

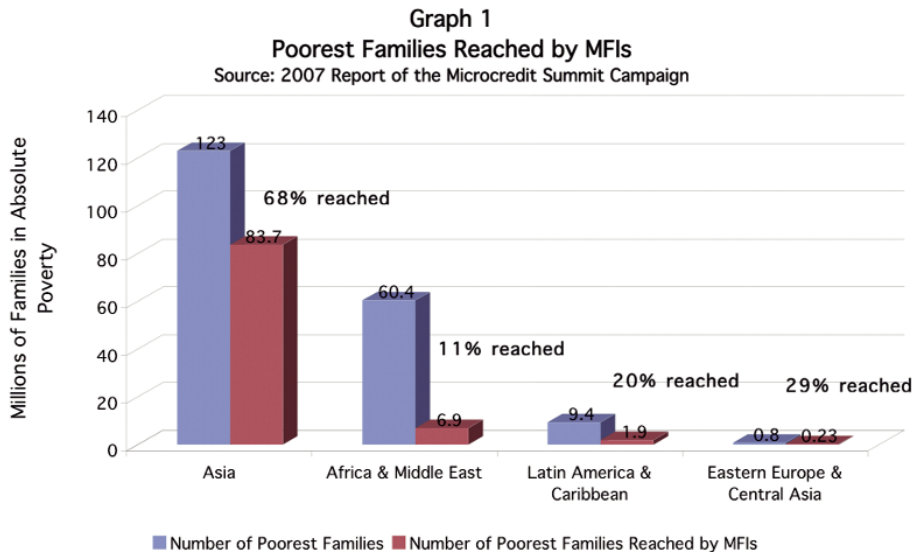
MICROFINANCE A SUCCESS STORY OF SOLIDARITY AND SUBSIDIARITY: THE STATE OF THE ART

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- Microfinance started a little over 30 years ago, inspired by a spirit of solidarity, and led by NGOs that proved that poor people need even more financial services than the wealthy and that they should be taken just as seriously as traditional bank clients. At the end of 2007, microfinance served over 130 million families across the globe.
- Today the NGOs are not alone; there are banks that offer not just loans for microenterprises but also for housing, as well as savings and international transfers; there are global insurance companies daring to insure the previously uninsurable such as weather risk for small agricultural producers in Africa. In the past 20 years, there has been a spectacular proliferation of microfinance institutions, and now new actors come in: today it does not surprise that Zurich is launching microinsurance in China or AIG is seeking to grow it in India.
- Innovations are expanding the frontier of the possible: mobile ATMs are taking banking to rural areas; payments services are becoming accessible through text messages now that mobile phones are inexpensive in large areas of Asia and Africa; biometrics are allowing illiterate women and men to open and manage their accounts privately and securely.
- Microfinance has proven a success story of civil society at work and of a fruitful (though of course imperfect) interaction with governments in the development of an industry that supplies a powerful tool for the reduction of poverty. The work started by NGOs in the company of donors, development banks and agencies, and academia has been joined by the private sector: commercial banks, cooperatives, insurance companies, and investment funds, among others.

How Successful is Microfinance in Providing Access to Financial Services for All?

- Numbers differ widely by source; the estimate of the 2007 Report of the Microcredit Summit Campaign is that 3,316 microfinance institutions (MFIs) are reaching over 133 million clients worldwide.
- But how far is microfinance from its goal of serving the poor? Very far:



The Microcredit Summit Campaign gives a rough but informing estimate on poverty outreach that indicates what percentage of families living in absolute poverty are reached by MFIs, calculating absolute poverty as the % of families with members living under US\$1 a day adjusted for PPP (see graph 1).

