfer. The transaction looked attractive from a financial perspective as well: portfolio companies were showing strong growth, and impressive portfolio cash flow provided strong financial incentive. Also, the substantial uncalled commitments that could be acquired presented an opportunity to buy shares at a discount to current valuation. However, Gray Ghost did perceive significant risk increasing its stake in a fund whose strategy was potentially in the process of changing.

Gray Ghost ultimately did acquire FOMIN’s investment in AIM for \$3.8 million, bringing its position to 23% and facilitating the streamlining of the structure. In the course of extended discussions about future strategy and the recap, Gray Ghost determined that a planned emphasis on regions other than Latin America, in particular Africa and Asia, while supportive of the broader strategy of Accion, did not play to AIM’s strengths. Agreement was reached for Accion to purchase Gray Ghost’s total position.

In the event, while AIM did build a significant portfolio in Africa, the core of its activity remained focused on Latin America. In early 2013 AIM completed the sale of its remaining assets to Bamboo and Accion, and registered the best performance of any microfinance equity fund to date, with a reported return of 16.5% to the original LPs.

²⁶ This quote and other information in this section were taken from a review of Antares produced by Omtrix dated August 2012.

15. Solidus (2006)

By late 2005, Gray Ghost had committed to 13 investments and was starting to look for ways to fine tune its overall portfolio characteristics. In particular, Gray Ghost began to look for some current income, and to increase its average transaction size. The Solidus Fund, promoted by Cyrano, a manager formed to assume management of the LACIF fund, seemed to offer an opportunity to do so as well as help MFIs strengthen their balance sheets by offering subordinated debt that would qualify as regulatory capital, at the time an innovation in funding for MFIs.

Gray Ghost Goals	Priority	Performance
Mobilizing social investors	3	Poor
Liquidity		
Creating financial track record	1	Poor
Balancing social and financial returns		
Promoting local management capability	2	Poor

While the investment offered some attractive characteristics, it did not clearly advance Gray Ghost’s priorities or use Gray Ghost’s preferred strategies: it targeted the larger, better established MFIs; the manager was primarily focused on the official investor community, with less than a quarter of its funding from private investors, and its commitment to reaching out to private investors had yet to be demonstrated. For Gray Ghost, Solidus also promised a more passive role than in its other investments: the fund had already had its first close in November 2005 without Gray Ghost’s participation, and thus, Gray Ghost had limited ability to influence terms. The estimate of social return was fairly skinny -- at 1.5% out of a possible 6% -- with Solidus getting no credit for furthering private investor participation in microfinance and with investments targeting larger, established MFIs in areas already having significant access to capital. Furthermore, the investment would worsen Gray Ghost’s overweight position in Latin America to over 60% as against a 40% target.

Nevertheless, the prospect of improving Gray Ghost’s financial parameters, after a series of investments heavily weighted towards its non-financial objectives, won the day. The prospect for 8%-9% returns, and 7% cash yields, looked compelling at a time when there was a dearth of alternative investment opportunities offering current income and given the tactical decision to improve the Gray Ghost’s near-term cash flow generation.

Of course, as is often the case, the investment did not perform financially as hoped. It proved harder to place funds at the target rates, and nearly impossible to secure the equity warrants that had been relied upon to provide some further upside. And despite the manager’s solid reputation and performance generally the portfolio did suffer some losses in 2009-2010, as did most other managers. Grassroots most recent projection was for Solidus to generate a more modest return than hoped with liquidation as scheduled in November 2014.

16. Centurion (2006)

In late 2005 Gray Ghost began discussing the possible transformation of a USAID funded, Development Associates International (DAI) managed microfinance sector support program in Russia into a fund that would channel capital to the nascent Russian MF sector. At the time the sector comprised 3-4 foreign sponsored MFIs which were of significant (\$10-20 million) size and focused on the major urban markets, and a couple of hundred MFIs of various forms, mostly credit

Gray Ghost Goals	Priority	Performance
Mobilizing social investors	2	Poor
Liquidity		
Creating financial track record	3	Good
Balancing social and financial returns	4	Good
Promoting local management capability	1	Good

coops and NGOs with portfolios of \$300,000 and up, scattered around areas poorly served by other financial institutions. There was increasing interest on the part of foreign lenders, and to some extent Russian banks, in the sector, and there appeared to be significant government support for the development of the sector. There was also an active and apparently effective industry association, the Russian Microfinance Center (RMC), a centerpiece of the DAI program. However, with the exception of the top tier, which was already receiving foreign interest (MicroVest and Blue Orchard were lenders to FORA, at the time OI's Russian affiliate) Russian MFIs were too small and immature to be good targets for foreign lenders.

