



School of Business,  
Economics and Law  
UNIVERSITY OF GOTHENBURG

# Investments that Make a Difference

*A Study Examining Swedish Investors and Microfinance Investments*

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Tutor: Merja Mankila  
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Ann Silfverhielm 840725-  
Cecilia Wallén 840730-  
Emma Nilzén 840713-

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Ann Silfverhielm, Cecilia Wallén and Emma Nilzén

## Abstract

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**Authors:** Ann Silfverhielm, Cecilia Wallén & Emma Nilzén

**Tutor:** Merja Mankila

**Title:** Investments that Make a Difference – A Study Examining Swedish Investors and Microfinance Investments

**Background and research question:** Microfinance has proven to be a valuable poverty alleviation method but in order to reach its full potential a lot of additional capital is needed. Over the past years we have witnessed an increasing extent of ethical consideration in the financial market and social responsible investments (SRI) have been a growing philosophy. Sweden is the fourth largest SRI market, but as oppose to international trends microfinance investments as a part of SRI has not yet been fully recognized among Swedish investors. To date, there are no known research papers that have examined the Swedish investors and their possibilities to invest in microfinance. Therefore, the research question of this study examines what potential microfinance investments have to become a social responsible investment for Swedish investors.

**Purpose:** The thesis aims to show empirical evidence regarding the Swedish SRI and microfinance investment industry with specific concern to examine the potential of microfinance to become a social responsible investment, SRI, for Swedish investors.

**Delimitations:** The study is limited to examine Swedish institutional investors that either currently are investing in microfinance or in other types of ethical, sustainable or social investments. Further, the study is only focusing on the investment needs in foreign MFIs in developing countries.

**Methodology:** A qualitative research is used to investigate the research question. By collecting primary data through semi-structured telephone interviews and secondary data for the empirical findings, the potential for microfinance investments have been examined.

**Empirical results and conclusion:** The empirical results showed that labelling microfinance investments as SRI might create unnecessary confusion. Consequently, the authors believe that microfinance investments should be examined without any specific categorisation in mind. After examining microfinance investments' opportunities and limitations, the authors came to the conclusion that the investments have a potential for the Swedish investors if the MFIs and Swedish investors manage the mentioned limitations and measures. The authors believe that the investments will have gained foothold on the Swedish market within five years.

**Suggestions for further research:** Further research could focus on future microfinance initiatives that are essential in order to incorporate the potential of microfinance investments in Sweden. Further research could use also execute the research in another country with scarce microfinance investments, using the scope of this study.

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## Definitions

<b>Conventional Banks</b>	A country’s established universal banks. The conventional banks require collateral from their clients and are profit-maximizing businesses.
<b>Institutional investors</b>	Investing organisation that manage collective assets for a large portion of people such as banks, insurance companies, labour unions, churches, foundations and pension funds.
<b>Microfinance</b>	“Microfinance serves as an umbrella term that describes the pro-vision of banking services by poverty-focused financial institutions (MFIs) to poor parts of the population that are not being served by mainstream financial services providers.”
<b>Social Responsible Investment</b>	An investment that in addition to financial criteria, also take social, ecological and ethical factors into the investment decision making process.

## Acronyms

<b>CGAP</b>	Consultative Group to Assist the Poor
<b>MFI</b>	Microfinance Institution
<b>NMI</b>	Norwegian Microfinance Initiative
<b>NGO</b>	Non governmental organisation
<b>PRI</b>	Principles of Responsible Investment
<b>SRI</b>	Social Responsible Investment
<b>Swesif</b>	Sweden’s Forum for Sustainable Investments

# 1. Introduction

*This chapter is designed to give a general overview of the study's topic. The chapter is divided into four sections, starting with the background followed by the problem and purpose of the study and finally presents the delimitations.*

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## 1.1 Background

### 1.1.1 Development of Microfinance

"Microfinance serves as an umbrella term that describes the provision of banking services by poverty-focused financial institutions (microfinance institutions) to poor parts of the population that are not being served by mainstream financial services providers" (Dieckmann, 2007). Further, UN considers microfinance one of the most important foundations to economic growth in developing countries (UN International Year of Microcredit, 2005). Microfinance arose in the developing countries in the 1980s as a response to the lack of access to national financial systems for poor people without collateral. The intention of microfinance was to reduce the corruption and to make sure that the money reach the people and do not get stolen by the government, any other middlemen or loan sharks (Ledgerwood, 2000, p.1). A loan shark is a person or unlicensed loan lender that lends money at exorbitant interest rates and recovers it under threat ([www.businessdictionary.com](http://www.businessdictionary.com)). The initial focus of microfinance institutions, MFIs, was to provide subsidised loans that most often resulted in large loan losses and recapitalisation needs for the MFIs. In order to overcome these defaults a new approach offering market based solutions consisting of small sized loans by building local sustainable institutions for the poor people appeared (Ledgerwood, 2000, p. 1). The ultimate goal of microfinance is to serve as many poor people as possible in a sustainable way. Recent microfinance theories state that the overall long-term objective of all MFIs is to become an integrated part of the global financial system (Ahlqvist, 2002). Research (e.g. Develtere and Huybrechts, 2002; Matthäus-Maier and von Pischke, 2006) show that MFIs reduce poverty and therefore their continuing growth will benefit the global fight against poverty. Not only does MFIs reduce poverty it also contributes to the overall global development in developing countries (Littlefield et al, 2003).

Over the past thirty years, the microfinance sector has matured and proved to be a valuable poverty alleviation method that can act in a sustainable way (cover its own costs) due to high repayment rates and relatively low interest rates. In the 1990s, innovative microfinance institutions began looking towards the commercial sector, as a non-traditional source of funding that would enable them to expand their operations. Some microfinance non governmental organisations, NGOs, entered the commercial sector by attracting investments from international investors who seek a return on their investment while at the same time care to contribute to a social cause. Other

microfinance NGOs began exploiting the commercial sector for funding by offering saving services to clients in addition to their loans (Bell, 2006; Legerwood, 2000, p. 2). This shift in the microfinance industry has spread; resulting in a noticeable change from a donor-driven NGO-dominated sector towards a sector with increasing connection to capital markets, also known as the commercialisation of MFIs. Therefore, the MFIs have developed to become more formal financial institutions of more sustainable characteristics, with the aim to become self sufficient, which increases the possibilities to access commercial borrowing and deposit taking (Dieckmann, 2007).

Studies show that only a small part of the potential microfinance market has been penetrated. In other words, there are still a lot of poor people the MFIs do not reach out to thus leaving room for additional growth (Tulchin, 2004). According to CGAP's Reille and Forster (2008) the volume of global microfinance investments more than tripled between 2004 and 2006. Although MFIs have expanded their customer base, the microfinance industry can still only meet the needs of a small fraction of its potential borrowers. To put this in perspective, MFIs currently have around 100 million borrowers, while the total potential demand is approximately at one billion people. This ratio shows an unexploited growth potential, corresponding to a growth factor around 10 times (Dieckmann, 2007).

### **1.1.2 SRI and Microfinance Investments**

Over the past years we have witnessed an increasing extent of ethical consideration in the financial market, especially among institutional investors. The philosophy is often labelled social responsible investments (SRI). SRI means that the investors make sure the investment objects fulfil their environmental and/or social criteria, in addition to the financial goals (Sjöström, 2004). What also attracts today's more social conscious multinational banks and institutions is the so-called "double bottom line" achieved when financing and supporting MFIs (Hermes and Lensink, 2007). The double bottom line is similar to SRI. Investing in MFIs can enable investors to combine a financial return and a positive social impact (Tulchin, 2002).

Dieckmann (2007) states that microfinance investments are the most successful among all SRIs in attracting institutional and individual investors due to their double bottom line. MFIs have shown their activity to be successful (alleviate poverty) and to be profitable. This fact has led to commercial banks starting to recognize the business of microfinance to a greater extent and to look upon MFIs as a more attractive investment alternative (Reille and Forster, 2008).



## 1.2 Problem

The greater emphasis on financial sustainability and the trend towards commercialisation of microfinance have raised many concerns regarding the MFIs necessity to raise new capital. However, this capital need has fallen short of expectations. There are numerous of domestic and foreign capital options apart from donations arising from investors such as business angels, institutions, commercial banks and investment banks. Despite the existence of a wide variety of capital options, MFIs are facing difficulties in attracting such investments (Tulchin, 2004). Much work is required for MFIs to grow as an asset class and thus increase their investment potential (Jansson, 2003).

“The European Summit on Global Microfinance Investments”, a conference in London (29-30 October, 2008) gathering leading persons from the microfinance field, reported that Europe significantly has increased their microfinance investments as a part of the current social investment trend. In addition, the summit also highlighted the urge for additional investors in order for MFIs to continue to grow. In contrast to the European trends, few Swedish microfinance investments are made. This matter was covered during a recent conference, “Mikrofinansdagen 2008”, in Stockholm (October 23, 2008) where key persons from the Swedish social responsible investing area attended. Despite the fact that the subject of microfinance and SRI is being widely discussed, the conference concluded that few microfinance investments are being executed ([www.csripraktiken.se](http://www.csripraktiken.se) 281008).

In the Swedish financial market, about two thirds of all the assets are subject to some sort of ethical or sustainability criteria (Eurosif, European SRI Study - Sweden, 2008). Further, research (e.g. Bengtsson, 2008; Nilsson, 2008; Sjöström, 2004) show that Swedish investors invest a great deal in SRI, but as oppose to international trends microfinance investments as a part of SRI has not yet been fully recognized among Swedish investors. Globally, microfinance investments have proven to be a good deal for the SRI investors caring about the social aspects of investments (Dieckmann, 2007). Controversially, the Swedish investors have barely started to explore the full potential of microfinance investments. To date, there are no known research that has examined the Swedish investors and their possibilities to invest in microfinance. Hence, there is a gap in the knowledge concerning the Swedish market conditions for microfinance investments. Therefore, the authors have stated one main research question to examine, together with two sub-questions as follows:

- ***What potential has microfinance to become a social responsible investment for Swedish investors?***
  - *What are Swedish investors' approach to SRI and microfinance?*
  - *What incentives are there for Swedish investors to invest in microfinance?*

### **1.3 Purpose**

The thesis aims to show empirical evidence regarding the Swedish SRI and microfinance investment industry with specific concern to examine the potential of microfinance to become a social responsible investment, SRI, for Swedish investors.

### **1.4 Delimitations**

The study is limited to investigate Swedish institutional investors that either currently invest in microfinance or in other types of ethical, sustainable or social investments. Further, the study is only focusing on the microfinance investments to MFIs situated in developing countries.

## 2. Research Method

*This chapter presents the methodology used to examine the research question and the purpose of the study discussed in the previous chapter. The choice of study is illustrated together with the motivation of the selection of the research companies and the chosen data collection methodology.*

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### 2.1 Initial Research

The potential for Swedish investors' to invest in microfinance is an important topic for MFIs, investors, researchers and media. Therefore, this subject contains a large research potential. The study started by gathering previous research papers, related literature and searching through the largest business magazines in order to get an overview of the subject. Additionally, contacts were being made with specialised representatives from different investment organisations related to microfinance in order to get expertise knowledge within the subject. Further, the subject was discussed with the tutor. Finally, the research question and purpose was determined during the initial planning stage.

### 2.2 Choice of Study

With the research question, what potential microfinance has to become a social responsible investment, the authors' purpose was to reduce the gap between the potential and the actual executed microfinance investments. The ultimately purpose was to highlight the potential (opportunities and limitations) for Swedish investors to invest in microfinance. Since this topic has not been paid much attention to in Swedish research, there is a clear lack of statistics thus the authors have chosen to conduct a qualitative research.

In order to study the research question, the authors found it necessary to map the Swedish financial sector in order to identify what investors that could be interested in this kind of investment. As stated above, the research within this field is scarce and there are no known research papers that have studied the Swedish investors' incentives, potential and possibilities to invest in microfinance. To uncover what potential there are for microfinance investments, the authors had to examine investors' attitudes towards such investments. Subsequently, this ultimately leads to two separate empirical parts; the mapping of the potential investors based on the secondary data and interviews with Swedish investors resulting in primary data.