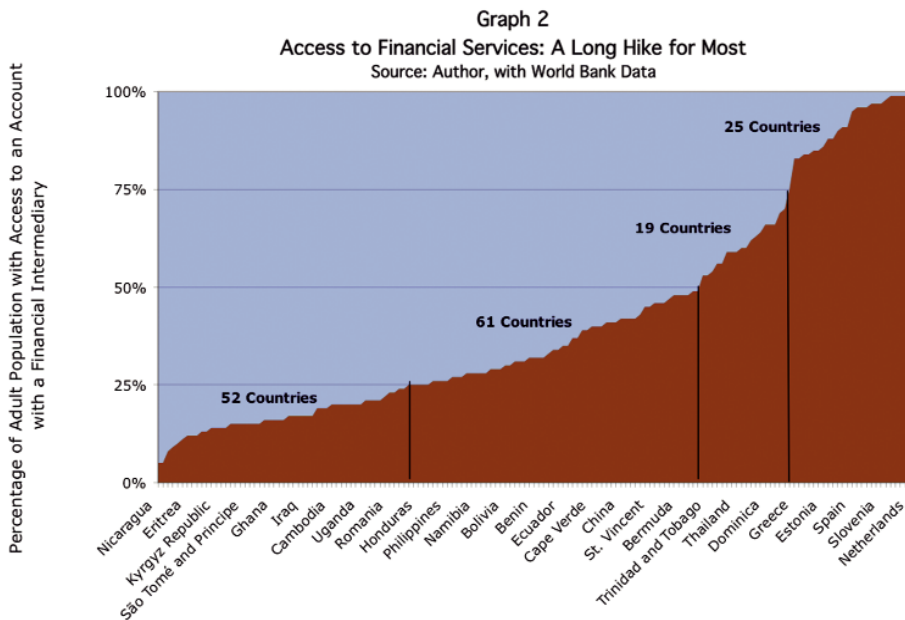
We can see strong results in Asia, where 68% of the poorest households are reached by MFIs: Asia boasts the longest-standing MFIs and the largest ones in the world as well: MFIs like Grameen, BRAC, ASA, and BRI set aggressive outreach goals and have not drifted from targeting the poor as clients.

Elsewhere results are weaker: Africa and the Middle East reach the smallest share of families, 11%, pointing to the difficulties in terms of pop-

ulation densities, basic infrastructure, and health issues that have been major challenges to sustainable microfinance. However, this region is becoming very dynamic and new technologies are making some services viable: before life microinsurance existed, lending to microenterprises in Africa was largely unsustainable; many homes did not dare borrow due to the ups and downs of AIDS and malaria and very low life expectancy, and those that borrowed were braver but subject to the same risks to a comparable degree; but today, what is called ‘credit life’, the life insurance policy of a loan to a microenterprise, is a commodity in Uganda and elsewhere, no MFI can compete in the market without it, and clients are coming back to this safer proposition.

Latin America and the Caribbean as well as Eastern Europe and Asia are in the low and high twenties, respectively; not an impressive record: Even though Latin America is seen as a region of increasing competition, we can see many poor are yet to be reached; this suggests competition is largely for the less poor clients.

- Widening the scope to access to financial services at large, we see an imposing mountain to climb (graph 2).



The World Bank database on access to financial services, covering 157 countries, shows that:

- In 70% of those countries (113), less than 50% of all adults have an account at a financial intermediary.
 - In one third of the countries (52), less than 25% of all adults have an account.
 - The achievements of microfinance in Asia shine a bright light on this bleak picture: MFIs are reaching 68% of the poorest families in this region, when only in a country like Poland or Italy do financial intermediaries reach a comparable proportion of their total adult population.
- But MFIs are not all financial intermediaries. In Asia as elsewhere we are still broadly talking about providers of microcredit for microenterprises:
 - Widening of the supply of financial services has quickly advanced in recent years. And this widening is necessary: for a poor family microcredit for its economic activity is important, but if the family lacks a safe haven for its savings to cover expected consumption needs or unexpected emergencies, if it cannot borrow to plan improvements to its quality of life in terms of housing or education, if it cannot protect the assets it accumulates, steps out of poverty will be accompanied by setbacks just waiting to happen. Microfinance is still too rigid.
 - Estimating demand for microfinance is tricky, because it is based on our limited understanding of this market. We have no idea what we are talking about and this is wonderful. Why? A few years back demand for microfinance was estimated based on microentrepreneurs who wanted a loan for working capital... but this no longer applies. We are now talking of demand for life and weather risk insurance, term-deposits, housing loans, payment services, and more. The market was initially defined by the ability of supply, but we are learning that is too narrow a perspective and we are thus broadening it. There is a fortune at the bottom of the pyramid, as C.K. Prahalad wrote, and my impression is that we are clueless about the size of the fortune. How we can best find out the size of the fortune is by engaging in conversation with the women and men that are the bottom of the pyramid, and by then investing enough resources in the