Centurion, with a local base, local staff and intimate knowledge of some aspects of the MF sector, was designed to intermediate this disconnect, helping promising MFIs develop to the point where they could have better access to foreign and domestic capital to fuel more rapid growth. It was conceived as a finance company which would use debt instruments to create relationships with 35 or so MFIs, mostly credit coops. In the medium term Gray Ghost hoped that Centurion could build on its relationships and knowledge of the sector to develop an equity investment capability, and explore possibilities of merging small regionally dispersed MFIs into networks that would prove attractive to mainstream financial institutions looking for distribution capacity in second and third tier geographies within the Russian Federation.

The concept was an excellent fit with Gray Ghost's focus on moving first to create regional management capabilities with superior value added. There was no competition on the immediate horizon. But Centurion faced significant hurdles as well. While Centurion was building unique knowledge of a neglected tier of the financial system, it had difficulty figuring out how to capture this value. Consideration of how to structure and staff an equity investment capability was inconclusive, to Gray Ghost's disappointment. The local team was strong on basic financial skills and had a solid knowledge of MF, but little financial structuring experience or familiarity with the kind of issues that would be raised by MFI transformations or mergers.

In any event, Centurion has been able to build a solid lending business, but its growth prospects are still unclear and it has had difficulty attracting funding and particularly ruble funding. Its inability to refinance Gray Ghost's dollar denominated loan put Centurion under severe pressure with the Russian crisis of 2009. Gray Ghost converted half of its \$2 million loan to equity and Centurion has gradually regained its footing and accessed new sources of financing. Gray Ghost continues to work with managers and other investors and lenders to capitalize on Centurion's unique experience and positioning.

17. Latin American Challenge Investment Fund (2006)

Similar to the Accion Investment purchase discussed above, Gray Ghost continuously sought out opportunities to make significant secondary market purchases of assets from founding investors, in most cases public or non-profit entities. Such purchases served two purposes: first, promoting a more active secondary market in MF assets, which Gray Ghost believed was essential to generating reliable private capital inflows, and secondly, complementing the resources, experience and concentrated expertise of the multilateral and bilateral official and philanthropic funders with an increasing engagement of private capital.

Gray Ghost Goals	Priority	Performance
Mobilizing social investors	2	Poor
Liquidity		
Creating financial track record	3	Good
Balancing social and financial returns		
Promoting local management capability	1	Okay

By promoting secondary markets and the smooth transfer of equity in established microfinance funds Gray Ghost hoped to demonstrate that microfinance was maturing and accessible. Funds and managers that could demonstrate the ability to accommodate and manage such transfers would be recognized, in Gray Ghost’s thinking, helping move the entire industry towards a more constructive and accommodating relationship with private investors.

LACIF appeared to be a prime candidate to demonstrate this maturation and increasing sophistication of the microfinance sector. For Gray Ghost, building relationships with the leading microfinance fund managers, like Cyrano, and the most experienced and knowledgeable investors, such as those represented in LACIF, was essential to the strategy.

In mid-2006, Gray Ghost completed the purchase of all shares held by the Multilateral Investment Fund of the Inter-American Development Bank (IDB) and the Norwegian Investment Fund for Developing Countries (Norfund) in the Latin American Challenge Investment Fund (LACIF). In the press release announcing the purchase, it was noted that:

The close of the transaction marks one of the first examples of private investors stepping in to provide an exit to sponsoring investors through a secondary market purchase of shares in a microfinance investment fund. The purchase reflects Gray Ghost’s strategy of enhancing the liquidity of microfinance assets, and raising the profile of well-managed and high performing microfinance funds in the private investor community.

“For us this transaction is the first of many which we hope will enable founding investors, including official institutions, to recycle their capital and redeploy it to new and innovative initiatives,” said Paul DiLeo, Chief Executive Officer of the Gray Ghost Microfinance Fund. “The transaction clearly demonstrates how mature microfinance funds can capitalize on their track record and re-orient themselves towards the private capital markets,” he added.

The purchase gave Gray Ghost a 41% stake in LACIF. At the time, LACIF was the leading debt fund focused on Latin American microfinance institutions (MFIs). The fund was established in 1998 and matured at the end of 2008. With assets valued at \$20.4 MILLION, the fund held loans to some fifteen (15) microfinance institutions in Peru, Ecuador, Nicaragua and El Salvador at the time of the purchase.

LACIF had just two more years to run and was already starting to plan to wind down its portfolio. The possibility of using the LACIF vehicle to launch a “LACIF 2” was explored with management, but not

pursued, and the fund wound on schedule and generated a 5.2% IRR for Gray Ghost’s 30 month holding period.

18. LocFund (2007)

In late 2005, Gray Ghost began working with the MIF, FMO and NorFund to launch a local currency debt fund for Latin America and the Caribbean that would focus on second tier MFIs. The main issues were to select a manager and finalize an FX risk management strategy. The four sponsors were prepared to commit \$21 million out of a planned \$35 million fund, with GG committing \$2 million.

