The first microcredits were issued 40 years ago. Since then, the microfinance sector has significantly expanded. Currently, a large number of microfinance institutions across the globe provide services to almost one hundred million clients. This accelerated growth demonstrates the importance of microfinance as a major instrument of financial inclusion, enabling the sector to recover from crises, calling for the implementation of more responsible economic models to ensure the viability of the sector and its mission. With less than a year before the Millennium Development Goals deadline, it is essential to enquire about the future of microfinance. How will it contribute to the post-2015 development agenda? What challenges does microfinance face to maximise its social impact?

These are the central issues of the 2014 Microfinance Barometer, which, for its 5th edition, looks at the future of microfinance practices and actors. In this edition, researchers and experts of the sector share their insights on the prospects of responsible microfinance, on the evolution of regulation, and on various stakeholder practices, both in developed and developing countries.

It is clear that technological innovation, improved offer, client outreach, and increased stakeholder responsibility are crucial for the sector. By activating these levers, the legitimacy of microfinance and its potential for driving development that reaches out to even the most vulnerable populations, will be confirmed. Moreover, in parallel to the willingness of authorities to provide better regulation for this sector, a number of self-regulated initiatives have emerged, which are aimed at promoting healthier and more robust microfinance. The Global Appeal for Responsible Microfinance, launched in 2012 by Convergences and a group of partners, is an example of strong engagement in the sector towards more inclusive and responsible financial services.

The microfinance sector must evolve to reaffirm its role as one of the key drivers in tackling this century’s development challenges. Convergences will continue promoting initiatives and supporting stakeholders that contribute to ensuring the sector’s viability and maximising its impact for the sustainable alleviation of poverty.

### Microfinance continues to develop

Microfinance continues to develop with USD 81.5 billion in loans granted worldwide and a 5% increase in the number of customers in 2012 (see data on pp.2-3). However, this is a fast-changing sector. Services, stakeholders, regulation, and technological innovations evolve and transform the landscape of the microfinance of tomorrow. The objective: to remain an alternative for more than 2.5 billion people currently excluded from the traditional banking system across the globe.

The sector provides a greater diversity of banking, financial, and insurance products, offered by a greater range of actors. Thus, conventional banks, mobile operators, and distribution chains complement the services made available by microfinance institutions. Technological innovation is also a key tool for the development of microfinance (see articles on pp.5-8). This evolution process is accompanied by a convergence of practices and prudential regulations, which are better adapted to the increasing maturity of the sector (see articles on p.9).

Social performance management remains a major concern for stakeholders, investors and operators alike, at a time when tools to ensure transparency and self-regulation are being implemented (see articles on p.4).

In Europe, microfinance is still a young sector, seeking to develop and to innovate in a context of economic crisis. The use of personal microcredits for improving inclusive mobility in France (see articles on pp.10-11) is an example of this quest for innovation.
A growing sector: microfinance opens the way towards financial inclusion

**MICROFINANCE KEY FIGURES**

A pillar of financial inclusion, microfinance continues to serve more and more clients worldwide.

A growing and solid base of microfinance providers, with a global loan portfolio amounting to USD 81.5 billion in 2012:

- The 1,252 institutions reporting to MIX in 2012 represent the majority of leading microfinance service providers.
- They cover a great diversity of models and types of institutions and reach out to 91.4 million low income clients for a USD 81.5 billion portfolio.
- The 100 largest institutions, ranked by number of borrowers, dominate the market with 70.6 million of the sector’s 91.4 million clients, representing 77% of the global market.
- South Asia leads the market with the largest number of borrowers (52%), and also the highest number of female (92%) and rural (80%) borrowers. Of the top 100 institutions, 43 are in South Asia and account for almost 48% of global borrowers.
- The global loan portfolio is mainly concentrated in Latin America and the Caribbean (40%), which has the lowest proportion of rural borrowers.
- The highest average loan balance is in Eastern Europe and Central Asia (USD 2,544), a region that also has more male than female borrowers.

**Growth returns in 2012 and 2013:**
- Globally, outreach has increased by roughly 5% throughout 2012 after a 4% decline in 2011. The return to growth is widespread across regions, with most countries (73 out of 95) experiencing growth in numbers of borrowers between 2011 and 2012.
- Africa reported the strongest growth, around 11% in 2012, easily outpacing South Asia at the opposite end, which reported a 3% growth. Using estimates for 2013, preliminary data for South Asia show strong recovery (nearly 10%), as growth is picking up again in India, specifically in states outside of Andhra Pradesh.

**Local sources of funding to MFIs on the rise through deposits and debt:**

- Local deposits remain the dominant source of funding for MFIs globally, mostly driven by Latin American and Caribbean institutions.
- In Africa, the Equity Bank of Kenya alone accounts for 40% of that region’s deposits. Limiting the data to only Non-Bank Financial Institutions (NBFIs) and NGOs, borrowings (USD 11.4 billion) surpass deposits (USD 10.5 billion) as the leading funding source.
- NGOs in Africa, East Asia and Pacific, and Eastern Europe and Central Asia, get more funding from “equity” (retained earnings or donations) whereas in Latin America, Middle East and North Africa, and South Asia, borrowings are the dominant funding source for NGOs. Although the share of borrowings as a percentage of total funding declined, the level of borrowings by NGOs in South Asia was marked by a rise in 2012, after a decline in 2011.