development of the financial services they need and want. This brings us to a heated debate in microfinance today.

Commercialization, Microfinance as an Asset Class, and Related Challenges

- Commercialization of microfinance is growing (through upgrading, downscaling, or start-ups), and MFIs are becoming an asset class. Earlier this year CGAP, the Consultative Group to Reach the Poorest, released first ever performance figures for microfinance investment funds:
 - It is an increasingly sophisticated group, including fixed income mutual funds, venture capital firms, and others.
 - It includes 93 investment funds dedicated to microfinance: Many are young funds: 53% of the 93 were created since 2007.
 - Returns vary: from a high of 8% for structured financial vehicles to a low of 0% for young funds.
 - Funds invested have grown strong: 80% from 2004 to 2007, reaching US\$3.5 billion in 2007.
 - Investments are concentrated in a few players: the top ten funds account for 2/3 of total investments, with German ProCredit being the largest; most others are funds of less than US\$25 million, though rapidly growing.
- On April 20, 2007, Banco Compartamos, which had started in 1990 as a small NGO lending to indigenous Mexican women, issued a landmark IPO of its stock, a very successful transaction 13 times oversubscribed, with a 22% surge in the stock price on the first day of trading, and attracting not only the usual investors focused on microfinance but investors at large, mainly because of a consistent record of growth and profits.
- Microfinance becoming an asset class is good news, with an important risk:
 - The good news is that microfinance is proving it can attract market resources for the very long trek towards inclusive financial services; also, as MFIs grow and competitions kicks in, microfinance prices will go down globally as has already happened in the few mature microfinance markets like Bolivia.

- The risk is that if subsidies (broadly defined, includes donations) exit too early and do not provide the funding needed for trial and error, for research and development that we still need to design the right technologies and the right organizations, we may leave large segments of the poor underserved or not served at all. In this sense, saying that microfinance is becoming mainstream is probably an overstatement.
- Through all this there is the challenge of developing microfinance as an industry that is not just profitable but also responsible. The Compartamos IPO raised controversy in part because Compartamos charged then and still does now very high interest rates (close to an annual effective interest rate of 90%, in a country with a 3% inflation rate) to its poor clients, in fact among the highest in its peer group in Mexico, while holding a dominant market share (Banco Compartamos is the largest Mexican and Latin American MFI, with almost 840,000 clients in Mexico at the end of 2007). There are many sides to the controversy around the Compartamos IPO, but I want to focus on the issue of efficiency vs. profitability. Much of the uneasiness around the IPO hinged on whether the Compartamos team had made efficient use of its resources to develop a strong poverty alleviation tool, the initial goal of the MFI, or whether they had drifted into a corporate culture of passing inefficiencies and little or big luxuries on the shoulders of poor clients simply because they could, until competition kicked in. Because the previous cannot be assessed subjectively, a desirable path for both policy makers and MFIs that want to bring social value as an asset to the market is to measure and communicate which MFIs are profitable because of efficiency, and which MFIs are profitable because of their ability to let the clients foot the bill. A recent book published by the ILO called ‘Microfinance and Public Policy – Outreach, Performance, and Efficiency’ provides data, insights, and specific proposals for anyone interested in this.

It is All about People

What is fundamental to develop the efficient and profitable MFIs we are talking about? People. The right people:

- A dream team can be found behind every successful MFI.