A qualitative research method is characterised by an in-depth and detailed reflection of the social reality (Bryman and Bell, 2007, p. 75). Due to the nature of the research problem, where the objective is to illustrate what potential microfinance has to become a SRI investment for Swedish investors, the authors chose to do a descriptive research. The descriptive research tends to answers questions like *who, what, when, where* and

*how* (Zikmund, 2000, p. 50) which the authors incorporated in their interview questions.

The study's qualitative research method mainly originates from in-depth interviews with respondents that were both microfinance investors and non-microfinance investors in combination with the authors' observations and analysis of other official material provided by the interviewed investors. The choice of in-depth interviews was based on the idea that an employee's description of reality will be an appropriate way for the authors to develop their full understanding of the real situation (Silverman, 2007, p. 55). Subsequently, based on the interviews, the authors were able to interpret and picture the reality based on the respondent's perception and answers.

Apart from gaining an in-depth understanding of the reality, the qualitative method often generates theory. Although, the qualitative approach will to some extent give an in-depth understanding of the reality of the respondents, it is important to be aware of the constraints and limitations derived from the respondents' answers. In addition, Bryman and Bell (2007, p. 155) highlight the importance of awareness for the potential chances of specific social characteristics' impact on the respondent's answers. Specific social characteristics are established at the work place due to the interaction with other employees during coffee breaks, from internal documents or other internal discussions. Therefore, the authors did bear in mind this phenomenon during the interpretation of the answers from the in-depth interviews.

## **2.3 Data Collection**

### **2.3.1 Primary Data**

To reveal the Swedish investors' attitudes towards microfinance investments it was essential to conduct primary data. Primary data is the data that is specifically gathered for the research project at hand (Zikmund, 2000, p. 58). A common method for gathering primary data is through interviews. When preparing the interview questions, it is essential to determine the optimal list of questions and formulate the questions in a representative way (Zikmund, 2000, p. 60).

The authors chose between performing the interviews in person or by telephone. Where telephone interviews often are cheaper and easier to administer, the personal interview can be preferred since it tends to be easier to get a good connection with the respondents when being face-to-face (Bryman and Bell, 2007, p. 215). It was with regards to the timeframe and the availability of the respondents that the authors made their decision. Having most of the companies located in Stockholm the majority of the interviews were made as telephone interviews, except from one company located in Gothenburg.

The authors prioritised a vast selection of investment organisations instead of looking deeper into one investment organisation. Consequently, the interviews have been

executed with only one respondent at each organisation.

In addition to the interviews, primary data was collected during a microfinance seminar in Gothenburg. The seminar included a lecture where Lars-Olof Hellgren, CEO of Mikrofinanshuset, and Nordic Microcap participated and talked about “Poverty and Microfinance”. The authors attended the seminar and simply observed and perceived the information during the lecture that was later used in the empirical findings.

### 2.3.1.1 Sample

#### Selection of Companies

In order to examine the research question it is necessary to investigate the Swedish investors’ attitudes towards SRI and microfinance investments. The authors consider Swesif, Sweden’s forum for sustainable investments, a suitable source to base the study’s selection of current and potential Swedish microfinance investors. At an initial stage of the selection process, e-mails were sent to all of Swesif’s 20 members and presented the purpose of the study. The sample was supplemented with the Swedish conventional banks, where interviews were set with two of the four largest banks. This supplement was made with regards to the large market share the financial banks have of the total Swedish financial sector. In total, the study’s selected population (24 potential investment organisations) resulted in the final sample of 11 investment organisations.

#### Presentation of Research Companies

##### **Banco**

Banco was founded in 1975 and is leading in Sweden within the area of ethical and sustainable investments. Banco was the pioneer within this field and several other investment funds have followed. Banco has signed several commitments regarding responsible capital managing, climate changes and human rights ([www.banco.se](http://www.banco.se) 011208).

##### **Dexia Asset Management**

Dexia Asset Management is a Belgian retail bank. Dexia has developed a range of banking services for private customers, small and medium corporations and institutional investors. In 1998 Dexia introduced the first commercial micro credit fund, Dexia Micro-Credit Fund, which is active in 19 developing countries and supports 30 MFIs ([www.dexia.com](http://www.dexia.com) 011208).

##### **EFG Bank**

EFG Bank created the market for structured financial investments in Sweden, by introducing the first equity linked bond in 1989. EFG Bank is focusing on modern portfolio management and structured placements. EFG Bank is mobilising capital to

Nordic Microcap, an investment company specialised in microfinance ([www.efgib.com](http://www.efgib.com) 011208).

### **Handelsbanken**

Handelsbanken is a Swedish bank that provides services in a broad range of banking areas. Their operations have been developed over the Nordic countries and recently also in the UK ([www.handelsbanken.se](http://www.handelsbanken.se) 011208).

### **Folksam**

Folksam is a Swedish insurance company that is fully owned by its customers. Their vision is to contribute to a long-term sustainable development of the society where the individual feels safe. Folksam is dedicated to environmental issues and works strongly for a sustainable development in society ([www.folksam.se](http://www.folksam.se) 011208).

### **Nordic Microcap**

Nordic Microcap is a private investment company investing in microfinance. The shareholders are mainly Swedish institutions, organisations and individuals. The company has more than 15 years of experience from the microfinance field. Their strategy is to invest in existing MFIs and develop these to self-sustainable businesses to be sold in a later stage ([www.africapfund.com](http://www.africapfund.com) 011208).

### **SEB**

SEB was founded in 1856 and is today one of Northern Europe's leading financial groups. SEB is a leading universal bank in Sweden, Estonia, Latvia and Lithuania. SEB serves 400,000 corporate and institutional clients and five million private customers ([www.seb.se](http://www.seb.se) 011208).

### **The Second Swedish National Pension Fund**

The Second AP Fund is a manager of national pension reserve assets. The Second AP Fund, based in Gothenburg, is one of the five "buffer" funds in the Swedish national pension system ([www.a2.se](http://www.a2.se) 011208).

### **Swedbank Robur**

Swedbank Robur is a fully owned subsidiary to Swedbank and was founded in 1965. It is one of the largest fund companies within the Nordic countries. In 25 years Swedbank Robur has had ethical and environmental funds in their product supply. They are one of the few fund companies on the Nordic market that conduct an ethics- and environmental analysis based on internal requirements ([www.swedbankrobur.se](http://www.swedbankrobur.se) 011208).

## Swedfund

Swedfund is a Swedish venture capital company owned and funded by the Swedish state. They have specialised in investments in developing countries. Currently they have several investments in MFIs ([www.swedfund.se](http://www.swedfund.se) 011208).

## Church of Sweden

The Church of Sweden has several international operations. They support economic justice, and therefore the Church of Sweden has since the 1980's been supporting microfinance with assistance to loans and savings through Oikocredit and ECLOF, the Ecumenical Church Loan Fund ([www.svenskakyrkan.se](http://www.svenskakyrkan.se) 011208).

## Respondents

The objective with the primary data is to get a representative result that can be generalised into a larger population. In order to meet this objective it is important that the right respondents are chosen. When communicating with the eleven investment organisations, the authors requested to get in contact with employees with insight into the company's investment decisions and/or knowledge in their ethical standpoint. This method was chosen in order to increase the generalisation of the empirical findings. The respondent at each company is presented in Figure 1.

**Figure 1: Respondent Overview**

Company	Respondent	Position
Banco Funds	Helena Hagberg	SRI Head Analyst
Church of Sweden	Per Söderberg	Microfinance Coordinator
Dexia Asset Management	Fredrik Wilkens	Head of Nordic Institutional Sales
EFG Bank	Patrik Soko	Head of Office
Handelsbanken	Malin Hallén	Senior Fund Analyst
Folksam	Carina Lundberg Markow	Head of Responsible Investments
Nordic Microcap	Lars-Olof Hellgren	CEO
The Second Swedish National Pension Fund	Carl Rosén	Corporate Governance & Information, Chairman of Ethics Council
SEB	Christina Strand-Wadsjö	Business Coordinator
Swedbank Robur	Ian Raftell	Equity Fund Manager
Swedfund	Oscar Carlsson	Head of Analysis

### 2.3.1.2 Interview Method

Depending on the purpose of a study, the interview structure will differ. With a

descriptive study, the most common interview types are semi-structured and structured. The structured interviews have a list of questions that is strictly followed at each interview. Semi-structured interviews are built on a list of question themes, instead of a set form of questions. The authors decided to do semi-structured interviews since this technique gives them the opportunity to be more flexible during the interview. The semi-structured interview also gives the respondent the possibility to interfere and contribute to the authors' own interests with new insights and understanding (Saunders et al, 2007, p. 312).

Nonetheless, the authors used semi-structured questions based on an interview template in order to increase the comparability (Lövstedt and Stjenberg, 2006, p. 176). The interview template (see Appendix I - Interview Template) was sent to the respondents before the interview, to give them the possibility to be prepared. The interview structure enabled the authors to vary the questions depending on what turn the interview took and was a help to also ensure that the same information was collected from all of the companies. With the template the authors outlined questions that were asked during the interviews (see Appendix II – Interview Questions).

Overall, the interviews' duration was set to one hour. All of the interviews were recorded and thereafter transcribed on the computer in order to allow a better interpretation of the recorded material. The respondents were also demanded to confirm the transcribed version of the interview to avoid problems with misinterpretation.

### **2.3.2 Secondary Data**

Secondary data is the already collected data. Secondary data is always gathered faster and at a lower cost than the primary data, therefore it is often used as a supplement to the primary data for a descriptive research (Zikmund, 2000, p. 61). Secondary data was collected in order to get an overview of earlier research done in the field of research. Since the area of microfinance investments in Sweden is fairly unexplored secondary data was used both for the theoretical framework and the empirical findings. The theoretical framework consisted mainly of theories regarding microfinance institutions and microfinance investments. In order to identify potential microfinance investors, the authors had to conduct a map of the Swedish financial sector's potential microfinance investors that was presented in the first part of the empirical findings.

Through Gothenburg University electronic databases were accessed containing business articles and publications related to the research. The most frequent used databases were Business Source Premier, Jstor and Scopus, where the authors collected the majority of the study's secondary data. Wordings such as "social responsible investing", "microfinance investments" and "microfinance Sweden" were used in the database searches. The theoretical framework has mainly been based on published articles



together with research papers, since the literature in this field is scarce.

#### 2.4 Credibility of Research Findings

**Reliability** is according to Hammersly (1992) "the degree of consistency with which instances are assigned to the same category by different observers or by the same observer on different occasions". In other words, the reliability and result of a study is strongly related to the quantity of studies with a coherent result. Subsequently, the reliability of a qualitative study is not relevant thus it should rather be seen as a way of increasing the authors' comprehension and understanding of the specific study. Hence the reliability aspect is not representative in a qualitative study (Silverman, 2007, p. 88). A qualitative study should rather be seen as a representation like any other trustworthy attempts, according to Bryman and Bell (2007, p. 170). In fact, since the reality is not perceived in only one way this study will only be one interpretation and attempt to reflect the reality. Worth notifying is that the selection of respondents and the timing of the conducted study could possibly result in a different outcome if these variables were chosen differently. As a result, the reader should be aware of the limitations that the qualitative study have. In a qualitative study, similar to this study, the reliability is impossible to achieve since every interview moment is unique and therefore difficult to re-create.

**Validity** is another word for "truth". According to Hammersley (1990) "truth is interpreted as the extent to which an account accurately represents the social phenomena to which it refers" (Silverman, 2007, p. 92). According to Holme and Solvang (2001, in Silverman, 2007, p. 73) the validity of qualitative studies is rather high due to their in-depth approach. During the sample selection the authors considered the significance of involving respondents with different standpoints and insights in order to increase the validity. However, when conducting a qualitative research like the authors' study, it is important to assume that the selected respondents information is not necessary reliable or valid. As a result, the authors have spent a lot of time discussing together and emphasised the importance of critically questioning each other during the course of study.

Regarding **generalization**, Bryman (1989) claims that it is difficult to generalise the outcome in a qualitative study since, there might always be doubts regarding the selection of the research population (Silverman, 2007, p. 85). The authors tried to improve the ability to generalize their study through selecting a broad range of Swedish investors (e.g. pension funds, banks, insurance companies, investment funds, the Church of Sweden) and respondents with similar positions related to the investment decision. Moreover, the generalisation of the study was enforced by choosing investment organisations that currently invest in microfinance as well as those who do not.