**Methodology**

1. MIX calculations are based on data provided by microfinance institutions to MIX that is publicly available at www.mixmarket.org. MIX collects data from the dominant actors of each market but does not collect data from every actor in every country.
2. Total figures for borrowers and loan portfolio as of 2012 are based on data provided by 1,252 institutions.
3. Growth figures for borrowers and loan portfolio values from 2010 through 2012 are based on a balanced panel data set of 806 institutions that provided both data fields to MIX for each of the years from 2010 to 2012.
4. Estimate growth values for 2013, globally and regionally, are based on all institutions that provided data to MIX for the periods from December 31, 2012 to either September 30, 2013 or December 31, 2013. Growth was calculated by institutions and then weighted by that institution’s market share using the assumed value for the end of 2013. These institutions number 347 and represent 71% of the 2012 market by borrowers.
5. Funding data is provided by microfinance institutions. To fill in any gaps in the funding data, values were assumed if enough data was initially reported by the institution. For example, equity was calculated if no value was provided by the institution, but the assets and liabilities were available. Similarly, deposits or borrowings were calculated assuming total liabilities were comprised of either deposits or borrowings and that two of the three values were available from the MFI. The number of institutions included in the funding analyses total 815 institutions and comprises 78% of the 2012 market by borrowers.
... however, approximately 2.5 billion people still do not have a formal account in a financial institution
Global social ratings

Six Universal Standards for Social Performance Management (USSPM) were published in 2012 by the SFT²: define and monitor social goals (USSPM 1), ensure board, management, and employee commitment to social goals (USSPM 2), design products, services, delivery models and channels that meet clients’ needs and preferences (USSPM 3), treat clients responsibly (USSPM 4), treat employees responsibly (USSPM 5), and balance financial and social performance (USSPM 6).

The charts below provide an overview of social ratings by two major rating agencies (Microfinanza Rating and Planet Rating) for 2008-2014 in relation to these six criteria³.

The chart above shows the results for all 206 institutions of the study. The gap in research findings between the different institutions is high and varies from 23% to 88%. The largest gaps are related to commitment (10% - 98%) and client treatment (2% - 90%). The overall median for the institutions is 58%, varying from 55% (defining goals) to 63% (social and financial balance).

Taking only the institutions rated twice over the reporting period results are mitigated as 5 out of 14 institutions have seen their ratings decreased, 2 reported the same results and 7 demonstrated overall performance improvement.

An analysis by legal status² demonstrates that banks have the highest overall performance (68%). They also have the highest scores on product design (USSPM 3), client treatment (USSPM 4) and treatment of employees (USSPM 5). Cooperatives, non-bank financial institutions (NBFIs), and non-governmental organizations (NGOs) have a similar overall rating (57%, 58%, and 59%, respectively) but demonstrate significant disparities by criteria. Cooperatives have the lowest score on USSPM 1, 2, 3, and 4, while NGOs demonstrate greater commitment to social goals (USSPM 2).

Let us turn to the regional differences. The most significant differences exist between Sub-Saharan Africa and other regions, with African MFIs scoring weakest on all standards. The South-Asian region (57%) is slightly below Latin America and the Caribbean (LAC) as well as Europe and Central Asia (ECA) (62% and 64% respectively) but, the ECA region showing the best results on client treatment (USSPM 4) and treatment of employees (USSPM 5). MFIs in Middle East and North Africa (MENA) score highest globally (68%), at the level of commitment (USSPM 3) and on products, services and distribution channels design (USSPM 3).

Social performance mentoring programme for Oikocredit and its partners

Oikocredit’s Social Performance Management (SPM) mentoring programme involves microfinance partners, local consultants and Oikocredit’s social performance experts. In 2011, the programme grew in East Africa and has since expanded into West Africa, Southeast Asia and Latin America.

The mentoring programme helps microfinance institutions (MFIs) develop a clearer understanding of clients’ needs, the products and services offered, as well as the benefits and risks involved. Mentoring began with a training workshop for consultants and senior staff of microfinance partners on how to assess client risks and opportunities. The representatives then went back and implemented new actions plans into their practices, with regular review and guidance from consultants.

Tanzanian rural savings and credit cooperatives, KAWOSA and Musoma, both recognized that membership fees were a barrier in reaching the most disadvantaged groups. Both MFIs decided to offer lower-income people group membership, enabling them to share the fees.

Still in Tanzania, Tujijenge, focused on providing more flexible loan products with improving client appraisal, preventing over indebtedness, training its staff on client protection principles and integrating SPM into its strategic planning. Tujijenge also developed a new health insurance product and other ways to help clients be better protected against risk.

In Uganda, the programme led Remode, a small MFI focusing on urban youth, to address the social exclusion of a nearby impoverished community. A group approach to lending enabled it to attract new clients.