Gray Ghost Goals	Priority	Performance
Mobilizing social investors		
Liquidity		
Creating financial track record	3	Excellent
Balancing social and financial returns	2	Good
Promoting local management capability	1	Excellent

At the time of its launch LocFund was the first standalone local currency lending facility for microfinance. While a number of lenders (OikoCredit, FMO and Triodos) devoted portions of their portfolio to local currency lending, these efforts generally benefitted from grant or government backstopping. While several other initiatives were under discussion, including LACIF II, a Blue Orchard – Citibank collaboration and a possible new fund from MicroVest, none materialized with the exception of Minlam.

While analyses – by Omtrix and, reportedly, IFC – suggested that a local currency facility would most likely be more profitable to investors than hard currency lending, a major sticking point was how “fat tail” risk would be handled. Such extraordinary event risk was the main reason that the multilaterals, like IFC had shied away from taking substantial FX risk onto their balance sheets: capital markets tend to penalize companies with large open positions. The implication of this for LocFund was that mainstream capital would be hard to raise, even at a premium, and the facility would have to rely more on social investors than other MF initiatives. CGAP and others had concluded that there was no solution to FX risk other than MFIs funding themselves in local capital markets. While undoubtedly valid, this approach ignored the reality that MFI demand for liabilities in many markets continued to outpace local market appetite, and a role for foreign debt appeared likely for the foreseeable future.

As important to Gray Ghost as addressing the FX challenge was the prospect of developing a new management team focused on Latin America. Despite the high level of activity in the region, there was only one regionally based team, Omtrix, manager of ProFund, with which Gray Ghost was already pursuing several initiatives. After careful discussions among the sponsors, it was determined that while a new manager would require a longer learning curve and less certainty on performance, the possibility of bringing a dynamic new player into Latin American MF, and one with a mindset and strong base in mainstream capital markets intermediation, was worth the time and effort.

The manager selected, Bolivian Investment Management (BIM) put together a strong management team. Pilar Ramirez, the first manager of LocFund, had worked nine years as President at FIE, after holding other positions there going back to 1985. She was complemented by a strong Central America based loan officer as well as the strong BIM team, including Fernando Sanchez, President of BIM who took over from Pilar as manager of LocFund in 2009 when she returned to FIE.

From Gray Ghost’s standpoint, the engagement of BIM as a new manager in the Latin American microfinance space has been a clear success. LocFund has performed well, and BIM is in the process of

launching LocFund 2 to continue and expand LocFund’s local currency lending program. BIM has continued to develop as a manager and has moved, as Gray Ghost hoped, into the equity space with the launch of Prospero Microfinanzas in 2010.

19. India Financial Inclusion Fund (2008)

By mid-2007, the Bellwether portfolio was well developed with 12 investments in nine Indian states. Looking ahead to Bellwether being fully invested within 12 months, Caspian began discussions with a group of “core investors” including Gray Ghost on a “Bellwether 2”, which would launch in August 2008 as IFIF. IFIF was to pick up where Bellwether left off, taking advantage of the transformed Indian MF environment that Bellwether had been a leading force in creating.

Gray Ghost Goals	Priority	Performance
Mobilizing social investors	4	Good
Liquidity		
Creating financial track record	3	Excellent
Balancing social and financial returns	2	Good
Promoting local management capability	1	Excellent

In engaging with these core investors, Caspian laid out a “growth and gap” story. Indian MF was poised for sustained rapid growth, and indeed many MFIs were posting annual growth of 100% -- but at the same time faced critical gaps and shortcomings. In its initial presentation to core investors in August 2007, Caspian highlighted the following:

- a) In the present scenario, probably the only relatively under-developed financial instrument that could impede growth of microfinance services in India appears to be equity. As in case of debt, unless fresh equity needs are met consistently, by specialized institutions that understand the underlying investments, the purpose of serving large number of customers viably will not be achieved by MFIs, NBFCs or Banks. Access to equity funding through microfinance focused investment vehicles that cater to all ends of the spectrum (small, medium and large MFIs/NBFCs/Banks) will determine the future of microfinance services in the country to a large degree
- b) Most MFIs, even the large successful ones, are mono-product institutions. Product diversification is both a customer need as well as a business development need for these institutions. Housing loans and micro enterprise loans rank high among customers as vital financial needs. Very often, lack of proper funding (maturity, risk pricing) is the reason for lack of product diversification and at times, it is lack of expertise within MFIs to deliver these products. Both these need to be addressed adequately to broaden product offerings
- c) In an environment where loan portfolios are scaling up rapidly, due attention is required to be paid to infrastructure issues, such as technology systems, credit bureaus, training and resource development. While some of this can be developed at an MFI level, others need to be provided at an industry level. Involvement of microfinance experts in such ventures is going to be a key success factor

Whereas Bellwether, launched in 2005, faced a landscape where there were only four investible MFIs which either had serious shortcomings, were overpriced or – usually – both, in 2008 India had several dozen investible MFIs testing widely diverse models and achieving significantly broader market penetration in terms of product and geography. Nevertheless the underserved market remained the largest in the world. The IFIF investment thesis was to use Caspian’s substantial capabilities and Bellwether’s pipeline to continue to be at the forefront of Indian microfinance. In addition, IFIF would

move beyond microfinance and develop other sectors of the financial inclusion space, such as housing and telecomm based outreach.