### 3. Theoretical Framework

*The following chapter presents the study's theoretical findings. The chapter commences with a presentation of the development, types and risks of microfinance institutions. Further, theory related to microfinance investments and opportunities as well as limitations in microfinance investments are treated. The chapter completes with microfinance investment initiatives.*

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#### 3.1 Microfinance Institutions

##### 3.1.1 The Development of Microfinance Institutions

Modern microfinance derives from micro-lending initiatives in South Asia and Latin America in the mid 1970s. A microfinance institution, MFI, is very often initiated as a NGO with essentially a social objective: helping the poorest of the poor by giving them access to a scarce resource; their ability to place their deposit in a safe place or access to credit. However, along with the MFIs maturation generally two features arise; firstly, there is an increasing pressure put on the institution when aiming to increase its outreach to poor people and secondly, the demand for more sophisticated microfinance services arises. As a result the demand for capital increases, not only in order to enable for the MFI to provide credit to a larger amount of people, but also in order to keep the more complex institution floating. Consequently, in order to improve the MFIs ability to raise capital, take on deposits and to reach out to more customers, an increasing number of mature and semi-mature MFIs are transforming themselves from NGOs to regulated MFIs and from regulated MFIs to commercial banks (Goodman, 2004). As it turns out, combining a financial return in addition to the MFIs social objectives creates a sound basis for a sustainable provision of services to the poor (Hermes et al, 2007). Still today, the core objective of microfinance is to provide micro-credits to the working poor. In fact, one of the cornerstones that microfinance theory relies on is the strong belief that also the poor are able to act in an entrepreneurial manner and are thus, in principle, creditworthy despite their lack of collateral (Dieckmann, 2008).

##### 3.1.2 Different Types of Microfinance Institutions

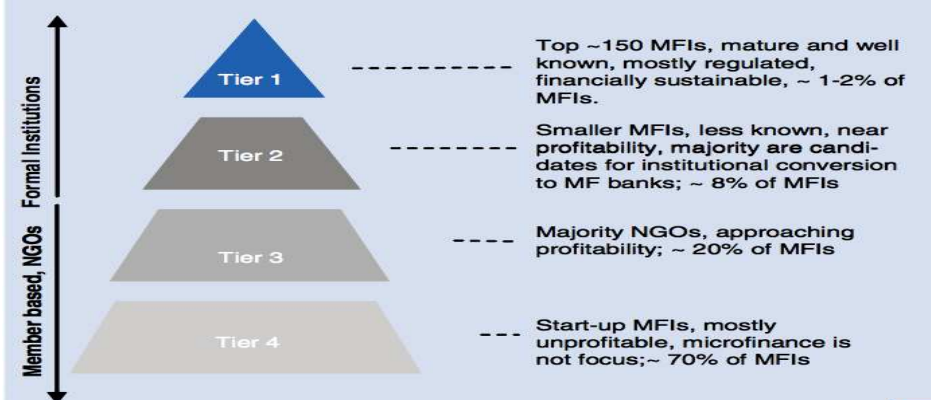
Furthermore, it is important to remember that the people living below poverty line can not be seen as a homogeneous group. Following the assumption that poverty has many dimensions and that the circumstances of two micro creditors may differ greatly from each other, there is a need for different types of microfinance institutional structures targeting different segments of poor people (Kakwani and Silber, 2008).

It is estimated that a total number of more than 10 000 MFIs exist worldwide. The various forms of MFIs can be divided into credit unions and non-profit oriented enterprises, NGOs, government agencies, private and commercial banks. As a consequence, microfinance investments cannot be looked upon as a homogeneous group

since funding situations of MFIs differ greatly from each other, depending on the structural form of the specific institution (Dieckmann, 2008).

Taking into consideration the level of commercialisation reached by the respective MFI, the funding situations available on the market can be organised into four tiers (shown in Figure 2): The top tier contain mature MFIs which have developed more formal structures and which are already receiving capital from commercial banks and private as well as institutional investors. In most cases they are profitable and managed by an experienced management team. However, this group accounts for no more than 1-2% of the MFI market. This later group is expected to grow since it has been proven to be the most economic sustainable development of MFIs in current times. The second tier having 8% of the market share consists of smaller and often less mature MFIs currently transforming into regulated MFIs. Further, the third tier is by and large made up of NGOs struggling towards profitability while suffering from a lack of funding. This group accounts for around 20% of the MFI global market. Thus, in a zero sum game, the fourth-tier institutions accounts for roughly 70% of the MFI market. This implies that 70% of all MFI are start-ups (Dieckmann, 2008).

**Figure 2: MFIs Development Stages** (Dieckmann, 2007)



**3.1.3 Risks for Microfinance Institutions**

Among investors in developed countries, MFIs would normally be classified as an emerging market, small capital investment of mainly unstructured financial product characteristics. This implies that in addition to normal liquidity and business risk, the microfinance industry involves a broad universe of other risks such as country, currency and transfer risks. In effect, risk management has become an area of increasing importance for MFIs as well as for investors (Coleman, 2003). As in all industries, risks can be categorised into controllable and uncontrollable risks (pictured in Figure 3).

**Figure 3: Risks in Microfinance Institutions** (Reddy, 2007 and Calerón, 2006)

	<b>Controllable</b>	<b>Uncontrollable</b>
<b>Microfinance Industry Risk Areas</b>	Financial Risk Operational Risk Market Risk Management Quality	Regulatory Risk Country / Political Risk Foreign Exchange Risk Currency Devaluation

**Financial risks** include credit quality, capital adequacy, assets and liability management and foreign exchange exposure. Risk mitigation strategies for the MFIs are to appoint risk managers and to implement an overall risk management system, and, to establish prudent internal financial policies as well as regulatory frameworks regarding for example provisioning and foreign exchange exposure. An investor can assess financial risks by using benchmarks for financial performance, for example, from the microfinance industry’s S&P, Microfinance Information Exchange (MIX).

**Operational risks** such as internal fraud and money laundering practices can be controlled by the use of internal control systems as well as with human resource incentive programs, thus, boosting corporate moral, mitigating internal fraud and securing money transfers.

**Market risks** are most often linked to the MFIs political ties, its reputation and general competition as well as interest rates competition. Therefore, it is important for the MFI to establish strong governance and committee structures to enable management and diversification of these risks.

**Regulatory risks** are those related to governmental interest rate regulations, threat of burdensome anti-money laundering regulations and of increased minimum capital requirements. They are most significant in Latin America and Asia, where MFIs put a lot of effort in highlighting best practices from other regions hoping to influence regulators and to advocate for beneficial policies.

**Political risks** such as war and civil disturbance, and institutional corruption can be sold by the purchase of political risk insurance, if it is affordable.

**Foreign exchange risks** include the risk of currency devaluation. In stronger emerging markets a strategy could be a combination of US dollar funding and currency swaps. Even though new initiatives arise based on portfolio risk spreading this strategy is expected to become more common in the future (Reddy, 2007).

**Currency devaluation** is a further threat for the MFIs. A MFI is unlikely to survive a major devaluation even if their portfolio remains healthy. Luckily, many MFIs have diversified sources of funding based on client savings, local borrowing, and external

borrowing, which is increasingly being hedged (Calerón, 2006).

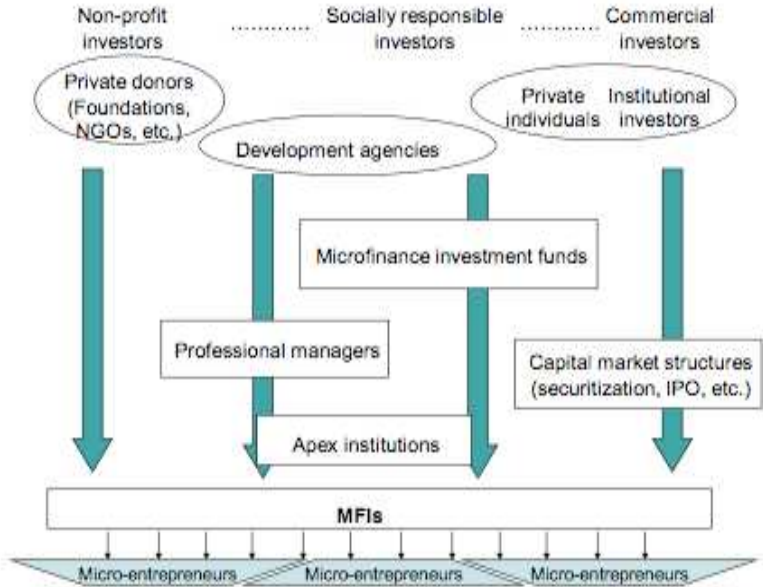
**Quality of its management** is a risk for the MFI due to commercialisation of the industry. The increased competition puts the management under an increased pressure. Its ability to handle a rapidly changing environment and to deal with the growing complexity is vital for a sustainable development of the MFI. Therefore, the biggest risk facing the industry seems to be the quality of its management (Mix, 2008).

**3.2 Microfinance Investments**

**3.2.1 The Microfinance Investment Landscape**

As illustrated in Figure 4, the microfinance investment landscape is symbolised by a diversity of actors. For a long time foreign microfinance investments were dominated by non-profit investors such as development agencies, foundations and charities. Recently, both private and institutional social responsible investors, who require some financial return, entered the industry and more recently international commercial investors have started investing in MFIs. The first international commercial investment fund that started investing in microfinance was Dexia Micro Credit Fund in 1998. Throughout the years, MFIs, investors and intermediaries have initiated the following three major supportive microfinance investment structures. Firstly, professional managers like Blue Orchard and Symbiotics are often guiding this kind of investments. Secondly, capital market structures like portfolio securitization and IPO have entered the industry. Thirdly, microfinance investment funds play a crucial role, with estimated 45% market share of all executed microfinance investments, in the canalisation of international investments. Finally, but with a less significant supportive role, Apex institutions or wholesale organisations as they are referred to channel funds to several MFIs in one country (Reddy, 2007).

**Figure 4: Microfinance International Investment Landscape** (Dieckmann, 2007)



### **3.2.2 International Funding of Microfinance Institutions**

A large amount of local and international investments are crucial for enabling the expected MFIs growth. Today, around 85% of the funding derives from local investors whereas 15% originates from foreign investors (Reddy, 2007). Although, many argue that domestic funding is the most desirable one since domestic capital markets are less expensive and more flexible compared to foreign investments. Nonetheless, the continuing involvements of foreign investments remain important until local markets have developed and are able to take the funding lead. As a result, foreign microfinance investments are expected to grow in the future (Fuchs, 2006). Approximately 82% of all foreign investments go to regulated MFIs. Generally, three sorts of investment alternatives exist. Firstly, own funds, such as grants and donations or equity capital. Secondly, debt such as loan or debt securities and thirdly retail funds can be found in more mature MFIs (Reddy, 2007).

### **3.3 Opportunities and Limitations in Microfinance Investments**

*Despite the low portion of foreign microfinance investments, their importance is increasing and remains crucial for the MFIs growth. Consequently, the authors find it important to clarify the opportunities, limitations and critics related to microfinance.*

#### **3.3.1 Opportunities**

##### A Growing Market

The microfinance industry is largely unsaturated and characterised by a large number of start up MFIs. To put this in perspective, MFIs currently have around 100 million borrowers, while the total potential demand is approximately at one billion people. This ratio shows an unexploited growth potential, corresponding to a growth factor around 10 times thus constituting an emerging investment opportunity (Dieckmann, 2007). Subsequently, it is clear that microfinance is looking less like a charity case and more like an investment case (Fuchs, 2006). Moreover, the MFIs development is expected to result in an amplification of the equity capital demand whereas the future demand of debt capital will derive from the less developed MFIs. Finally, the growing market show signs of additional investment opportunities such as providing supplementary services to the poor apart from lending such as saving services, pensions, insurances and housing credit (Reddy, 2007).

##### The Dual Return Profile of Microfinance Investments

Few fields in development or commerce emphasize both social and financial performance as strongly as microfinance investments. The dual return is sometimes referred to as the Double Bottom Line return where the social activities are evaluated as well as the financial performance (Tulchin, 2002).