In Uganda, UGAFODE Microfinance Limited harnessed a focus on delivering real benefits to clients in order to generate clear commercial and social returns, and a solid foundation for future growth. They thus decided to increase the number of low income, economically-active clients and provide high-quality, customer focused financial services, enabling clients to improve household incomes and livelihoods through the provision of inclusive financial services.

The SPM mentoring programme’s biggest challenge is meeting participants’ needs. Social performance is ultimately about building organisational awareness and protecting clients from unexpected hardships. We hope that current partners will benefit as much as our Ugandan partner UGAFODE did, which achieved better outreach to target groups, significant growth in its client base and improvements in financial and social performance from its participation in the programme in 2011.

More information on UGAFODE at: http://www.ugafode.org/about/faq/001706/001706.pdf

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Notes

¹ Social Performance Task Force (SFT). More information can be found on www.sftinfo.org
² The two scores were obtained through aggregating the available data and presenting it on the 0-100 scale, provided by Microfinanza Rating and Planet Rating, on the basis of 206 ratings obtained in 2008-2014. Currently, well over 200 institutions use its own system. However, they have excluded under the framework created by the SFT, existing a retroactive approach of the USSPM scores and a comparison of results obtained by the agencies.
³ Non-bank financial institutions.
⁴ Some sample included 2013 institutions, as 3 institutions’ results were not representative.
The future of microfinance

Joint interview

Which objectives for microfinance?

Tilman Ehrbeck is the director of CGAP’s and Narasimhan Srinivasan is an international consultant and independent director.

What will the inclusive finance sector look like in 10 years?

Tilman Ehrbeck: The inclusive finance sector will continue to expand beyond traditional banks and microfinance institutions. There will be new partnerships between a more diverse set of actors – including mobile network operators and organised retailers – offering a wider range of financial products and services at a lower cost to more people. We are also exploring new “champions” of financial inclusion emerging, who often use technology to expand financial services to the poor.

Another set of important champions includes former NGOs and Microfinance Institutions (MFIs) which are transforming into broader regulated banks and introducing mobile retail banking to the low-income populations in their domestic markets for the first time.

These developments will continue to shape the inclusive finance sector for years to come.

Narasimhan Srinivasan: Branchless banking and technology linkages will be ubiquitous. There will be a multiplicity of players functioning as banking agents, financial institutions and insurers. Specialised institutions offering mobile financial services and payment services will enter into competition to banks, forcing them to enter into alliances. Credit products from banks and financial institutions will be mass marketed using the branchless banking networks. Technology, especially mobile, will be transforming towards the expansion of services and client comfort. Regulation will focus more on savings products, asset assessment and accountability being centralized using multiple label services (relating to technology, ATMs and agent networks) will be in focus. Bank branches will concentrate more on managing agent networks than on customer services. Product development will gain importance within banks. Indeed, they will not be able to train their employees, dispersed across the territory, unless products are simple and easily marketable.

What are your main recommendations to increase the impact of microfinance, especially with regard to the poor?

Tilman Ehrbeck: Learning from the poor about their financial needs, preferences and behaviors is an important first step. Poor people are very active managers of their financial lives. We know from the study of their books of accounts that they need and use a full range of formal financial services. While gaining deeper understanding of their financial lives is important, translating this knowledge into better products, delivery options, and enabling policies so something the sector is still grappling with. But if done right, such a customer-centric approach can advance financial inclusion by deepening access and usage of appropriate formal financial services. Ultimately, financial services should see some of these new financial providers pushing MFIs to either compete or to further specialize on the niche microenterprise lending model they have perfected. The result will be a healthier, more diverse market and – most importantly – greater financial inclusion.

Narasimhan Srinivasan: Microfinance has to achieve three objectives to make a difference to the poor:

1. Provide risk mitigation through a combination of insurances, savings and pension products;
2. Improve the affordability of credits and make credit products suitable for the different purposes of the poor;
3. Invest in improved governance so that customer protection is an intra-institutional issue rather than a sector-wide concern. Product development, optimization of processes for cost efficiency, engagement with customers to improve financial literacy levels and credit discipline and commitment to customer protection are key areas of continuing work for the microfinance sector.

Addressing evolving financial needs:

Can microfinance meet the challenge?

Over the past few years, broadening financial services to the poor has become a core tenet of full financial inclusion.

Influential studies, such as Portfolios of the Poor, have shown financial lives of clients are complex and their financial products need goes well beyond traditional microcredit. For some years now, the microfinance sector has been moving in that direction, broadening financial offerings to include different types of savings, insurance, payment, and a greater diversity of credit products.

However, this remains a work in progress. So far, traditional microcredit – short term loans with fixed and frequent payments – remains the bread-and-butter of the industry. Even for forward-looking Microfinance Institutions (MFIs) that have branched out into other products, microcredit remains the dominant source of revenue, often subsidizing other products. To a large extent, this is driven by the underlying economics of microfinance. To understand why, consider two illustrative examples: housing microfinance and commitment savings.