For Gray Ghost, IFIF provided an opportunity to capitalize on its extraordinary efforts to support the launch of Caspian and Bellwether and on Bellwether’s success in developing India into a dynamic MF investment opportunity. IFIF was also well positioned to continue to lead “inclusive finance” efforts in India to meet a broader range of needs of the low income population, and develop and test solutions that could be applied in other markets. Based on the experience with Bellwether, IFIF scored well on Gray Ghost’s social impact metric. Caspian had clearly demonstrated a commitment and ability to project MF into underserved areas of India.

IFIF aimed to raise \$75-100 million and completed a first close in August of \$30 million from CDC (\$20 million) and GMEF (\$10 million). Despite being among the “core investors” who helped shape the IFIF concept, structure and investment proposition, Gray Ghost did not participate in the first close as it waited to see what its indirect exposure (through GMEF) would be and how its other Indian exposure – its largest country and currency concentration – was developing. Gray Ghost ultimately committed \$5 million to IFIF in its final, August 2009 close out of total capital of \$89 million.

The combination of the market opportunity, highly capable new MFIs, a widening product offering and promising new technologies resulted in something of an MF boom in India, with a number of “new generation” MFIs like Ujjivan and Equitas joining the original four more traditional MFIs and attracting attention of both mainstream investors and an array of new India focused funds launched in the wake of Bellwether, including the Unitus Equity Fund, LOK Capital, the Michael and Susan Dell Foundation and Aavishkaar-Goodwell.

As we now know, the boom in the sector did not end well. 2010 saw a confluence of developments leading to the AP crisis in October. IFIF by then had a portfolio of 10 investments at a cost of \$40 million. With the onset and deepening of the crisis, IFIF suspended investment activity and ultimately three investments were written off, two directly due to AP and one other for largely unrelated reasons. In early 2012, with the environment stabilizing and largely positive signals from the authorities, investment resumed. By the end of the investment period in October 2012, it appeared that most of the remaining, uninvested funds would be absorbed in follow on investments in the remaining seven portfolio companies. The five MFIs in the portfolio – the three other companies are “enablers” in housing and technology – all rank within the new “Top 10” MFIs which emerged post-crisis, and three are in the “Top 5”. With this footprint in the sector and more than five years remaining until IFIF is set to liquidate it appears there is ample time for the portfolio to create financial and social value, and continue Caspian’s leading role in the Indian microfinance, financial inclusion and impact spaces.

20. Findesa / BANEX / LAC Holding Company (2008)

In April 2008, Gray Ghost, through Antares purchased 13.8% of the shares in Findesa offered by IDB/MIF and DesJardins (DID) of Canada. Antares was already an existing, albeit small, investor in Findesa and all together the shareholding totaled just over 15%. It was subsequently agreed to allocate 6.7% of Findesa to GMEF leaving Gray Ghost with a consolidated holding of 8.3%.

Gray Ghost Goals	Priority	Performance
Mobilizing social investors	4	Poor
Liquidity	1	Poor
Creating financial track record	3	Poor
Balancing social and financial returns	5	Okay
Promoting local management capability	2	Poor

Gray Ghost’s relationship with Findesa dated to August 2006 when Antares first took a small (4%) position in the company. Alex Silva of Omtrix had served on the Board of Directors since February 2006 and after a brief hiatus rejoined the Board in 2008 as the GGMF/GMEF nominee.

At the time of the increase in Gray Ghost’s investment, the political climate for microfinance in Nicaragua was being challenged by political and economic issues. The economy was projected to grow at around 3% to 4% for 2008, the weakest in Central America. Inflation had fallen from its highs but was still expected to be 17% for the year, the highest in Central America. And there were ample signs that Nicaraguans were increasingly over-indebted. Portfolio quality on the regulated financial sector – including Findesa – was deteriorating, reaching 3% at mid year from 2.1% at the end of 2007. The political environment was worrying. The left wing (Sandinista) government had occasionally expressed support for interest rate caps and criticized the MF industry for excessive rates. The rule of law generally was perceived as eroding with political appointments to the courts including the Supreme Court.