## **Social Return**

Reaching out to the heterogeneous group of poor people around the world, the main object of microfinance is to provide the working poor with a sound banking institution. By assisting the micro-entrepreneur with favourable conditions the micro-entrepreneur is given the tools necessary for him or her to climb out of his or her poverty in a sustainable way. Social returns of microfinance investments contribute to an overall reduction in world poverty and sustainable development through the creation of millions of jobs, a reduction of child mortality, improved maternal health and improved housing conditions as well as gender equality, and women empowerment (Tulchin, 2002; Littlefield et al, 2003).

There are several reasons why MFIs put a lot of focus on female borrowers; Firstly, women by tradition represent the poorest segments of the society, thus are generally offered fewer economic opportunities than men. Secondly, bearing in mind the fact that women by tradition are responsible for the household and children up bringing the women are considered to be more motivated and the risk of opportunistic behaviour as well as issues arising due to moral hazard have been proved to be reduced in comparison to what can be seen amongst men. Consequently, the MFIs are promoting loans to female borrowers to a greater extent than to the men, as women tend to be more loyal and reliable clients. As a result microfinance leads to the empowerment of women (Hermes and Lensink, 2007).

The measurement of an investment's social return can not be determined as easily as the financial return created by an investment. Several methods have aroused trying to measure social value (Reddy, 2007). One example is the Social Performance Index, SPI, which investigate the structure of an organisation. The social performance is measured through the principles, the actions and the corrective measures implemented by the MFI. With respect to microfinance, four dimensions of social performance can be identified:

- The MFIs outreach to the poor and excluded
- The adaptation of services and products to the target clients
- The level of trust between the MFI and the clients
- The social responsibility of MFI

Often a MFI choose to focus on one or several dimensions thus social performance can not be regarded as a synonym to solely poverty outreach (Zeller et al, 2003).

## **Financial Return**

The microfinance industry is characterised by small institutions in comparison to traditional commercial banks, clients lacking guarantees, and, risky country environments. Nonetheless, commercially oriented investors are increasingly funding the MFIs with capital (Matthäus-Maier and von Pischke, 2006, p. 65).

In the 21<sup>st</sup> century, the stock markets around the world have declined severely. For instance the US stock market has experienced its worst period since the Great Depression. Simultaneously, several indicators prove the regulated MFIs' ability to maintain healthy portfolio quality while national and international financial markets fluctuate (Leader in The Economist, 2008, Issue 8603). For instance, several countries in Latin American have suffered from economic stagnation and political turmoil. While the value of the countries' aggregated general bank portfolios have declined, the regulated MFIs portfolios have grown rapidly. The Ecuadorian financial and banking crisis in 1999 demonstrates while two-thirds of the national banking system collapsed, MFIs grew steadily and maintained high levels of portfolio quality. Evidence from other countries suggests that the spotted MFI characteristics are not unique for countries on the Latin American market. Also, when analysing the financial crisis in Asia in the late 90's similar evidence can be found (Calerón, 2006).

Microfinance assets have proved not to be correlated with general stock market and interest rates fluctuations. Therefore, holding assets in microfinance as part of an investment portfolio is a good way to diversify an investor's global portfolio risk. The trend of "return malaise" on the general financial market provides the microfinance industry with an increased opportunity to access the capital markets (Calerón, 2006).

A second feature providing the microfinance industry with a remarkably high repayment ratio of approximately 95% is the joint liability group lending structure the industry is characterised by. In contrast to traditional banking where a loan is often granted on an individual basis, one of the MFIs key factors of success has been the group lending method where a group of people are jointly responsible for a loan. In other words if one group member does not repay her part of the loan, others may have to contribute to ensure the payment. If the group as a whole fail in their repayment requirements all members will be denied access to future loans. Consequently, joint liability group lending creates incentives for individual group members to screen and monitor other group members in order to eliminate the risk of credit default of one of the group members, thus managing the risk of adverse selection. As a result, agency costs arising due to information asymmetries on the market will be strongly reduced (Hermes et al, 2007). The group lending solution shows evidence of a high repayment frequency since the moral hazard behaviour of individual group members is being reduced, due to the use of local social and group member pressure. In addition, the



group lending method decreases the MFIs transaction costs due to the collective distribution consisting of small sized loans (Ledgerwood, 2000, p. 4).

The microfinance industry has experienced sustained growth rates of more than 30% for the last decade (Tulchin, 2004). The UN designated 2005 as the Year of Microcredit, acknowledging that banking the “unbankable” is commercially viable and demonstrating that microfinance is now well established on the international development agenda. Further, the net rate of return of microfinance investment funds in general has been estimated to a yearly return of 10%. Generally the investment horizon is 5-10 years (Matthäus-Maier and von Pischke, 2006, p. 214).

#### Attractive Risk-Return Profile

While microfinance investments allow investors to undertake social investments for poverty alleviation they simultaneously offer an attractive risk-return profile marked by stable financial returns (Dieckmann, 2007). Consequently, investors, such as commercial investors can solely be attracted by microfinance investments’ strong credit quality and attractive risk-return profile. The return and risk profile remain interesting as a result of the successful group lending method applied, where the default rates on microfinance loans remain relatively low, around 4-5%, which is less than half of the rate on subprime loans made by US lenders (Uhlfelder and Ajanovic, 2005). In addition, even weaker MFIs in developing countries often show a portfolio risk of less than 5% (Matthäus-Maier and von Pischke, 2006, p. 214). Paradoxically, along the MFIs maturation into full fledged banking operations the long-term credit risk rise (Uhlfelder and Ajanovic, 2005). The most advanced MFIs offer an ROE of 17.5%, which sometimes is higher compared to that of conventional banks (Dieckmann, 2007). It has also turned out that the high interest paid on microloans, annually averaging around 30%, actually makes the operations surprisingly profitable (Epstein et al, 2007).

#### Sustainable Humanitarian Aid

Instead of a serving as a donation, commercial microfinance investments offer a perpetual and sustainable contribution. In other words, the repaid money for a loan can be transformed into new loans and contributes with the opportunity for a sustainable humanitarian aid (Uhlfelder and Ajanovic, 2005). In addition, in a world of increasing emphasis on corporate social responsibility companies investing in microfinance automatically benefit from the media attention nothing compared to an expensive PR campaign (Fuchs, 2006).

#### Risk Diversification

As mentioned, microfinance investors often value social returns over financial returns. Nonetheless, for many institutional investors, microfinance securities have proven to be a low-volatility, non-correlated asset class with the mainstream financial assets as well

as the general domestic economy. Overall, the yield is comparable to a money market or Libor investment. As a proof, despite the recent dip in emerging markets returns have remained robust (Fuchs, 2006). Some evidence confirms that microfinance investments enhance the efficient diversification of a portfolio. Basically, a higher return can be obtained for a given level of risk (Dieckmann, 2007).

### 3.3.2 Limitations

*The limitations for microfinance investors are obstacles for the investors making the investments remain low. Critics have also been criticising the microfinance for some of these limitations.*

#### High Risk – Low Return

Some investors consider microfinance investments as risky due to the numerous limitations presented below, despite the fact that microfinance investments diversify investors' portfolios since they tend to have low correlation with national level risks (Tulchin, 2004).

#### Track Records and Transparency

Track records and transparency are vital for microfinance investors. MFIs have reported extremely low loan losses, about 1-3%, which is on a better level than the conventional banks in the formal financial system. Being aware of the great difficulty for business in the poor areas, critics have been questioning the accuracy of the statistics (Easton, 2005). Therefore, the investors demand documented performance when making their investment decision and it is therefore vital for MFIs to have their financial reports and official documents in order. Investors also find comparable sources helpful to weigh against each other when making an investment decision (Tulchin, 2004). Unfortunately, there are very few MFIs that have sufficient track records for their financial return, costs and level of loan losses. This general lack of information and poor transparency makes it impossible for investors to compare microfinance investments with regular investments (Goodman, 2004).

#### Limited Investment Capacity

The microfinance industry is despite its strong growth still fairly undeveloped and fragmented. The majority of MFIs are small. More than 90% of the MFIs have fewer than 10 000 customers (Tulchin, 2004). Despite the microfinance investments attractive risk-return profile it is important to underline the difficulties to make large money out of such investments due to the MFIs investment capacity limitation, which tends to prevent larger investments (Uhlfelder and Ajanovic, 2005). Since conventional banks generally do not prefer small or medium size investments, such as microfinance investments, the challenge for the banks is to invest large sum microfinance assets that are concentrated to preferably a single MFI in order to make the deal profitable (Fuchs, 2006).

### Bad Reputation

Microfinance is sometimes associated with a stereotypical negative image. Investors often picture MFIs as non-profit organisations (regardless of true performance) as an entity with a social mission, a lack of governance expertise within the top management, an organisation with weak balance sheets that is driven by donors. This negative image prevents potential investors to invest their money in microfinance (Matthäus-Maier and von Pischke, 2006, p. 92). Criticism claims that MFIs hurt the poor with unfairly high interest rates. It is argued that they charge higher interest rates to their customers as compared to the regulatory cap established by governments for traditional banking institutions. Critics also claim that as the commercialisation spreads, the balance between business and development in MFIs will be in favour of the business. As many MFIs become commercialised, their social programs previously offered could possibly be reduced or eliminated. This phenomenon is often referred to as “mission drift”. Consequently, these critics spread among the public and investors alike may ultimately lead to microfinance’s bad reputation (Bell, 2006).

### Lack of Knowledge

When MFIs are promoting their financial services it is clear that the investors lack knowledge regarding the microfinance industry and its investments. Investors have generally not been educated enough to see microfinance as an investment opportunity. Therefore, the microfinance investments simply must be on par or better than other investment alternative and also have an equal risk-return profile to attract investors’ attention (Tulchin, 2004).

### Targeting the “Right” Poor

Everyone does not agree upon the fact that microfinance helps fighting poverty, but most of them agree that the vulnerability of the poor is reduced. It is important to remember that the poor is not a homogeneous group, and criticism has been raised to the MFIs for not reaching out to the poorest of the poor. MFIs tend to prefer their clients to be less poor because this makes it easier to achieve a sustainable financial organisation. This can be considered as a limitation for the investors seeking to obtain the dual returns of microfinance investments (Develtere and Huybrechts, 2002).