Housing microfinance has been around since the 1990s, including at Grameen Bank. Demand is widespread – according to the World Bank’s Global Findex database, home improvement is the most common reason for borrowing (after health and emergencies) among the poor in low and middle income countries. Indeed, it is common for MFIs’ clients to use microenterprise loans for home improvement. The challenge for MFIs is that most home improvements require loan amounts 2-3 times larger than traditional microcredit, which entails maturities that are similarly 2-3 times longer. The mathematics of how interest rates and loan maturities interact mean that such loans must have substantially lower interest rates than remain profitable, meaning a less profitable product for MFIs. As a consequence, housing microfinance remains a challenge.

The case of commitment savings is similarly instructive. Take school fees: the principal common reason for borrowing and another common use for microenterprise loans. School fees are an eminently predictable expense, and motivated MFIs may choose to structure commitment savings products that look very similar to microcredit – especially with regard to the poor.

The case of credit can be a challenge, as it runs into client tendencies to procrastinate, but for MFIs there is a more difficult challenge: such savings products are rarely profitable. Indeed, according to a Consultative Group to Assist the Poor (CGAP) study outlining the business case for small savings, such products are only profitable when selling. However, for MFIs whose clients already use loans to pay for school fees, offering such products will simply cannibalising an existing high-margin product with a new zero-margin product. Perhaps unsurprisingly, this is rarely done.

The case, then, is that broadening product offerings is not a simple one. Certainly, MFIs may diversify into other areas, but only to the extent that they don’t cannibalise too much into their primary revenue source – the microenterprise loan. But if one accepts that microenterprises represent a relatively small part of a far broader demand for financial services, can one expect traditional MFIs to pivot successfully into these new areas? Based on business experience, probably not. It is easier and cheaper to adopt strategies that lower revenues in the short-term, particularly when long-term prospects remain uncertain.

The most likely scenario is disruption from multiple technologies. Will white organisations that specifically target clients outside the microenterprise sector enable banks to drive down costs? Will white organisations mean a broader range of new products and services even to the less poor but still financially excluded. These organisations may end up with narrower margins than many MFIs, but should be able to make this up through higher volumes. This process will take time, but by 2020, we

DANIEL ROYAL
SENIOR MICROFINANCE EXPERT EUROPEAN MICROFINANCE PLATFORM (E-MFP)

Narasimhan Srinivasan: These developments will continue to transform the inclusive finance sector for years to come.

Tilman Ehrbeck: The most likely scenario is disruption from multiple technologies.
Product innovation

Community development through innovative microfinance

Since its foundation in 1986, VSSU has had as the core of its model the holistic development of local communities using local resources. Its financial inclusion services are currently linked to a number of social initiatives in more than 510 villages of the Sundarbans, India, with a cumulative membership of 116,000.

VSSU’s innovative initiatives focus on delivering client-oriented products and services. While most MFIs work with bank loans, VSSU has chosen to focus on ‘savings-based credit’. Experience shows that a savings-based model can lead to a win-win situation for both the client and the institution in the long run. Indeed, this model helps foster a mutual relationship between the institution and its clients for multiple reasons:
1) impact surveys show that all people living in poverty can save, and the demand for savings services is much higher than for any other financial service; 2) savings help clients build assets, confidence and financial management skills, reducing vulnerability for families; 3) savings are a low-cost source of funds for the institution and have helped the organisation operate without any grant support to date. Personal savings also allow clients to obtain loans at lower interest rates.

As an illustration:
- Only a portion of the savings collected from members is allocated for maturity and loan disbursement. This helps the client build up savings in addition to the increased income and assets from the loan invested in his or her microenterprise.
- Each product (deposits and loans) always comes with multiple term, interest, repayment, etc. options, providing flexibility within a structured framework.
- Credit alone is not enough. There is also a need for services like free insurance, incentives, training, exposure, and marketing delivered as a package so that even impoverished clients can create a habit of regularly depositing savings and repaying loans.

The microfinance sector in India has recently witnessed the catastrophic impact of excessive focus on numerical achievements. Development does not follow any scientific formula of progress; it needs to be client-focused, process-oriented, and have a holistic approach with sustainable impact as its goal.

An innovative MFI in Bolivia: Planting the seeds in agriculture microfinance

The best way to predict the future is to invent it. Innovation in microfinance requires a strong commitment to recovering the original spirit of service to those excluded from capital and economic opportunities. In Bolivia, 66% of rural inhabitants are poor; even though the country is recognized as a pioneer in microfinance, no more than 5% of the total portfolio of loans is committed to agriculture and an even lower percentage to small-holder farmers. SembrarSartawi (Development Finance Institution - DFI) is changing this by leading a renewed social pledge and working where others are cautious to engage.

The DFI is committed to reaching rural producers and managing risks related to small-scale agriculture: climate impacts, diseases and pests, as well as volatile agricultural markets.

It combines Technical Assistance (TA) to transfer best practices with credit and support for market access. TA is provided to increase yields and reduce risks; financial services create access to capital while market access contributes to better returns, making agriculture more profitable and qualifying small-holder farmers for further loans. These components work together to create a virtuous circle. TA improves access to financial services, helps farmers invest more productively in their livelihoods, maximises investments and increases productivity; market information as well as purchase partnerships that SembrarSartawi promotes between local companies and small-holder farmers enhance opportunities to reach more profitable markets. Two private institutions implement the model: TA and market access are delivered through an independent institution, which coordinates services with a separate institution that provides credit.