Despite these negative trends, it was thought that Findesa was relatively well-placed to weather the challenges. Findesa was one of the two largest MFIs in Nicaragua, the other being one of the ProCredit banks, with \$125 million in assets and 23,000 clients. It had a presence in both urban and rural areas. It had a CAGR of 61% from 2003-2007, but was projecting a slowdown to 18% from 2008-2013. Its PAR was declining and at 2.5% half that for the Nicaragua MF sector overall, as reported by the MiX. Its application for a banking license had been approved and it would receive its bank charter –and change its name to BANEX - in early 2009. Findesa had consistently bettered its annual targets and had what was believed to be strong Board, with representatives of IDB, Triodos, and FMO as well as Gray Ghost / Antares and a group of local shareholders.

There were vulnerabilities as well. Findesa has some particular exposure due to association of some local shareholders with the previous right wing government; political score settling through targeting opponents’ business interests was not unheard of. In addition, while Findesa was charting a strategy to protect itself from over-lending and generate new sources of revenue, in some cases these created their own vulnerabilities. In diversifying out of microfinance, Findesa had drifted from its roots as a microfinance lender to expand products and services oriented to SMEs. Specifically, Findesa had built up a major concentration in cattle loans, a sector in which its expertise was limited, and stubbornly exceeded Board mandated exposure limits to the sector. The banking license itself became a liability when BANEX came under pressure as it required the bank to meet capital requirements which its NGO brethren did not have to observe. And its success in building a diversified shareholder base came to haunt it as well when recapitalization was required: the BANEX investors dickered even as ProCredit injected tens of millions of dollars of fresh capital into its Nicaragua subsidiary.

From Gray Ghost’s perspective, there was another consideration bearing on the Findesa investment. In 2007, Grassroots had begun work on a Latin American microfinance holding company initiative, in informal collaboration with Omtrix. The goal of the holding company initiative was to build a network of MFIs across the region to rival that of mainstream commercial banks and other microfinance networks and holding companies, and ultimately build a regional bank with assets predominately MF loans. The holding company was expected to provide shareholders and management with more diversified and ultimately more liquid positions in the group, i.e. through a stock market listing while enabling management and founding shareholders to preserve control working in concert with other like-minded investors. Among other objectives it was thought that this persistent control would enable the group to maximize its social impact and find meaningful ways to measure, monitor and communicate its social impact.

Five Tier 1 MFIs were identified as candidates for the holding company, with the objective of getting 2-3 to combine and create a platform to begin acquiring Tier 2-3 MFIs throughout the region. Findesa was seen as an attractive component of the initiative because of its strong relations with investors, dynamic product development efforts, and commitment to diversifying out of Nicaragua; Findesa had already launched a pilot subsidiary in Honduras.

The Grassroots team, working with Omtrix, succeeded in engaging two MFIs in the concept: BANEX (then Findesa) and a South American MFI. A series of contacts culminated in a meeting of the principals in Miami in September 2008, a few months after Gray Ghost finalized its investment. But by then, storm clouds were already gathering in Nicaragua and perhaps due to this, or to other incompatibilities, the holding company concept did not gain traction after Miami. Instead, 2009 saw BANEX management and shareholders become increasingly preoccupied by the repercussions of the “No Pago” movement that had broken out in the north west of the country and was spreading. By September 2009 it was clear that BANEX was under severe stress and the bank supervisory authorities were pressing with growing urgency for a recapitalization. Ten months of intense negotiations among shareholders and between shareholders and lenders and the Supervisor did not adequately stabilize the bank and in August 2010 BANEX was placed into liquidation. Gray Ghost, through Grassroots, played a lead role in the unsuccessful efforts to save the bank with Paul DiLeo of Grassroots chairing the shareholders committee.

21. Gray Ghost 2 / GMEF (2008)

By 2005, Gray Ghost was well along in meeting its goal of building a portfolio of microfinance investment vehicles suitable for private investors and demonstrating the opportunities and limitation of such investments. But it was still searching for initiatives that would help it address a second objective: actively engaging private investors in microfinance. Various possibilities had been considered: providing reports on specific MIVs was dropped due to regulatory concerns and the possibility of a perceived conflict of interest. Organizing visits by investors to MFIs was done on a limited scale, but seemed difficult to scale and was probably better undertaken by the MIVs or MFIs directly. Gray Ghost did solicit proposals from MicroRate and the MiX to launch MIV

Gray Ghost Goals	Priority	Performance
Mobilizing social investors	1	Poor
Liquidity		
Creating financial track record	2	Poor
Balancing social and financial returns	4	Poor
Promoting local management capability	3	Good

regulatory concerns and the possibility of a perceived conflict of interest. Organizing visits by investors to MFIs was done on a limited scale, but seemed difficult to scale and was probably better undertaken by the MIVs or MFIs directly. Gray Ghost did solicit proposals from MicroRate and the MiX to launch MIV

rating initiatives, and IAMFI was in the early stages of conceptualization, and it sought out possible collaborators to explore how to advance tax or regulatory changes that could encourage investment in microfinance and other social investments.