## **3.4 Microfinance Investment Initiatives**

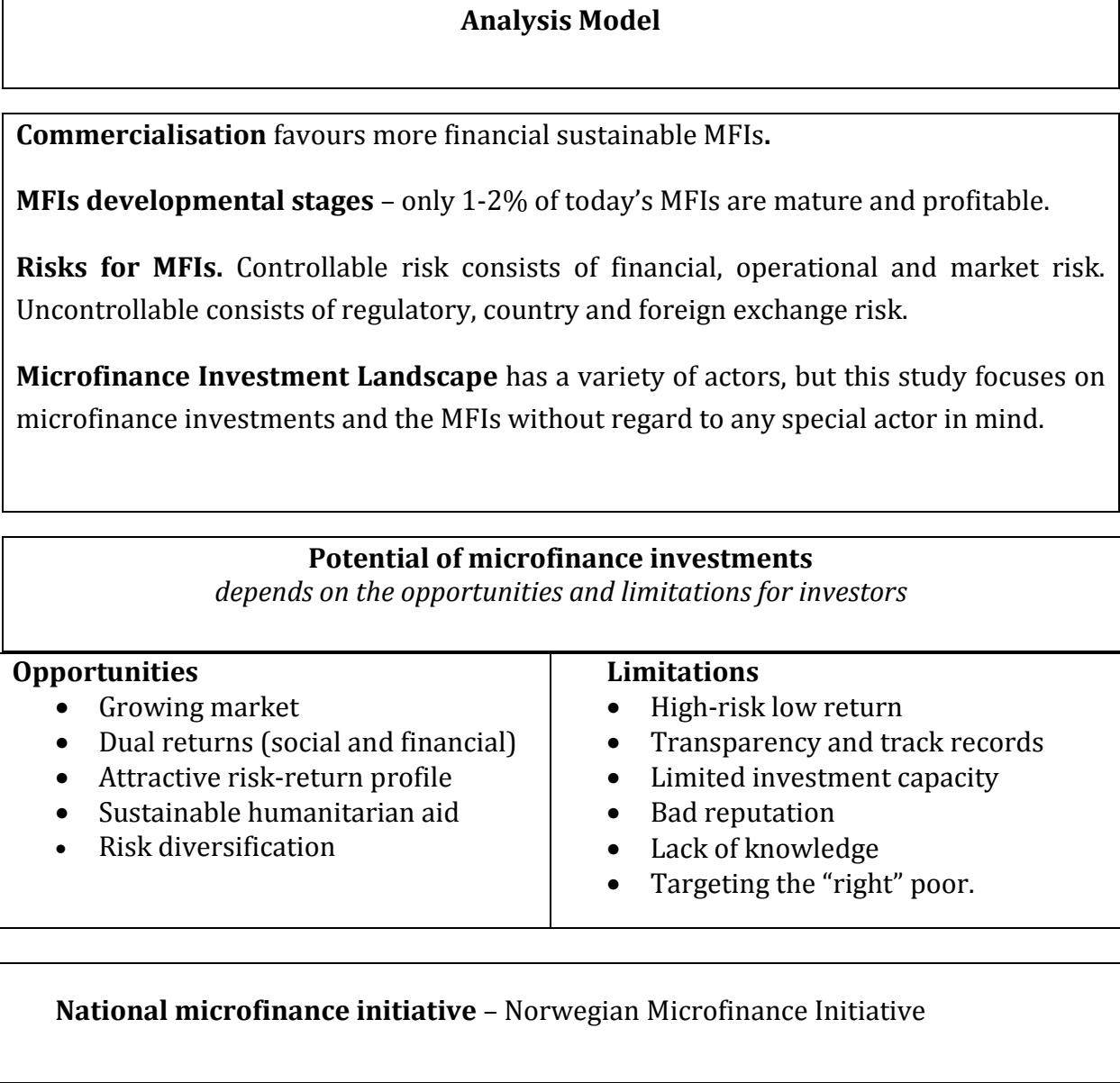
The Norwegian microfinance initiative, NMI, is a private-public partnership and initiative, which in December 2008 announced its creation of two investment funds, NMI Global Fund and NMF Frontier fund. DnB Nor Bank, private equity investor (Ferd), insurance companies (KLP and Storebrand) the Norwegian Agency for Development Cooperation (Norad) and the Norwegian Investment Fund for Developing Countries (Norfund) are involved in NMI. Together the signatories’ ambition is to help create job

positions and prosperity for poor people in developing countries on a sustainable basis. NMI Global Fund will focus its investments on more mature microfinance institutions in selected regions and developing countries. NMI will do something few others have done, and that is to give loans in local currency which significantly reduces currency and inflation risk for the borrower. In this case the public can contribute with expertise and the private sector with additional capital, professional support and knowledge of commercial and financing activities NMI. Moreover the initiative aims to reduce management costs and reduce currency risk involved ([www.norfund.no](http://www.norfund.no) 091208). The NMI fund will charge around 30% interest rate on micro loans and expect a return of 6-10% when the risk is high and money market rates when it is lower ([www.reuters.com](http://www.reuters.com) 091208). The public-private initiative ambition is to operate on a commercial basis and therefore to yield an attractive outcome from both development effects and traditional financial returns ([www.norfund.no](http://www.norfund.no) 091208).

### 3.5 Summary for Analysing the Theoretical Findings

In Figure 5 the authors have summarised the most important theoretical findings covering the research topic, in order to structure the relevant findings. In this way the authors know what to emphasise in the empirical research. This model is further used when analysing the empirical findings against the theoretical findings.

**Figure 5: Summary for Analysing the Theoretical Findings**



## 4. Empirical Findings

*This chapter will guide the reader through the study's empirical findings. Since the empirical findings were gathered in two parts, this chapter will present it in the same way. The first part of the chapter is the mapping of the potential Swedish microfinance investors followed by the second part where the results from the interviews are presented.*

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### 4.1 Potential Swedish Microfinance Investors

The authors find it relevant to examine the Swedish SRI market and its investors, based on their perception that microfinance investments can be associated with SRI.

Several researches' (Dieckman, 2007; Lundberg and Westholm, 2006, [www.swesif.org](http://www.swesif.org)) have categorised microfinance investments as a SRI asset. These studies further reveal that both these investments attract social conscious investors; the ones looking for investments offering an attractive risk-return profile with dual returns (financial and social).

Another connection between SRI and microfinance is shown when examining SRI strategies. Screening, shareholder advocacy and engagement are traditional SRI methods ([www.socialinvest.org](http://www.socialinvest.org) 281108). Community investing is an emerging SRI strategy with connections to microfinance. The community investment strategy directs capital from investors and lenders to communities with insufficient traditional financial service institutions. The microfinance industry, credit institutions, private equity firms, and venture capitalists in developing countries are good examples of community investing (Lundberg and Westholm, 2006). Microfinance, community investing differs from charity as it earns a competitive financial return, while providing an attractive social return to investors as well as to the communities. Further, community investments focus on microloans, affordable housing, small business creations, development of community facilities, and the empowerment of women and minorities in a sustainable way ([www.socialinvest.org](http://www.socialinvest.org) 281108). In Sweden, Nordic Microcap, Swedfund and the Church of Sweden are some examples of current Swedish community investors ([www.swesif.org](http://www.swesif.org) 101208).

Another argument for the potential for Swedish microfinance investments to profit from being associated with SRI is the large Swedish SRI market. Sweden is considered one of the leading SRI markets in Europe after UK, France and Italy. Almost 70% of professional financial assets are subject to some SRI criteria (ethical, environmental, social) on the Swedish market (Eurosif, European SRI Study - Sweden, 2008).

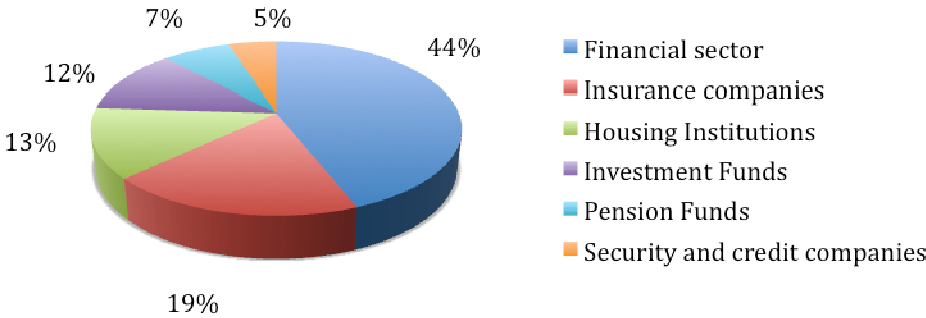
*Concluding these findings, the authors have identified a clear potential among SRI investors as possible microfinance investors. Further, in absence of a mapping of the Swedish financial sector searching for potential microfinance investors the authors have*

conducted one. As previously stated in the introduction chapter, the Swedish microfinance investments are few on the Swedish market. As a result, the authors find it necessary to examine if the SRI connection to microfinance is appropriate which is further discussed in 4.2.1.

**4.1.1 The Swedish Financial Sector**

The Swedish financial sector consists of financial companies that act as financial intermediaries or providers of financial services, the different players are pictured in Figure 5. The financial sector makes sure society’s savings are handled in an efficient way and transformed into investments and/or consumption (Svenska Bankföreningen, 2008). The Central Bank, financial banks, financial housing institutions, other credit market companies, investment funds, security firms, investment banks, insurance companies, pension funds and foreign financial subsidiary companies are included in the Swedish financial sector ([www.scb.se](http://www.scb.se) 231108). In December 2007 the Swedish financial sector amounted to 13 800 billion SEK (Svenska Bankföreningen, 2008).

**Figure 5: The Swedish Financial Sector** (Svenska Bankföreningen, 2008)



**Investors**

In recent years, SRI has grown from small retail investment funds into an investment philosophy applied by a growing proportion of large institutional investors such as pension funds, insurance companies and retail investors. Institutional investors include any investing organisation that manages collective assets for a large portion of people such as banks, insurance companies, labour unions, churches, foundations and pension funds (Sjöström, 2004). Today, Swedish institutional investors and retail investors (individual investors) are the largest and fastest growing SRI investor category in Sweden.

*Below follows an in-depth presentation of various Swedish institutional investors with social considerations, along with relevant investment guidelines and regulation.*

## **Institutional Investors**

### **Banks**

Out of the 123 registered banks in Sweden, the largest ones are Nordea, SEB, Handelsbanken and Swedbank. These four banks are so called universal banks (since they are present within most parts of the financial market) and they cover about 75% of total deposits of Swedish citizens. By offering companies as well as the public different risk management services banks help their clients diversify, reduce or redistribute the portfolio risk. Most of the banks started as savings institutions in the early 20<sup>th</sup> century. Over time, they have transformed and diversified into large international financial groups offering a part from the traditional banking services, life insurances, investment funds and mortgage services (Svenska Bankföreningen, 2008).

All four universal banks have some sort of ethical funds with different niche objectives to offer their customers yet, Swedbank and SEB tend to offer a largest amount of ethical funds (Lundberg and Westholm, 2006). In addition, Nordea and SEB have shown their social concern and responsibility by signing UN's Principles of Responsible Investment (PRI). PRI originated in 2005, when Kofi Annan, the general secretary of UN, suggested that the world's institutional owners should introduce ethical principles for all investments and not only in the form of ethical funds. PRI includes environmental issues, human rights and appropriate corporate governance. Its purpose is to help investors to engage in companies and thereby incorporate active ownership practices. Further, pursuing the principles help the investors to consider environmental, social and governance issues in their investment decision process. As a result long-term returns to beneficiaries are improved ([www.unpri.org](http://www.unpri.org) 211208).

### **Pension Funds**

The Swedish National Pension Funds (Second AP Funds) are so called buffer funds within the Swedish general pension system. The four competitive funds have the same task; to invest the Swedish society's pension capital and yield the best possible utility for the pension system thus on a long-term earn a high return at a low risk. The four pension funds should throughout their investments take into account ethics and environment without sacrificing the internal target, that of a high return at a low risk ([www.ap.se](http://www.ap.se) 151208). In 2001, the Swedish government imposed screening requirements on the Swedish governmental pension fund's investment decision process with regards to their consideration to social and environmental issues related to the investment (Sjöström, 2004). In 2007, an ethical council was established in order to coordinate the four funds' ethical and environmental work within the funds' investments in companies outside Sweden. The Ethical Council's ambition is to make the funds' account for an ethical consideration hence impact companies that violate



international conventions signed by the Swedish state in order to make them act more ethically while improving their environmental concern ([www.ap.se](http://www.ap.se) 151208). The Swedish National Pension Funds, 1-4 and 7 are signatories of UN's PRI ([www.unpri.org](http://www.unpri.org) 211208).

### ***Pension Fund's Regulation***

According to the law for Swedish National Pension Funds, 1-4 (2000:192), the Swedish Pension Funds are predominantly permitted to acquire stocks or other company shares that are or within one year from their issuance will be introduced on a regulated market. The law allows the Swedish National Pension Funds to invest maximum 5% of their portfolio investments in unlisted instruments. The unlisted instruments are restricted to three types of investments; stocks or shares in venture capital firms, claims rights or shares in Swedish or foreign funds that mainly invest in stocks or other shares that have not been introduced on a regulated financial market (the law for Swedish National Pension Funds, 1-4, ch. 4, 8§).

### ***Insurance Companies***

The insurance market in Sweden is characterized by a concentrated market conditions where a small number of larger companies dominate. The four largest insurance companies account for 83% of the Swedish insurance market: Länsförsäkringar, If Skadeförsäkring, Trygg-Hansa and Folksam (Försäkringsförbundet, 2007). Today several of the conventional banks conduct operations within the insurance sector as well as several large insurance companies run their own banks (Svenska Bankföreningen, 2008).

All of the four insurance companies take responsibility for the environment and work towards a sustainable development through different projects in the local society ([www.lansforsakringar.se](http://www.lansforsakringar.se); [www.if.se](http://www.if.se); [www.trygghansa.se](http://www.trygghansa.se); [www.folksam.se](http://www.folksam.se) 021208). Folksam is the only insurance company that actively works with social responsible investments. Folksam believes that it is possible to incorporate ethical and environmental guidelines while delivering strong returns and they have therefore recently invested in a SRI hedge fund (Cui, 2007). Folksam is also the only Swedish insurance company that is a signatory of UN's PRI ([www.unpri.org](http://www.unpri.org) 151208).