Serving 15,000 small farmers, the portfolio has reached US$ 30 million, 60% of which is in agriculture. 1,600 clients have received specific assistance improving yields by 20% on average. Non-performing loans make up less than 2%, and financially, the DFI has achieved positive and attractive results for social impact investors.

Furthermore, social metrics are one of the DFI’s top priorities. SembrarSartawi has developed specific systems to measure changes in the productivity of smallholders in order to monitor progress and measure the final impact, all in view of a triple bottom line: social, financial and environmental.

The future is challenging. At the local level, there are still vast rural areas to cover; internationally, SembrarSartawi is being solicited to transfer and replicate these results. This innovative model has proved itself to be an effective tool to serve small-holders in agriculture, and is being closely watched by policy makers and international organisations. In sum, SembrarSartawi is planting the seeds of the future in rural agriculture microfinance.
How would technological innovations influence microfinance?

According to the latest Mobile Money for the Unbanked (MMU) annual report, ‘State of the Industry 2013: Mobile Financial Services for the Unbanked’, it is estimated that 2.5 billion people in lower income countries are unbanked. Yet more than 1 billion underserved people in these markets already have access to a mobile phone. The phone and the infrastructures coming with it can be used to offer sustainable financial services. The question is no longer whether technological innovations are available for the poor, but how to ensure that the right innovation is developed and successfully implemented.

Two of the most critical barriers to serve the poor are high operational costs associated with the staff-heavy outreach approach, and operational inefficiencies associated with managing cash and information flows. The use of technology is a critical opportunity to lower these costs and improve product outreach and development.

Mobile operators now have a mobile banking offer that enables MFIs to build technological platforms that allow for money transfer and mobile-banking. Not that these mobile solutions will succeed if they don’t take all local conditions into account, the disappointing replication of M-Pesa in South Africa being an example. MFIs or telcos should therefore never adopt a one size fits all approach when it comes to financial services. A further prediction that seems foreseeable is that there will be continued partnerships between telcos and financial institutions to offer client mobile based micro-credit and money transfer services. In Kenya, Safaricom in partnership with Commercial Bank of Africa (CBA) introduced M-Shawari, a mobile-based micro-credit services product. Tanzania has followed suit, Vodacom in partnership with CBA has launched a banking service named M-Pawa allowing Tanzanians to save and borrow money on their mobile phones. BNP Paribas is a partner to Orange Money service in West Africa. This wave of services raises the possibility of potential mergers between telcos and financial institutions. There could soon be a new wave of more advanced mobile banking services: mobile-only microfinance, m-insurance or financial institutions offering mobile operations services like Equity Bank in Kenya which was licensed to operate as a Mobile Virtual Network Operator.

Therefore, there is a need for MFIs to engage into technology and grow a wider range of mobile banking and insurance services on mobile phones, beyond simple payments. To achieve this, different models may need to be put in place. Some MFIs will develop new range of services, products or delivery channels, in parallel to their brick and mortar approach. Others could take a new shape with mobile-only MFIs such as Musoni in Kenya. Partnerships with banks, telcos, and technology firms will be more and more common. The role of MFIs as business correspondents and super agents of distributors will be a new development for the sector. However, cost benefit analysis must be considered. MFIs should examine systems and operations to determine which technologies work, and develop partnerships with technology service providers so as to mobilise sufficient skills-sets required.

In the future, the evolution of mobile technology will blur the lines that separate telecoms from financial institutions. The current challenges of the underdeveloped distribution networks and partnerships regulatory challenges and expensive compliance, and resistance by telcos in opening up their platforms to offering MFIs who can plug into their existing distribution platforms and fraud cases will be history in the future. Studies show a positive trend, as mobile phone penetration for 2012 surpassed the 16 million subscribers mark and is currently estimated at 17 million, a trend expected to continue. The telco industry continues to grow and is expected to expand more regions. With 219 services in 84 countries at the end of 2013, mobile money transfer for instance is now available in most developing and emerging markets.

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Towards convergences between the banking sector and microfinance?

Administrative costs are too high when lending small-scale loans to the poor. To keep their strong social mission and retain self-sustainability, MFIs can have a profitable mix, which returns can finance investment activity in the other leg, namely that of governments and foundations instead, should help convergence via deepening financial inclusion.

Commercialisation is controversial. Mexico’s Banco Compartamos, is a case in point. Since its Initial Public Offer (IPO) the number of active borrowers has quadrupled. Nonetheless, ongoing connections between the banking sector and MFIs involve synergies that could resolve excessive widening over deepening. The microfinance industry can learn from the sector.

MFIs are either becoming commercial banks or are increasingly linked to the financial sector for funding. Moreover, MFIs’ convergence process risks losing government support, and are now part of the regulated banking sector. Microfinance institutions (MFIs) share the same objective. Unlike their 19th-century European counterparts, however, MFIs’ convergence process risks losing its social goal.

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Convergence will make wider financial products within reach of poor clients at lower prices. And like the 19th-century institutions have demonstrated, convergence is possible, albeit with government support and subsidies—just like any other R&D activity involving a social benefit not fully internalized by the private sector.