But Gray Ghost management felt that while these efforts were gaining some traction, more could be done, and it was decided that Gray Ghost should move to directly intermediate private investors by launching a second fund targeting private institutional and individual investors in North America and Europe. By mid 2006, initial meetings had begun testing the appetite for a “Gray Ghost 2” that would mobilize capital from other private investors and deploy it using then same strategies and mix of financial and social objectives as Gray Ghost.

The investment proposition of what became the Global Microfinance Equity Fund (GMEF) closely reflected the approach and learnings from the Gray Ghost fund: it would be a globally diversified fund of funds, providing equity, and focused on promoting local management teams dedicated to specific regions. The management team would be active at both the global and, in many cases, the local fund level. Gray Ghost would be the anchor investor, with a commitment of at least \$10mm. In preparation for launching GMEF, Grassroots Capital Management was spun out of Gray Ghost in 2007.

The GMEF investment team aimed to launch or support local teams including an Indian equity fund, a Latin American equity fund, a Latin American holding company, an East Africa equity fund, a South East Asian equity fund, a Russian holding company and an MENA holding company. GMEF also invested in two pre-existing vehicles: AfriCap and Catalyst.

A team of three partners was assembled to form the management team, with Paul DiLeo joined by Viswanatha Prasad of Caspian and a new, UK partner. Target capitalization ratcheted up from \$30mm in the earliest discussions in 2005 to \$100mm or more, largely due to a perception of growing investor interest, what appeared to be a robust pipeline, and a top heavy and costly management structure. A first close goal of \$40mm was set for 2007 with a final close planned for 2008.

Discussions with investors proved more challenging than anticipated (of course!). In particular, global diversification was less of a selling point than expected, and there was strong push back against the double layer of fees envisioned in the fund of funds structure. In response, the team restructured the offering to provide for a single layer of fees. While superficially simpler, this change in fact introduced numerous complexities and would eventually be recognized to severely undermine the viability of the manager. Nevertheless a satisfactory first close was completed of \$30mm in April 2008, including a nice mix of investors. Aside from GGMF as anchor, they included a European financial institution, a US private wealth manager, a US hedge fund, and a number of individuals familiar with MF. After this initial success, headwinds increased to gale force. By around mid 2008, most fundraising discussions were suspended in the face of the deteriorating global financial situation and rising uncertainty. While interest revived in Europe in 2009, it did not in the US.

An intense fundraising effort, particularly by the UK based team, resulted in additional commitments in 2009, and in particular, \$79mm from two European pension funds. In early 2010, GMEF completed a final close at just under \$120mm which included 10 institutions for \$106mm and the balance from 8 individuals and management. The apparent success masked several problems, however. The large institutional investors had bargained hard for fee concessions that further undermined the viability of the manager even as they insisted on policies and procedures based on their experience with managers many times Grassroots’ size. More fundamentally, neither these investors nor the Grassroots partner directly responsible for the relationships had much history with microfinance. Unfortunately, without

the team being fully aware of the extent, microfinance had already entered uncharted waters, where the lack of long term perspective and commitment would prove fatal.

2010 saw a confluence of challenges to both the social and financial assumptions that had brought microfinance this far:

- Second half 2009 saw the emergence of the No Pago in Nicaragua, which would seriously impact many MIVs, including GMEF, and raised questions about transparency, competence and depth of experience in the industry, as well as heightening the perception of political risk.
- Taking a step beyond the “what’s wrong with MF” compilation by Dichter and Harper in 2008, we had Bateman’s “Why doesn’t MF work” in 2010 and highly critical examinations of Grameen Bank and Yunus.
- Early 2010 saw a detailed study of personal enrichment in Indian MF, as backdrop to anticipated SKS IPO.
- A new wave of analysis of microfinance impact on poverty, gender issues, and other claims based on the randomized control group method failed to find clear evidence of impact, contradicting the more anecdotally based analysis that had predominated previously.
- In October the AP crisis unfolded in India, which would fatally undermine most of the then-leading MFIs in India, widely perceived as the most compelling investment opportunity up until that point.
- Perhaps more significant than any microfinance specific developments, however, were the pressures on institutional investors having nothing to do with MF, most directly, a premium on portfolio liquidity; less directly, staff cutbacks and turnover, and a general skepticism about anything experimental or exotic, in marked contrast to the anything-goes days of the bubble.