### ***Investment Funds***

Mutual investment funds invest money exclusively in public companies listed on the stock market in order to limit the financial risk and maintain a stable and preferably favourable return (Lundberg and Westholm, 2006). Savings in investment funds have increased its importance as a result of the positive stock development prior to 2008 and as a result of the new pension system including the premium pension option. There are

currently about 80 investment funds in Sweden including foreign investments funds with offices in Sweden. Altogether they offer about 3300 funds. The largest investment funds in Sweden are Swedbank Robur (23% market share) followed by SEB Fonder (17%), Handelsbanken Fonder (13%) and Nordea Fonder (12%) other investment funds account for 35 per cent of total market share. In general all funds have different niches ranging from various geographical areas, sector focus, investment themes and niches to different security types such as stocks or bonds (Svenska Bankföreningen, 2008). For instance, SRI funds (also called ethical funds) are niche funds that have become significantly more popular in recent years (Lundberg and Westholm, 2006). Today many of the Swedish investment funds also offer other large international investment funds' funds (Svenska Bankföreningen, 2008).

A recent study concluded that the average return during the last ten years (1996-2006) for the Swedish SRI funds were higher than the average return for all other funds on the Swedish market (Lundberg and Westholm, 2006).

### ***Investment Fund's Regulation***

The Swedish law for investment funds (2004:46) involves two different types of investment funds; security and special funds. The major difference between the two funds is the origin of the fund's capital. For instance a security fund can only be funded by means from the public whereas a special fund also can be created through means from a specially stated or limited clientele of investors. In addition, the special funds can be slightly less restrictedly designed. The security investment funds are essentially restricted to deal with financial liquid assets. Nevertheless, 10% of the security investment fund's value can contain other instruments than the previously stated instruments such as in non-listed companies. In addition, security investment funds are allowed to only invest in securities that are or will be transferable on a regulated market, or subject to regulated trade on another market, which is open to the public in combination with the permission from the Swedish Financial Supervision Authority, within one year from the issuance (Swedish law for investment funds 2004:46, ch 5 § 5).

*Having presented the mapping of the potential microfinance investors in the Swedish financial sector, the authors will proceed with presenting the empirical findings revealed during the interviews with the potential investors.*

## 4.2 Potential for Microfinance to Become a Social Responsible Investment

*The presented result is divided between SRI and microfinance, opportunities and limitations associated with microfinance investment. This section concludes with visions for incorporating microfinance investments in Sweden.*

### 4.2.1 Social Responsible Investments and Microfinance

*As previously stated in the introduction chapter, the Swedish microfinance investments are few on the Swedish market. As a result, the authors find it necessary to first examine if the SRI connection to microfinance found in the first empirical part is appropriate.*

#### Corporate SRI Policy

The Second AP Fund does not separate SRIs from general investments. According to the respondent, the pension fund's objective is to maximize the return while taking into account the environment and ethics throughout all of their investments. Further, Folksam also incorporate all SRI perspectives as fundamental requirement to all its investments. Following the two companies' investment policies, SRI investments are solely exercised in listed companies.

SEB strives to be a responsible investor. SEB is a PRI signatory and their corporate governance policy seeks to promote sound corporate governance practices and exercise influence on listed companies to encourage more sustainable practices. Handelsbanken, on the other hand, has not yet incorporated a SRI policy within the bank. According to Handelsbanken, a policy is currently being elaborated that will be implemented in the nearest future. The respondent continues to tell that Handelsbanken strives towards becoming a PRI signatory, with the main objective to incorporate SRI as fundamental criteria for all future investments of the bank.

Banco, Swedfund Robur, SEB and Folksam apply negative screening and shareholder advocacy as SRI strategies. SEB also applies positive screening for a few funds.

#### SRI and Microfinance

Swedfund, EFG Bank, Nordic Microcap and Dexia currently invest in microfinance. Simultaneously, the majority of the selected Swedish investors expressed their interest and curiosity for microfinance as a potential future investment alternative. The interviewed banks, SEB and Handelsbanken, underline the significance of ensuring that the microfinance market is well commercialised before they will consider investing. SEB will consider investing in microfinance if the market develops and if there is a demand from their customers. Further, Folksam and Swedbank Robur revealed plans of microfinance investments in the future.

The Second AP Fund and EFG Bank categorise microfinance as an alternative investment but do not choose to label it SRI. Further, Nordic Microcap, Swedfund and Dexia categorise microfinance investments principally as private equity investments in developing countries, since the investments have proved to be able to yield an attractive return in addition to its social return. Banco, on the other hand would categorise the microfinance investment asset as a SRI community investment. Folksam on the other hand refers to it as an alternative SRI. According to Handelsbanken's SRI policy, all investments and microfinance included is regarded as ordinary investments. Swedfund, EFG Bank and Dexia Asset Management strongly believe that microfinance investments deserve a definition separated from SRI.

Finally, EFG Bank mentions a discussion with one major Swedish insurance company regarding their interest in microfinance. The insurance company did not consider it to be a traditional investment but rather as a SRI investment. Since they did not have an ethical policy for such alternative investments the investment deal did not close.

#### Financial Sustainability versus Charity

Dexia claims it is important to communicate the difference between charity and commercial investments. "For many years microfinance has been viewed as charity or governmental aid activity. Today the industry offers attractive financial return at a relatively low risk, thus, it should potentially attract large financial institutions" (Dexia). Moreover, Nordic Microcap, questions if charity organisations and NGOs undermine other more sustainable investment initiatives such as commercial investment capital. By tradition, the poor people have belonged to SIDA and other Swedish charity organisations. Similar to Sweden's industrialisation in the 19<sup>th</sup> century, if developing countries are to be developed in a sustainable way, the engagement of native entrepreneurs is crucial. Consequently, Nordic Microcap, EFG Bank, Dexia, Folksam and Swedbank Robur argue that short lived charity does not result in a sustainable economic development as oppose to commercial investments. Yet, all respondents agree that the existence of aid and charity in times of war and catastrophes are of essential importance.

Also the Church of Sweden believes a commercialisation of the microfinance industry can lead to a further reduction in poverty. Foremost, the Church Of Sweden do not make direct capital investments in MFIs, instead they invest money in microfinance organisations such as ECLOF and microfinance vehicles as Oikocredit.

#### **4.2.2 Opportunities with Microfinance Investments**

The results presented below, reflect the opportunities of microfinance investments and the attractive characteristics those investments can bring to the investor's portfolio.

During the empirical study the following opportunities with microfinance were revealed:

- Risk diversification
- Attractive financial risk-return profile
- An investment with dual returns
- Creations of a future self sufficient bank
- A growing market

#### Risk Diversification

All of the study's selected investors agree upon the fact that microfinance investments have proved to be an asset class by itself. According, to their arguments investments in microfinance are not correlated to international stock markets or interest rates fluctuations. Thus, by investing in microfinance the investors are able to diversify their portfolio thus reduce their portfolio risk by investing in an asset not fully correlated to the rest of their portfolio. Moreover, when investing in microfinance the portfolio risk is further reduced through the allocation of resources to a wider and more diversified group of MFIs.

#### Attractive Financial Risk-Return Profile

In order for MFIs to act in a sustainable way every single MFI has to be profitable, according to Nordic Microcap. Furthermore, if microfinance investments do not offer a sound financial return these types of investments cannot serve as potential investments among institutional or private investors, Dexia continues. The majority of the interviewed investors consider microfinance investments to be an interesting investment opportunity mostly because of its proven attractive financial return in combination with its social return. The fact that microfinance theory is based on a concept of business and commercial thinking the industry is considered to have great potential in the future, according to Folksam. Handelsbanken sees the potential in microfinance investments with regards to the attractive financial returns. In addition, EFG Bank, Folksam and SEB highlight the fact that microfinance investments have proved to be attractive also in a situation of national or global financial turmoil on the general financial market. According to EFG Bank their microfinance fund, Nordic Microcap, offers an expected annual return of 5-15%, which in current times exceeds other investment alternatives on the mainstream financial markets. Moreover, Swedfund emphasises the increased level of return on equity for numerous MFIs reaching an average level of 11.2% in 2004. The Second AP Fund considers the industry's most attractive characteristics to be; the attractive dividends, the sound rate of return and, also, the limited credit risks thanks to the high payback ratio in the industry. Swedfund points out that the industry is characterised by a payback ratio between 95-100%.

### An Attractive Investment With Dual Returns

As mentioned earlier, most of the interviewed companies find microfinance investments achieving both an attractive financial return and social benefits. For instance, Swedbank Robur considers microfinance as the ultimate way in which two worlds, the ideological and the capitalistic, can be united. The Second AP Fund, who selects their investments in a conscious way bearing in mind both environment and ethics, claims that microfinance investments offer an attractive return whilst reducing the global poverty. Continuously, EFG Bank takes the discussion about dual return to another level when saying that microfinance investments reduce war as when people standards of living improves incentives to war tend to decrease. In contrast, the Church of Sweden questions whether both objectives can be met without one being sacrificed. The Church of Sweden has two financial mechanisms. Firstly, the international department focuses on social objectives and execute donations to the poorest of the poor and, secondly, the financial department requires a financial return on all its' investments. From the church's point of view, this enables the international department to focus on the poorest of the poor and the financial department to focus on maximising the return on their investments.

### A Growing Market

“There are about 700 million people living in Africa south of Sahara, 80% of these people lack access to a bank institution or a sound savings system for that matter” says Lars-Olof Hellgren during his lecture about “Poverty and Microfinance” (Gothenburg, 061208). In effect, the microfinance industry is largely unsaturated.

According to Swedfund the industry has experienced an extremely strong growth of 20%-40% depending on the region during the latest years.

EFG Bank, Nordic Microcap and Folksam describe most of the MFIs very similar to Swedish saving institutions born in the early years of the 20<sup>th</sup> century. Thus, investing in microfinance offers the investor a rare opportunity to take part in the construction of such a business and gain market share within a growing industry. Otherwise put, it implies a possibility to invest in a business in an early stage similar to the Swedish saving institutions a century ago and thereby the potential of becoming shareholder of the equivalent of today's Swedish commercial banks (EFG Bank, Folksam and Nordic Microcap). EFG Bank highlights the importance to invest in a MFIs early stage as oppose to a later phase when the MFI have developed into a formal bank. In addition, Swedbank Robur points out that the MFIs are especially in most need of the money during start-up phase and not when they are close to being integrated in the financial system.

### **4.2.3 Limitations with Microfinance Investments**

The interviews revealed several limitations with microfinance investments, namely:

- Lack of knowledge
- The Swedish investment fund and pension fund regulations
- Investment availability
- Investment horizon
- Lack of transparency and track records
- Investment capacity
- High risk – low return
- Bad reputation
- Targeting the “right” poor

### Lack of Knowledge

EFG Bank and Folksam say that there is a great need of expertise regarding microfinance and what investment opportunities there are. EFG Bank has seen a tendency of investors who believe microfinance is some sort of financial aid instead of an attractive investment. Therefore, EFG Bank and Folksam find it crucial to increase the microfinance knowledge among the public and investors. Banco also agrees that knowledge is the key to understand and to be able to promote microfinance investments. SEB and Handelsbanken argue that the lack of knowledge is the reason to why there is so few microfinance investments executed in Sweden.

### The Swedish Investment Fund and Pension Fund Regulations

The Swedish law for investment and pension funds restricts the Swedish investment funds and pension funds to only invest in listed companies and/or companies that will be introduced on the stock market within a year after the issuing. This is mentioned as a limitation, as many MFIs are not listed on the stock market. For instance, the Second AP Fund says that the Pension Fund Regulation allows them to invest maximum 5% of their investments in unlisted assets if this is done through private equity funds. According to Swedbank Robur and Banco the Swedish Law restrict all investment funds to maximum invest 10% in unlisted assets. EFG Bank, Dexia and Swedbank Robur point out that in addition to the law, internal investment policy documents often further limit unconventional investments.