MFIs have a strong growth potential. Considering 100 institutions that responded to our survey, 72% have an average growth rate of 22%. Most institutions have attracted foreign investment for many years, but still struggle to meet consumer demand. Future research will be less than proportional to portfolio growth in mature markets, demand for equity financing will soar. MFIs’ reliance on foreign investors, NGOs, dons, local businesses and entrepreneurs—in terms of the growth and convergence of their operations. This requires significantly more and earlier consideration of the business. MFIs must consolidate their ownership structures with long-term institutional investors who can commit sizeable amounts of capital, provide active governance and support, and enable further growth.

While the above concerns mature markets, opportunities arising from vast, largely untapped markets like China, Pakistan, Burma, Congo DR, Ethiopia, and more, should not be underestimated. These ‘last frontier’ markets complement those like India and Nigeria, where MFIs have attracted foreign investment for many years, but still struggle to meet consumer demand. Microfinance’s best years are yet to come.

Microfinance is a winners’ market. However, convergence is inconceivable unless MFIs are either becoming commercial banks or are increasingly linked to the financial sector for funding. Moreover, MFIs’ convergence process risks losing government support, and are now part of the regulated banking sector. Microfinance institutions (MFIs), a few hundred have contributed to most of the growth.

Towards convergences between the banking sector and microfinance?

Interactions between the banking sector and microfinance are not new. In the 19th century Europe witnessed a cooperative banking movement in Germany and France, respectively. The movement had the objective of reaching financial exclusion. Both initiatives benefited from government support, and are now part of the regulated banking sector. Microfinance institutions (MFIs) share the same objective. Unlike their 19th-century European counterparts, however, MFIs’ convergence process risks losing its social goal.

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Interactions between the banking sector and microfinance are not new. In the 19th century Europe witnessed a cooperative banking movement in Germany and France, respectively. The movement had the objective of reaching financial exclusion. Both initiatives benefited from government support, and are now part of the regulated banking sector. Microfinance institutions (MFIs) share the same objective. Unlike their 19th-century European counterparts, however, MFIs’ convergence process risks losing its social goal.

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Regulation

Microfinance actors converge on the issue of better regulation for the sector

What is the role of microfinance networks and how will they evolve?

Microfinance associations (MFAs), member-based organisations representing financial institutions serving poor and low-income segments, are critical financial sector actors that have an important role to play in promoting market development. Key market functions associated with standardisation, promotion, knowledge sharing, and the development of transparent business environments rely on strong representative organisations to ensure local demand-driven approaches and scaling of innovations. Their ability to stay relevant to their members, and the broadening of their role, will depend on their ability to adapt to a rapidly evolving financial landscape.

A more international, known national and regional level representation is required. The sector has been in operation for over 2 years. Together, they represent 4,260 MFIs serving about 100 million clients, with an outstanding loan portfolio of slightly over USD 31 billion. The vast majority of MFAs are still relatively young institutions, the average age being 12 years. The MFA sector, with the majority having experienced the most significant development in the last 5 to 6 years only.

The traditional role of MFAs has been to support retail microfinance institutions (MFIs) with services improving their institutional performance and increasing their ability to attract needed commercial capital to fuel growth, as well as to inform, develop and promote financial inclusion initiatives. This generally consists of providing supply-side data in the form of financial performance reports, benchmarking against industry standards, and social performance assessments. In some markets, MFAs have expanded their role to include demand side products (i.e. savings, insurance, and local credit bureau services) and participation of their members in local credit bureaus and promotion of financial literacy initiatives.

To ensure the future, MFAs are confronted with some very important opportunities and challenges. First and foremost, their role as industry representatives will be dependent on attracting needed commercial capital to fuel growth, as well as to inform, develop and promote financial inclusion initiatives. This generally consists of providing supply-side data in the form of financial performance reports, benchmarking against industry standards, and social performance assessments. In some markets, MFAs have expanded their role to include demand side products (i.e. savings, insurance, and local credit bureau services) and participation of their members in local credit bureaus and promotion of financial literacy initiatives.

The consequences of microfinance regulation: The case of Kyrgyzstan

The situation in Kyrgyzstan regarding regulation is unique. It provides insight into the positive and negative impacts of the regulation and the lack thereof, can have on the microfinance sector.

Microfinance developed very swiftly in Kyrgyzstan after the 2000s. Rather than a legal act, all MFIs were restricted by a number of regulations from the Central Bank, which made them very restrictive for microfinance operators. Providers of microfinance were not allowed to process loan applications, to make collateral-free loans, to conduct transactions using an internet banking agent network, to attract investors.

The aim of the new law was to create a more a stable and controlled environment that attracts investors.

The future of microfinance

The future of microfinance faces a number of challenges and opportunities. First and foremost, the sector needs to find ways to attract needed commercial capital to fuel growth, as well as to inform, develop and promote financial inclusion initiatives. This generally consists of providing supply-side data in the form of financial performance reports, benchmarking against industry standards, and social performance assessments. In some markets, MFAs have expanded their role to include demand side products (i.e. savings, insurance, and local credit bureau services) and participation of their members in local credit bureaus and promotion of financial literacy initiatives.