In a more or less related fashion these factors combined to bring down GMEF. In early December, the UK based Grassroots partner, with the shortest engagement in microfinance, resigned, triggering a key person event, and placing the LPs in the unenviable position of having to re-justify their commitment to microfinance at the worst possible time. The major investors took this opportunity to halt further investments, release uncommitted capital, move to renegotiate existing commitments, and place the fund into wind down, barely eight months after they had closed their commitments. The remaining Grassroots partners continued to manage or oversee most of the underlying regional investments, in the face of more or less disruption due to the GMEF collapse. One investment, in BANEX (the nascent LAC holding company) was completely written off following a “no-payment” movement and failure of shareholders and creditors and assemble a rescue. AfriCap was significantly written off due to poor management. The remaining investments, in Catalyst, IFIF and Prospero, are proceeding satisfactorily, if at a somewhat lower altitude than before the AP crisis.

To some extent, GMEF was brought down by an unfortunate coincidence of extraordinarily adverse developments: the global financial crisis, the No Pago movement, the AP crisis. But the Grassroots team made numerous mistakes as well, starting with the team itself, which did not have a coherent, common vision of microfinance and its own goals and expectations. This translated into poor communication with LPs, which was a particularly critical flaw in the case of those LPs relatively new to microfinance. The structure of the fund, both in terms of the unviable fee structure and the dominance of one or two large investors, laid more kindling.

For all the blood and tears, however, the GMEF debacle was a part of the larger rethinking of microfinance engendered by AP, No Pago, and harsh critiques of motives and over-exuberant claims of impact and this rethinking has been unequivocally positive. Most of the industry has taken vigorous

action to curb abuses and reconsider its claims for financial and social performance. Investors are more likely to rigorously articulate their expectations and requirements, and more carefully select investments that will provide a good fit. The industry, and Gray Ghost and Grassroots, have moved ahead, albeit a bit bruised.

22. Prospero Microfinanzas (2008)

In 2008, Grassroots began developing a concept for a “Latin American Capital Pool”, which eventually was named Prospero Microfinanzas. The goal was “to meet the need for equity among the next generation of microfinance institutions across Latin America so as to deliver a market-based approach to poverty alleviation.”

Gray Ghost Goals	Priority	Performance
Mobilizing social investors	4	Okay
Liquidity		
Creating financial track record	3	TBD
Balancing social and financial returns	2	Good
Promoting local management capability	1	Excellent

Prospero intended to provide equity investment to up and coming microfinance institutions and shape and influence investees’ abilities and capacity to achieve success as sustainable microfinance institutions with positive social impact. The investment thesis was that so-called Tier 2/3 MFIs in Latin America had an appetite for equity/quasi equity products and that increased competition from downscaling banks and established MFIs was encouraging flexibility and innovation by smaller, newer or lesser-known MFIs. Accelerated product development required access to a wider pool of resources and capabilities but at the same time, care had to be taken to reinforce cohesive strategic vision among likeminded investors. NGOs due to their legal personality face difficulties in raising equity equivalent and there was a need for a flexible investor open to innovative, balance sheet strengthening capital products.

Gray Ghost and GMEF were to serve as anchor investors together with the founding investors of LocFund; BIM was to serve as the co-manager with Grassroots.

The Gray Ghost Fund approved a \$3mm commitment in principle to Prospero in December 2008, in anticipation of a mid-2009 first close. That first close was delayed and ultimately took place in July 2010. In the interim, the liquidity position of Gray Ghost Ventures, which was the parent of the Gray Ghost Fund, tightened and Gray Ghost reduced its commitment to \$0.5mm.

In the meantime, GMEF collapsed and moved to curtail not only new commitments but even to extract itself from its existing commitments. Complex discussions to eliminate or substantially reduce the \$15mm GMEF commitment Prospero took more than one year, during which Prospero was forced to suspend its investment activities. Ultimately, agreement was reached to reduce GMEF to \$3.1mm and investment activities resumed in 2012 with a six month extension of the investment period to end-2013.

As of mid 2013, Prospero seems on track to complete its portfolio of 8-10 investments in the target group of MFIs.

23. Microfinance Growth Facility

In 2008, Gray Ghost was approached by IDB/MIF and OPIC to participate in the equity tranche of MiGroF, which was conceived as a response to the global financial crisis. MiGroF was intended to provide medium and long term senior loans and subordinated loans to microfinance institutions (MFIs), microfinance investment vehicles (MIVs) and other financial intermediaries in Latin American and the Caribbean to facilitate sustained growth of micro and small enterprises in light of the contraction of international financing sources and the projected increased demand from such businesses. The facility was intended to a public-private partnership; since the promoters were mostly DFIs (MIF, IIC, OPIC, CAF, NorFund) the participation of Gray Ghost, together with Omidyar, was sought to signal that private investors were expected to play a central role.

At the time of the approach, Gray Ghost was no longer making new commitments but ultimately agreed to a token \$250,000 commitment in light of its close working relationships with IDB/MIF, OPIC and other sponsors.