### Investment Availability

The investors know just a few microfinance alternatives on the market available for the Swedish investors. According to Nordic Microcap they are the only pure microfinance investment fund on the Swedish market. They believe that the high social demands and the low profit is the reason why there are no competitors on the Swedish market. Nordic Microcap says that their business model is not a fast way to make money and therefore it is not a very attractive alternative in the financial sector. Handelsbanken and SEB, not currently investing in microfinance, have only recognized Dexia as a microfinance

investment alternative. Swedfund, who also invest in microfinance, mentions themselves and Nordic Microcap as the only investment opportunity for Swedish investors. Swedbank Robur sees the potential in investing microfinance, but they find it difficult to find suitable microfinance investments due to the earlier mentioned fund regulation.

#### Investment Horizon

Folksam and EFG Bank both highlight the limitation with having the invested money locked in the microfinance investment for about 5-7 years. This uncertainty is a limitation for the investor not being able to redeem the investment at any point until expiration date. Folksam says that a lot of fund advisors do not recommend this type of investment due to the lack of flexibility.

#### Lack of Transparency and Track Records

Dexia, EFG Bank, Handelsbanken, SEB and the Second AP Fund and Swedbank Robur say that the lack of transparency in MFIs is a considerable limitation for microfinance investments. Dexia and the Second AP Fund point out that MFIs lack of track records makes the investors more critical. Dexia means that the investors are more cautious since they do not have a proven history and therefore they do not know what risk to expect. The lack of transparency and track records make it more difficult to assess risks in microfinance and therefore makes the investments less attractive, SEB continues in accordance with Handelsbanken. The Second AP Fund has a requirement for three years of track records for any of their investments. EFG Bank believes that it will never be possible to attain a sufficient track record when investing in a MFI in an early stage.

#### Investment Capacity

The Church of Sweden does not consider the quantity of microfinance investments as the major problem facing the microfinance industry. In contrast, they reckon that there are few MFIs with a sufficient structure to receive large investments and financial aid. Dexia also agrees that MFIs have a low capacity to collect and manage larger investments. In addition, SEB, Handelsbanken and EFG Bank state that the small size of the MFIs, limits the MFIs ability to manage large capital inflows. If a larger amount of money can not be invested, it may be difficult for the investment to become profitable.

#### High Risk – Low Return

EFG Bank has noticed that among the investors in Nordic Microcap, there is a widespread fear of the risk that the MFI will go bankrupt. This misconception makes the invested amounts to be very modest. The risk is considered to be too high in relation to the return the investment can yield. Swedfund mentions currency and country risks that occur when Swedish investors chose microfinance investments over domestic investments. Nordic Microcap says that it is crucial for the MFIs to manage the risks in a



professional way. By doing so the risks will be reduced and more capital can be obtained. The Second AP Fund considers microfinance to be a very small asset that does not generate a satisfactory rate of return. The Second AP Fund and Folksam underline the importance for the investment managers not to undertake unnecessary risks.

#### Bad Reputation

The previous mentioned lack of knowledge leads to another problem - a bad reputation for microfinance often based on prejudices. EFG Bank has observed that Africa is associated with financial aid and corruption.

The Second AP Fund compares microfinance's sometime exorbitant interest rates with the popular text message loans' unethically high interest rates. Therefore, the Second AP Fund questions whether it is wise for a large Swedish corporation to be connected with microfinance investments. In contrast, EFG Bank claims that the high interest rates have been widely discussed without any real substance. But still, both EFG Bank and The Second AP Fund claim that those accusations make investors more afraid to invest in microfinance.

#### Targeting the "Right" Poor

The Church of Sweden does not invest in microfinance, but it supports microfinance through several projects that target the poorest of the poor. The Church of Sweden sees themselves as a compliment to the commercial investors with a different target group. Their belief is that the MFIs do not target this group of poor people and therefore the Church of Sweden has decided to help these people through savings driven actions. The savings driven actions are also called community-owned and managed microfinance, which is based on local savings rather than micro credits. The saving and lending is made with assistance from NGOs that primarily offer education. In that way, the financial profits are both made and distributed on a local level. Swedfund also brought up the fact that the MFIs have difficulty to reach the poorest of the poor. They believe the reason for this is the high administrative costs due to the bad infrastructure.

#### **4.2.4 Visions for Incorporating Microfinance Investments in Sweden**

Looking into the future, the investors picture different scenarios regarding how microfinance can become a more attractive investment.

Swedfund believes that in order for microfinance investments to become a commonly practised investment, the major players such as the Swedish conventional banks must enter the microfinance industry. According to Swedfund the banks will not enter until it is proved to be a sound investment with a reasonable risk-return profile. SEB states that they are prepared to enter the microfinance market when there is a customer demand. In order for SEB to invest in microfinance, the market needs to be more developed. For Handelsbanken to invest in microfinance, they must secure profitability since they are a

profit-maximizing bank.

Dexia mentions Norwegian Microfinance Initiative, NMI, which was initiated by Norfund, Norway's equivalence to Swedfund. The initiative's other signatories were banks, private equity investors and insurance companies. According to Dexia, NMI has been successful and this kind of project would be suitable in Sweden to begin to implement microfinance investments and attract Swedish investors. They also point out that one of the success factors in this kind of initiative would be that each individual would be less exposed to risk, since the participants share the risk. Swedfund is also aware of the accomplishments of NMI but stress the fact that the knowledge is not yet extensive enough in Sweden. Swedfund has noticed an increased awareness among other business school students and therefore they believe that microfinance investments will become an attractive investment in the future. EFG Bank also mentions a positive attitude towards becoming a member in a microfinance network in Sweden if a network similar to NMI would be created.

### 4.3 Summary for Analysing the Empirical Findings

Figure 6 summarises the findings in the two empirical parts, which enables the authors to compare and analyse these findings against the theoretical framework.

**Figure 6: Summary for Analysing the Empirical Findings**

<b>SRI and Microfinance</b>	
<p><i>Earlier research label microfinance as SRI based on the following arguments:</i></p> <ul style="list-style-type: none"> <li>- these investments attract the same social conscious investor caring for the dual returns</li> <li>- the emerging SRI strategy community investing is eg. investing in microfinance</li> </ul>	<p><i>How the investors label microfinance investments</i></p> <ul style="list-style-type: none"> <li>• Alternative investment</li> <li>• Traditional investment</li> <li>• SRI investment</li> <li>• Alternative SRI investment</li> </ul> <p>Divided opinions whether microfinance investments should be categorised as an SRI investment.</p>
<b>Potential Microfinance Investors</b>	<b>Microfinance Attitudes</b>
<p>The Swedish Financial sector consists of following institutional investors with social considerations:</p> <ul style="list-style-type: none"> <li>• Banks</li> <li>• Pension funds</li> <li>• Insurance companies</li> <li>• Investment funds</li> </ul>	<ul style="list-style-type: none"> <li>- Four of the eleven interviewed companies execute investments in microfinance</li> <li>- Two companies may make future microfinance investments</li> <li>- General interest among the companies, but they have not perceived a debate about microfinance</li> <li>- Important to separate the difference between charity and commercial investment</li> <li>- Commercialisation is the best way to achieve sustainable economic development</li> </ul>
<b>Opportunities with Microfinance</b>	<b>Limitations with Microfinance</b>
<ul style="list-style-type: none"> <li>• Risk diversification</li> <li>• Attractive risk-return profile</li> <li>• An investment with dual returns</li> <li>• Creations of a self sufficient bank</li> <li>• A growing market</li> </ul>	<ul style="list-style-type: none"> <li>• Lack of knowledge</li> <li>• The Swedish investment fund and pension fund regulations</li> <li>• Availability</li> <li>• Investment horizon</li> <li>• Lack of track record and transparency</li> <li>• High risk – low return</li> <li>• Bad reputation</li> <li>• Targeting the “right” poor</li> </ul>
<b>Visions for incorporating Microfinance Investments in Sweden</b>	
<p><i>The investors pictured several scenarios regarding how microfinance can become an attractive investments</i></p> <ul style="list-style-type: none"> <li>• Swedish conventional banks should invest in microfinance</li> <li>• Swedish microfinance initiative similar to NMI</li> </ul>	

## 5. Analysis and Conclusion

*This chapter presents a discussion comparing empirical findings with the theoretical findings and incorporating an analysis of these findings. The chapter is finalised with the conclusions, limitations and suggestions for further research.*

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### 5.1 Analysis

The analysis of the empirical findings will be structured between the two sub-questions in the problem wording in order to finally examine the main question.

- ***What potential has microfinance to become a social responsible investment for Swedish investors?***
  - *What are Swedish investors' approach to SRI and microfinance?*
  - *What incentives are there for Swedish investors to invest in microfinance?*

#### 5.1.1 Swedish Investors Approach to SRI and Microfinance

##### SRI and Microfinance

Sweden is the fourth largest SRI market in Europe (Swesif SRI market study report, 2007). Further, alternative SRI investments are expected to grow in the future (Eurosif's SRI report for Sweden, 2008) thus the authors expect the microfinance investments likely to increase. The Swedish investors' great interest for social investments implies that there is a potential for microfinance investments in Sweden.

The authors have observed that the Swedish conventional banks show an increasing concern for SRI. Historically, public investors have been the major microfinance investors followed by individual and institutional investors. It is not until the latest years institutional investors have gotten an interest in microfinance (Reille and Forster, 2008). Several respondents argue that the conventional banks should be the pioneers of microfinance investments. Furthermore, they possess a large share of the Swedish financial sector why it would be likely to expect that they have the means to conduct microfinance investments. However, this type of investments has fallen short for the banks. The authors have identified a catch 22 in this matter where the banks' lack of knowledge and ability to communicate microfinance as an investment alternative prevent the creation of a demand for such investments among clients. On the other hand, banks argue that they await clients' demand for microfinance investments and once such a demand has been identified, a supply of microfinance investments will be offered. Nonetheless, the interviews revealed a greater microfinance investment interest from an insurance company and an investment fund. Despite the conventional banks' financial strength the authors do not find them as an obvious initiator.

In order to communicate the social return of microfinance investments in an efficient way, the authors find it increasingly important to develop universal standards that measure social return in a similar way to how financial return is being measured. Further the authors find it likely to believe that it is this demand that has driven the emergence of different social estimation models such as Zeller et al.'s (2003) Social Performance Index. In order to attract new investments, the authors find it vital to communicate the social benefits of microfinance investments through such measurements.

The authors observed three types of SRI investors among the interviewed investors; those where SRI is incorporated in all investments (Banco, SEB, Second AP Fund, Folksam), those who partly incorporate SRI in their business (Handelsbanken, Swedbank Robur, EFG Bank) and, finally, those whose core business is of social nature and therefore do not regard SRI as an investment class different from the rest (The Church of Sweden, Swedfund, Nordic Microcap).

Bearing in mind empirical examples from the interviews, of microfinance investments that have not been executed due to their SRI label, the authors see a risk of confusion when integrating microfinance as a part of SRI. Contrasting this with the first part of empirical findings that show several research that label microfinance as SRI. Indeed, the authors think that on the one hand microfinance investments deserve to be termed SRI due to their pure social objectives. But, on the other hand, the authors find it likely that in some years the SRI term might be dispersed and applied among the large majority of Swedish companies. Consequently, a more sustainable categorisation of microfinance is to label it with a term of its own.

### **Microfinance Attitudes**

The authors have identified different opinions whether microfinance initiatives should be driven by charity organisations and governmental aid organisations such as SIDA, or, by commercial investors. In accordance with the study's empirical findings the authors believe that if MFIs should continue to meet the large unsaturated demand among poor people (Tulchin, 2004) while contributing to a sustainable economic development a commercialisation of microfinance is necessary. Having examined the future ability of MFIs to raise the necessary capital in order to reach out to the additional global demand of 900 million poor people (Dieckmann, 2007; Lars Olof Hellgren, 061208), the authors consider in accordance with Goodman (2004) a commercialisation of the MFIs the ultimate solution. Several of the study's empirical findings argue that charity and aid are rather short-lived financial supports with few chances of a sustainable development for MFIs. Thus accessing financial capital is the best solution for more developed MFIs to realize their objectives that of a social return and the financial self-sufficient objective.

Nevertheless, the investors agree that in time of crisis, charity and aid organisations have an important mission to fulfil. The authors' strong belief is that in order for microfinance investments to gain foothold in Sweden a commercialisation is necessary.