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In France, personal microcredits are tailored towards private individuals in hardship, with the objective of helping them to integrate the professional world and society. Funding can be provided for a long list of things: household items, training, healthcare, etc. Mobility features at the top of the list of needs. Each year, almost 74% of personal microcredit loans go towards purchasing or repairing a vehicle or obtaining a driving licence.

There are two main reasons behind this. First, the rise of precarious employment is forcing employees to surrender to adopt divided working hours in places which are poorly accessible by public transports. Second, public subsidies for mobility are small, but they rarely cover the wide variety of needs.

Mobility is a key societal issue which many are not aware of. In a recent study, Auxilia, a consultancy firm, pointed out that 6.8 million people in France are affected by mobility difficulties. Furthermore, mobility is a key factor in gaining access to employment. 60% of employers surveyed by Auxilia had to face a situation in which a job applicant turned down an offer of work because of transportation problems. Those living in vulnerable situations are the most affected. Half of those making their way into the workforce have a driving licence, and only a third have a vehicle.

Spurred on by these observations, several companies and associations have come together in order to found the ‘Laboratory for Inclusive Mobility’. Its aim is to gain a better understanding of the factors that hamper mobility in order to strengthen existing solutions, such as personal microcredits, while also inventing new solutions. In addition to this laboratory, Fédération Nationale des Caisses d’Épargne, Total, Renault and MACIF Group have joined Wimoov, an association that specialises in providing support for mobility with the goal of designing a package that includes personal microcredit, a second-hand car, fuel, repairs and insurance.

The aim is to promote a comprehensive mobility package which is easily obtainable and long-lasting. Microcredits have a key role to play in such an initiative.

**MICROFINANCE IN FRANCE**

**On the road towards ‘inclusive mobility’**

In 2013, 12,886 loans were granted to France’s 6.8 million inhabitants affected by mobility difficulties. Of these loans, 50% were provided by the Fédération (FCS) [Social Cohesion and Development] and 50% by non-bank financiers. In 2013, 2.4% of all credit applications were approved for personal microcredits.

**Microcredit in France 2013 results**

In 2013, FCS allocated €21 million towards these goals, including €10 million for conventional guarantee mechanisms and €10 million to guarantee ‘NAORE’ loans, the remaining balance going towards the funding of auxiliary networks. This enabled implementing 12,530 new Fogefi guarantees amounting to €51.5 million, a similar level to 2012. The leverage effect is significant because the amount of loans that can be distributed under this framework is slightly greater than €87 million. In turn, ‘Galland law’ territorial funds of France Active, developing new guarantee mechanisms for inclusion and job creation, supporting safety networks for creation of enterprises, new support for enterprise creation and recovery (‘NAORE, Nouvel accompagnement pour la création et la reprise d’entreprise’).

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Microfinance is a young and heterogeneous sector in Europe, especially with regards to the diversity of institutional models, lending approaches and regulatory frameworks. Microfinance mostly targets micro-enterprises, which represent 91% of all European businesses. Moreover, 99% of start-ups in Europe are micro or small enterprises and one third of these were launched by people that were unemployed.

According to the European Microfinance Network (EMN) Sectoral Overview Survey published in 2012, 154 MFIs among 32 European countries provided 204,080 microloans for a total volume of over €1 billion. The average loan size for 2011 was €5,135. 59% of all loans reported in the EMN Overview Survey were disbursed in Eastern Europe, which represent 35% of the total volume reported.

European microfinance markets are characterised by a large diversification of the products offered. Most of the European MFIs provide their microloans as individual loans (92%). Second, especially in the Eastern European countries such as Serbia or Bosnia-Herzegovina, the institutions offer shorter average loan terms. Another key feature is the great divergence between interest rates, which varies as low as 4% in Austria, France and Italy to 35% in Serbia. The average annual interest rate for all institutions surveyed is around 11%. As a reference point, the average Euribor rate in 2011 was 1.4%. Among some countries, such as the UK or Romania, where there are no usury laws, MFIs charge higher interest rates than the ones operating in countries where interest rates are capped, such as Germany or the Netherlands.

**Regulation trends**

As lending practices vary considerably, the design of a “European Code of Good Conduct for Microcredit Provision” was identified by the European Commission (EC) as an important element to encourage the adoption of best practices in the sector. The Code primarily applies to MFIs providing loans up to €25,000 and encompasses a set of standards. The endorsement of the Code is voluntary and is not expected to disrupt any legislative requirements of EU member countries.

The implementation of the Code is a priority for many European microfinance providers, since its application will most likely become a requirement to access EU funds.

The EC supported 29 microcredit providers based in 16 member states through the European Progress Microfinance Facility (EPMF) launched in 2010. So far, this programme reached 9,000 final beneficiaries who benefited of €80 million of microcredits. Another key program is JASMINE (Joint Action to Support Microfinance Institutions), a pilot initiative launched in 2008 and aiming at helping MFIs scale up their operations within the European Union. 30 microcredit providers benefited from this programme in 2013.