Declined Investments

In addition to its role in helping launch and promote 23 MIVs, Gray Ghost also had influence on the development of the microfinance sector through what it declined to fund. In many cases these initiatives proceeded quite successfully in the absence of Gray Ghost participation: ShoreCap, LFS Access, MicroCredit Enterprise, Unitus Equity Fund and LOK Fund were some examples of funds that went on to be quite successful. In these cases, Gray Ghost’s decision to decline was generally not based on doubts about the viability of the vehicle, but rather either an inconsistency with one or another of Gray Ghost’s priorities, or a determination that Gray Ghost’s capital was not necessary for a successful launch.

Approved		Declined
	2003	
1 DB MDF		
2 AIM		
	2004	
3 MicroVest		1 Accion Service Co
4 CASA / The Positive Fund		2 Bco Sol
5 BOMS I		3 MicroCredit Enterprise
6 ELF		4 GMF
7 STLF		5 LOK Capital
8 Calvert Fnd		6 ShoreCap International
		7 SEEMIC
		8 Unitus Equity Fund
	2005	
9 Bellwether		9 Dignity Fund
10 GCMC		10 Minlam
11 Catalyst		11 MF Investment Corp
12 BFSF		12 OI Loan Guarantee Fund
		13 Shared Interest

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Approved		Declined
	2006	
13 Antares		14 MFS XXEB
14 AIM Secondary		15 Incofin Impulse
15 Solidus		16 Global Partnerships
16 LACIF		17 LFS Access
17 Centurion		18 MENA Access Fund
18 BOLD		19 MicroCred
	2007	
19 LocFund		20 AfriCap
20 BANEX		21 DWM MF Fund
		22 Avishkar Goodwell
		23 ADV
	2008	
21 Prospero		
22 IFIF		
23 GMEF		
24 MIGROF		

Appendix: Gray Ghost’s Social Performance Approach

In 2004 in an effort to standardize how it incorporated social performance into its evaluation of prospective and actual investments, Gray Ghost developed a simple model based on a set of indicators on MFI and MF investment fund performance. The goal was to combine estimated financial and social return into a single target rate of return for each investment. Gray Ghost examined four broad dimensions of social value: innovation, impact, outreach, and funding, with the aim of finding 3 to 4 “relatively available, relatively measurable, and relatively consistently defined” indicators for each dimension.

A concept note produced by Gray Ghost described the social rate of return estimate as the following: “For each of the four dimensions, the subsidiary indicators are used to generate a composite score ranging from 1 – 10. This score is then used to award basis points: Gray Ghost allocates 150 basis points to each dimension, such that if a fund receives a perfect score in each, it receives a total of 600 basis points of social returns. Gray Ghost then added this social return to the estimated financial yield of the investment to come up with a total estimated blended return. This was then compared to the risk adjusted financial hurdle rate, calculated separately, providing guidance as to whether the investment yields a total financial and social return commensurate with risk.”

This tool was used to guide investment decisions until 2008. With the launch of the Global Microfinance Equity Fund in 2008, the tool was updated and enhanced by the Grassroots team to incorporate the results of important work underway in the industry that had become available. First, consistent with increased emphasis by many participants in the microfinance industry, indicators of a robust consumer protection process developed as part of the Campaign for Client Protection (SMART) were incorporated. These indicators include the existence of truth in lending policies, grievance procedures and monitoring of collection practices, among other features. Second, Grassroots began to incorporate client-level impact data generated by poverty scorecards such as the Progress Out of Poverty Index (PPI) into its framework. Poverty scorecards, which emerged from work by the Grameen Foundation, Ford Foundation and CGAP, and tools developed by Prizma (Bosnia), Microfinance Centre (Warsaw), ASA (Bangladesh) and others, were designed to support meaningful targeting, product development, market research and peer group comparisons.

While improving metrics specific to microfinance remained a priority, Grassroots also saw the need to incorporate these into a more general framework for social performance evaluation, since many social investors have multi-sectoral interests that may, for example, encompass the environment or gender issues, in addition to the eradication of poverty. In this regard, Grassroots began working with B Corp to help develop transparent, comparable and comprehensive social and environmental impact standards across sectors. Grassroots participated in a working group to develop specific ratings to measure the social impact of financial services businesses - lenders, private equity/venture capital fund managers and investment advisors. It then continued this work participating in the initial group of 25 GIIRS “Pioneer

funds” and completed nine assessments out of the roughly 200 companies rated in the GIIRS global beta test.²⁷

Finally, Grassroots also began to explore features that could be incorporated into the charters or by-laws of MFIs to enable them to preserve their double-bottom line character even as they grow and access capital markets. While Gray Ghost did not implement such features, it generated the experience and knowledge base that has enabled Grassroots to continue to explore this dimension of social performance. Based on its experience with the Gray Ghost portfolio, including such failures as GMEF, Grassroots believes that the development of such features will give different types of investors a clearer understanding of what they are investing in, and reduce conflicts as MFIs develop and grow.

²⁷ The GIIRS database now includes over 300 rated companies.