*As shown in the above analysis, it is merely the unexplored territory of microfinance and indecisive investment classification debate among potential investors in combination with the absent customer demand that explains why microfinance investments have not been incorporated among Swedish investors. Therefore, the next section will develop other ideas crucial for evaluating the potential of microfinance investments among Swedish investors.*

### 5.1.2 Investment Incentives in Microfinance

Following the study's empirical and theoretical findings, the authors have found clear evidence of incentives for investing in microfinance. The study's results confirm previous research when describing great opportunities with microfinance investments. However, being situated in developing countries the MFIs often operate on immature markets and therefore major limitations within the microfinance industry remains.

#### Opportunities

Mentioned by all the interviewed investors, the greatest opportunity with microfinance investments is the risk diversification opportunity it offers. In accordance with Calerón (2006), who demonstrated that microfinance is less or not at all correlated with the market, the authors would like to underline the advantageous characteristics microfinance investments add to an investor's portfolio not at least in current times of financial and economic decline on the global market.

This study also endorses the fact that investors are attracted to microfinance investments due to their double bottom line, in line with Tulchin (2003) and Hermes and Lensink (2007). The majority of the respondents believe that there is no trade-off between the social and financial returns. Thus, microfinance investments are considered to be attractive investments with dual returns. Others argue that their investment objective is ultimately to maximize the financial return and not to invest in fairly unexplored markets for the good cause that might sacrifice some of the financial return. The authors' conception is that the question whether there is a trade-off between these social and financial return is to date an unsolved matter, which deserves further research but consider the dual returns achievable.

Several studies (Dieckmann, 2007; 2008) have contributed to the authors' conviction that there is a great growth potential for the microfinance industry. Further, the fact that only 1-2% of all MFIs are mature and profitable, and it is in this tier that the authors believe the Swedish investors find the major potential, shows a great opportunity for growing returns. The authors would also like to underline the fact that this growth could result in more structured microfinance products offered to investors is essential for the

MFIs long-term supply of capital. According to the authors, a larger microfinance market leads to increasing investment opportunities for Swedish investors while contributing to the MFIs improved outreach and poverty reduction. Continuing, the increased size of the MFIs could preferably result in a better capacity of the MFIs to manage larger investments, which might improve the MFIs ability to raise capital. This growth makes microfinance suitable for larger investors.

All interviewed investors acknowledge the credit risks aligned with investing in microfinance. However, the perceptions of the risk-return profile of microfinance investments differ between the respondents, ultimately leading to risk and return being an opportunity or a limitation depending on who is asked. It is clear that it is mainly the investors already investing in microfinance that see an attractive risk-return profile, whereas some of the other interviewed investors that do not invest consider it to be a high-risk investment because of the lack of transparency and track records. Taking into consideration the experiences from current microfinance investors and the authors gained knowledge, microfinance investments' risk-return profile should be regarded as attractive.

### **Limitations**

The clearest obstacle for Swedish investors interested in microfinance investments seems to be the lack of knowledge. The problem is two-folded: first, the public lacks knowledge about microfinance which makes it harder to attract capital, and second, a majority of the interviewed investors clearly lack knowledge about how to invest in MFIs. The lack of knowledge among the public leads to a bad reputation of microfinance built on prejudices (Matthäus-Maier and von Pischke, 2006). The bad reputation can explain the low microfinance investment rate on the Swedish market. A large number of the investors saw the low availability of microfinance investments as a limitation. The authors believe that the later argument is based on the investors' lack of knowledge since it has been revealed that various microfinance investment options are available. Consequently, the lack of knowledge among investors results in poor promotion of microfinance investments. In order for microfinance investments to gain foothold in Sweden, the authors claim it is of extreme importance to educate both investors and the public to move away from prejudices, the charity label and instead promote microfinance as the return yielding investment it actually is.

Consistent with Matthäus-Maier and von Pischke (2006), the respondents mentioned the fact that the majority of the MFIs are too small and do not have the sufficient structure to attract nor handle funds from large institutional investors. Therefore, it is vital for the MFIs to reach a critical size in order to attract capital. The authors would like to emphasise the increased pressure put on the MFIs skills of managers and the organisational structure such a growth in size would imply.

Another limitation for Swedish investors is the law. Some investors are restricted by the Swedish Law for Investment Funds (2004:46) and the Law for Swedish National Pension Funds (2000:192) when it comes to investing in unlisted companies such as the majority of microfinance investments. In addition, some of the investors also had internal policies making the unconventional investments even more limited in terms of not being able to invest in unlisted MFIs. The fact that the internal investment regulations have not changed is probably because neither the Swedish actors on the financial market nor their customers have seen the potential in microfinance investments. Consequently, several investors pointed out that there is no demand for microfinance investments on the Swedish market today. The authors find it necessary that both the Swedish regulations and the internal investment policies will have to change before the concerned actors will be able to exploit the full potential of microfinance investments. Such a deregulation would increase the investors' investment flexibility, is crucial for the investors' ability to invest in microfinance at an early stage. The empirical findings state that the investors not currently investing in microfinance require several years of track records and a better transparency before they will consider investing in MFIs. According to Goodman (2004) the general lack of information makes it difficult for the investors to compare microfinance investment against traditional investments. Risks on emerging markets are regarded as more extensive (Coleman, 2003) resulting in the demand for track records and transparency of MFI and MFI funds. The authors underline the magnitude for MFIs to improve their financial reports' visibility.

### 5.1.3 Microfinance Investment Potential Among Swedish Investors

A general agreement of the potential of microfinance investments occurred among the interviewed investors. Investors that already have SRI incorporated in all their investments were generally more positive towards microfinance. Whereas the positivity varied among the investors who did not invest in microfinance. Overall the later investors were more restrictive and often had requirements related to the identified limitations of microfinance investments that need to be solved before such investments would be considered. Among the investors who claimed that the demand for microfinance investments is weak, the authors believe that the potential of this investment type will remain low. Despite the different levels of positivity it is clear that all the investors required safe microfinance investments and that this is why the discussion about future investment initiatives and measures are fundamental. The authors argue that there is a potential for microfinance investments yet it is obvious that the investors with an interest in microfinance lack the knowledge of how to conduct such investments.

### Visions for Incorporating Microfinance in Sweden

The interviews revealed an interest for a Swedish microfinance initiative, where the Norwegian Microfinance Initiative, NMI, (Norfund) could serve as a role model. In such



an initiative expertise found in the public sector could be combined with the private sector's financial resources. Some of the Swedish investors proposed that the conventional banks should initiate Swedish microfinance investments. However, the authors do not believe that the Swedish microfinance investments will be initiated by the conventional banks.

In the short run, the authors consider a national Swedish microfinance initiative the most promising initiative. In such an initiative synergies can be created when expertise found in the public sector is combined with the private sector's financial resources. The authors would like to underline the importance of spreading the concept of microfinance among multiple actors (institutional, private as well as public) in order for microfinance to gain foothold on the Swedish market.

## 5.2 Conclusion

*In conclusion the authors present what potential microfinance has to become a social responsible investment for Swedish investors.*

Considering the fact that Sweden is the fourth largest SRI investor in Europe it is evident that a common interest for social investments exists among Swedish investors. Based on the authors' initial perception of microfinance, the research categorised microfinance investments as SRI. Controversially, the authors have come to the conclusion that associating microfinance investments with SRI might lead to unnecessary confusion. Examining the two parts of the empirical findings, that somewhat contradict each other it is clear that there are several opinions regarding how microfinance investments should be categorised. In order to avoid misconceptions the authors suggest microfinance investments to be treated as an investment alternative of its own while attracting both SRI investors and commercial investors. Consequently, examining the potential of microfinance investments is done without any specific investment categorisation in mind.

This study confirms previous research, namely that microfinance investments offer an attractive dual return. An investor who seeks an investment not fully correlated to the market with an attractive risk-return profile, while contributing to the global poverty reduction should consider investing in microfinance. In addition, the future growth rate of the microfinance industry along with an increasing commercialisation shows strong potential for Swedish microfinance investments.

Despite the mentioned opportunities, several limitations persist which prevent the full potential of microfinance investments to show. Due to the fact that few of the institutional investors seem to be willing to take the lead in exploring the microfinance

industry, the lack of knowledge within the field remains. Another reason for why microfinance investments have not been exploited is the MFIs structural limits to manage large capital investments. Subsequently, the chances of making large profits in a short period of time are limited. Additional limitations are MFIs lack of track record and transparency. Further, the Swedish law and internal investment policies appear to constrain the investment flexibility. In contrast to the majority of the interviewed investors' perceptions, it has been demonstrated that there are several microfinance investment options available for Swedish investors making the availability limitation argument less significant.

Having examined the potential of microfinance investments in Sweden the authors have come to the conclusion that the opportunities related to such investments are highly interesting thus signalling a potential. However, in order to exploit the full potential it is crucial to overcome the current limitations that are preventing the Swedish investors to execute such investments. The following enhancing measures in Sweden are essential to overcome these limitations; spreading microfinance knowledge, investors' investment flexibility as well as improving MFIs track records, transparency and social performance measurements. Once these measures among the Swedish investors and the MFIs have been taken into account, the authors believe that microfinance investments significantly have increased their potential. Therefore, the authors find it likely that within five years these investments will have gained foothold on the Swedish market ultimately contributing to the global poverty alleviation.

### **5.3 Limitations and Suggestions for Further Research**

Due to study limitations the conclusions drawn from the study are only tentative. It is important to bear in mind that the result is based on a small sample size, from a non-random selection of Swedish companies. Interviewing only one respondent involved in investment decisions at each company, the personal values of the respondents may have influenced the answers and therefore the authors have to be careful to when generalising. Another limitation is the method used for empirical findings, where the authors applied telephone interviews for the majority of the interviews. Therefore, the authors are aware that the study's result could have differed if another method would have been used. Finally, due to the unexplored topic of research in Sweden, the authors have faced difficulties finding suitable literature and previous studies.

During the course of the study, ideas of future microfinance initiatives were born. One of the initiatives was the Norwegian initiative, NMI. The authors find a national public/private initiative similar to NMI essential in order to incorporate the great potential of microfinance investments in Sweden. Due to the delimitation of the research question and time constraints, the authors have not examined this topic further but

consider this to be relevant for future research. Further, the authors suggest a study similar to the authors' that could be conducted in another country where microfinance investments are scarce.

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## Appendix I – Interview Template

### **SRI**

- Definition
- Syfte med SRI
- Krav på SRI investeringar
- Svårigheter med SRI

### **Mikrofinans**

- Mikrofinansinvesteringar
  - Tillgång
  - Information
  - Risker
  - Potential för svenska investerare
- För- och nackdelar med mikrofinans
- Mikrofinans som en del av SRI

## Appendix II – Interview Questions

1. *Hur definierar ni SRI?*
2. *Hur skulle ni beskriva er SRI verksamhet? (Strategi, affärsplan, vision, statistik/siffror)*
3. *Vilka områden inom SRI är en del av er SRI portfölj idag?*
4. *Vilka typer av SRI utför ni?*
5. *Vad är syftet med era SRI investeringar?*
6. *Vilka krav ställer ni på era SRI investeringar?*
7. *Vilka svårigheter finns det med SRI?*
8. *Investerar ni i mikrofinans idag? Ja/Nej*
  - a. *Nej: Varför inte?*
9. *Skulle ni överväga att investera i mikrofinans i framtiden? Ja/Nej*
  - a. *Ja: vilka incitament (för och nackdelar) finns det att investera i mikrofinans i framtiden?*
  - b. *Nej: Varför inte? Vilka för- och nackdelar ser ni med mikrofinans?*
10. *Finns det tillräckligt många alternativ för mikrofinansinvesteringar idag?*
11. *Tycker du informationen om mikrofinans är tillräcklig för att överväga att investera i mikrofinans?*
12. *Varför tror du att få svenska investerare investerar i mikrofinans idag?*
13. *Vilken potential tror du mikrofinans har att bli en "Social Responsible Investment" för svenska investerare?*
  - a. *Är det rätt att kategorisera mikrofinansinvesteringar som SRI?*
  - b. *I vilken form tror ni att mikrofinansinvesteringarna skulle kunna ske?*
  - c. *Vad tror ni behövs för att potentialen skall kunna realiseras?*