- But the bad news is: these dream teams are hard to come by. Management quality is the #1 risk faced by MFIs in the world today, according to ‘Microfinance Banana Skins 2008 – Risks in a Booming Industry’ a report by the Centre for the Study of Financial Innovations, sponsored by Citigroup and the Consultative Group to Assist the Poor. This report ‘explores the risks of microfinance as a business and as a social service as the sector is undergoing profound changes’, and sets management as the top of the 29 risks identified.
- Good microfinance managers are scarce; the rapid grow of the sector is making them scarcer. Also, it has to be admitted that excellent microfinance managers combine an unusual set of attributes and attitudes, including that:
 - Under no circumstances will they deliberately pass their inefficiencies onto the clients in the form of higher prices.
 - They will embrace change and innovation and will love to think how to turn what is impossible today into something possible tomorrow.
 - They want to see their clients grow and exit poverty, knowing that the existence of the MFI does not depend on the persistence of poverty but the opposite, on loyal clients that can grow with the institution.
 - They thrive under increasing competition and uncertainty.

Does Microfinance Help to Reduce Poverty?

Many wonder whether microfinance is not just a way to provide financial services to poor people at a profit but with either negative or nil effect on the quality of the life experience of clients:

- This is a relevant question that has been usually replied with assertions of conviction rather than with solid answers generated by the right tools.
- Measuring rigorously whether microfinance helps reduce poverty is difficult and expensive: the vast majority of measurements are invalid; they come from data gathered or analyzed inadequately.

Solutions are being found:

- MFIs are focusing on what they can and should do well, which is to ensure they are achieving their stated goals. An example: the

Social Performance Management Project, sponsored by the Ford Foundation, the International Foundation for the Development of Agriculture, and other donors, is equipping MFIs with tools that enable them to translate their institutional missions into practice: for example, by establishing specific procedures to identify and measure whether they are reaching the target populations set in their mission statements.

- Academics are no longer writing from a desk about poverty and microfinance but working alongside MFIs to accurately measure impact and improve the design of microfinance. Innovations for Poverty Action (IPA) and the Poverty Action Lab are initiatives led by teams of young development economists of top American universities, that do on-site ‘experiments’ to test and improve impact; for example, IPA figured out that clients of an MFI in the Philippines could save more if they made a commitment that restricted access to their accounts until they had saved an agreed amount of money, than if they had full access to their accounts (as was widely assumed), which is benefiting both the MFI and its clients.

On the Role of the Government and Microfinance as Inspiration

What is the role of government in all this? When government has attempted to become a microfinance provider, it has mostly failed (BRI in Indonesia being a BIG exception). MFIs have often perceived that government either interferes directly or that it generates unhelpful regulation and sets incentives that are perverse (as indicated in the *Microfinance Banana Skins* 2008; note that regulation is the third largest risk for MFIs according to this report). But government does indeed become a catalyst of the process that microfinance has set in motion when it:

- Provides a regulatory and policy framework that ensures competition and stability:
 - Demanding transparency.
 - Removing regulatory barriers that have proven unnecessary elsewhere.
- Channels subsidies to overcome barriers for the development of services such as savings and payments, which are lagging behind credit and insurance.

- Develops the information and communication infrastructure for low-cost technologies, which microfinance services can use to reduce its transaction costs, and which can also enable other products and services to start reaching the poor (hopefully microfinance will trigger the development of many other markets). For Example: Mobile phones in Africa; or the information technology that prevents data fragmentation among MFIs, and in turn allows the good functioning credit bureaus (preventing undesired situations such as over-indebtedness, which has already caused trouble in many microfinance markets: the Bolivian microfinance sector suffered a strong crisis of over-indebtedness that credit bureaus failed to detect, which triggered along with other factors a severe backlash against MFIs).

Microfinance turned the poor from a problem of governments to clients of companies. This shows us how our roles are not set in stone and our freedom can always be expressed in new ways that expand the range of the possible. I hope that microfinance will not fade but continue the trek to the summit of the mountain we saw, and that it will inspire new ways of working together towards a more prosperous life for all.