In the framework of the multilateral financial framework for 2014-2015, the European Council adopted the new EU programme for Employment and Social Innovation (EaSI), that will make €920 million available for the 2014-2020 period. EaSI is the new EU umbrella programme for employment and social inclusion and is managed directly by the EC. It integrates and extends the coverage of three existing programmes: Progress, EURES and the EPMF. Under this programme the EC will provide not only guarantees and funded instruments to the microfinance providers in Europe, but also funding for capacity building and technical assistance.

**2010-2011 European Microfinance Network survey Focus on products**

Even though the European microfinance sector is still dominated by business loans, the supply of other products and services has increased over the recent years. Indeed, some national legal frameworks restrict MFIs’ ability to offer a wider range of financial products and services. Furthermore, the European Commission (EC) and all existing support instruments funded by the European Union (EU) focus on business microlending.

Around one third of MFIs covered in the survey do not provide non-financial services. Among the remaining two thirds, the categories “Other” with 34% and “Business Development Services (BDS)” with 26% are the most popular non-financial services supplied by MFIs.

More than one out of two MFIs offer BDS on a regular basis (Figure 21). 14% of the MFIs offer BDS only if asked by client, followed by 12% who refer it to clients. This indicates that the use of BDS is mainly not obligatory for the clients, as only 11% of the MFIs report that BDS is mandatory for all their customers and 6% set it as a requirement in some cases.

**CONVERGENCES**
“Microfinance is and will be the future of the center initiatives for financial inclusion”

How have you seen microfinance evolve in Kenya and worldwide over this period?

I have worked as a microfinance banker for the last 14 years. During this time, microfinance has evolved and strengthened its role in the financial sector. In the early 80s and 90s, microfinance was dismissed as small time women’s involvement. Only tiny loans were offered to poor women, mostly in groups. Today, banks have turned to small and medium enterprises. The role of microfinance is poverty eradication and it has been also accepted by governments as a means for financial inclusion. As a result, regulation of the microfinance sector shows the financial authorities’ desire to streamline the microfinance industry as part of the mainstream financial sector. Institutions like KWFT have developed worldwide networks that penetrate deeply into rural areas enhancing financial inclusion and empowering women.

What are KWFT commitments and actions for responsible and impact microfinance?

KWFT Women focuses on women’s and their families’ needs. Its products are developed with this in mind. In addition, Kenya Women strictly observes the double bottom line. This is why in Kenya Women social performance reporting is considered as crucial as financial reporting. More importantly, the Kenya Women approach involves operating deep into rural areas to outreach and financial institution and to provide ready access in rural areas as a means of discouraging rural-urban migration. When people migrate into towns seeking better opportunities which are more often than not elusive, the major end up in slum areas where living conditions are deplorable.

Can you assess the impact of your work?

Assessment of the impact of our work is not done by our institution alone, but also by the communities whom we serve. Adoption of our products is one measure to use, especially because not only are they financial products, but they are also life enhancing interventions. Evaluation by rating institution, such as MicroRate and others is also carried out. These rating institutions assess both the financial and the social performance. Staff satisfaction surveys reveal staff perception of the value of their work.

The institution has received over the last three years the “Best Employer Award”. This shows that thanks to evaluation, our institution’s values are recognised. At the national level, evaluation has shown the institutional worth.

How do you see the future of microfinance?

Microfinance is the centre now and in the future in the attempts to achieve financial inclusion. With increased use of new technology, microfinance will drive achievement of the Millennium Development Goals and the future Sustainable Development Goals. It is microfinance that will help poor people change the way the financial world works for them. Technology will be key in this.

THE GLOBAL APPEAL
FOR RESPONSIBLE MICROFINANCE

The Global Appeal is a worldwide effort to build momentum and commitment to financial inclusion and responsible finance. It was developed with this in mind. It was launched as the «Paris Appeal for responsible microfinance» during the 4th edition of the microfinance World Forum in 2011, the Global Appeal renewed, reinforced and widened the call for microfinance to serve poverty reduction and the achievement of the Millennium Development Goals at the 5th edition of the World Forum in 2012.

The Global Appeal articulates a vision for a fully responsible and responsive industry, and outlines a path forward for all relevant stakeholders: microfinance institutions, regulators, policymakers, investors, researchers, and financiers, through 7 principles:

1. MFIs Serve Clients in a Responsible Manner
2. MFIs Advance the SPTF Universal Standards for Social Performance Management
3. MFIs Operate with Sound Governance and Financial Responsibility
4. Regulators and Policy Makers Support a Sound Microfinance Sector
5. Institutions in Microfinance Uphold the Principles for Investing in Inclusive Finance
6. Researchers Assist the Microfinance Industry to Learn

Read the full text, browse the 2,000+ signatories, and endorse the campaign online at:

www.theglobalappeal.org

They have already signed the Global Appeal:

Portman, Nathalie; Michel Rodac; Jean-Michel Severin; Chuck Waterfield; Action; Acacia; Buro Bangladesh; CARE; Credit Cooperatif; Crédit Municipal de Paris; e-MFP; FINCA; Finansial; Freedom From Hunger; Grameen Crédit Agricole Microfinance Foundation; Foundations; Grameen; IFI Conseil; Macl. Microcredit; OxUOS; Pampga, REM; Secours Catholique;...

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