

MICROFINANCE IN ASIA

Trends, Challenges and Opportunities

EDITED BY JAMIE BEDSON

Produced by The Banking with the Poor Network in collaboration with the SEEP Network
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Preface

This report, *Microfinance in Asia*, neatly compiles the wide-ranging and voluminous content presented at the Asia Microfinance Forum 2008 convened in Hanoi, Vietnam, in 2008. *Microfinance in Asia*, also drawing on various regional country reports, seeks to address questions for the future. How can the supply of microfinance services begin to match unmet demand in Asia? Can the enormous challenge of responding to this unmet demand be achieved by the current stock of human resource and technical microfinance capacity. Inadequate regulation for the microfinance industry seems to be an abiding constraint, varying by country. How can the central banks and other relevant regulatory agencies which most effectively promote and facilitate efficient and profitable microfinance services be better recognised and rewarded? *Microfinance in Asia* also confirms how vitally important microfinance networks are, and so too the information-sharing and knowledge management roles they play. But as providers of public goods, sustainable funding is always a challenge for networks and thus donors have an important role to play. A major future shift identified in *Microfinance in Asia* is the new products and services and business applications being delivered by microfinance institutions. In new microfinance markets, consumers don't just want basic lending services; they want services for remittance transfers, life insurance and pension planning products, and loans customised to fund the purchase of modern energy services. This report will hopefully have many avid readers. I hope and expect that, above all, the contents of *Microfinance in Asia* will help equip microfinance practitioners with ideas on how to successfully grow and strengthen their businesses and better serve the unbanked and the poor, thereby helping to achieve the BWTP Network's mission of achieving greater financial inclusion in Asia.

Craig Wilson
*Executive Director,
The Foundation for
Development Cooperation
Executive Committee Member,
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As Chairman of the Banking with the Poor Network, I am extremely pleased to commend this *Microfinance in Asia* report to members and colleagues across the region and internationally. The report reflects the wider challenges and opportunities facing our membership and all microfinance providers and stakeholders in their respective countries, and also the shared experience of those industries across the region. Interest in the policies of financial inclusion and the role of microfinance is ever-growing amongst stakeholders globally and particularly in Asia, where the unmet demand remains huge. However, what this report highlights is many of the challenges in addressing this demand, particularly in relation to limited funding and the dearth of adequate regulatory frameworks to address this shortfall. While this quest is essential for the growth of the industry and provision of quality financial products to more of the region's poor and low-income households, commercial growth and sustainability must not undermine the long-term viability of the microfinance industry. With this report and the associated industry assessments, the BWTP Network looks forward to further increasing its value as a resource for its members and the wider microfinance industry in Asia.

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Microfinance in Asia is the result of contributions made by a range of microfinance practitioners, including individual chapters prepared by contributors and participants at the Asia Microfinance Forum 2008.

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- > Bindu Sharma, Consultant (Summary of Industry Assessments)
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- > Anna Bantug-Herrera and John Owens, Asia Region, Chemonics International (Microfinance and Technology)
- > Nicola Armacost, Arc Finance (Microfinance and Sustainable Development).

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The BWTP Network Executive Committee generously provides their time to grow the Network and also contributed to the development of this report. Thanks go to BWTP Network Chairman, Chandula Abeywickrema (Hatton National Bank), Craig Wilson (FDC), Nimal Mamaduwa (SANASA), Syeda Obaida Haque (Shakti Foundation for Disadvantaged Women), Md. Abdul Awal (CDF) and Ruben de Lara (TSPI).

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All presentations from the Asia Microfinance Forum can be found on the BWTP network website at www.bwtp.org.

Jamie Bedson
Editor,
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BWTP Lead Coordinator

Acronyms

> ADB	The Asian Development Bank	> FINGO	Financial-intermediary Non-Government Organisation
> AEPC	The Alternative Energy Promotion Centre	> GCI	Grameen Capital India
> AMFA	Azerbaijan Microfinance Association	> GFI	Government Financial Institution
> ANS	Asia Network Summit	> GIS	General Information Sheet
> ATM	Automated Teller Machines	> GUARDIAN	Gramalaya Urban and Rural Development Initiatives and Network
> BB	Branchless Banking	> GXI	G-Xchange Inc
> BKD	Village-based Institution	> IFAD	The International Fund for Agricultural Development
> BOP	Base of the Pyramid	> IFAS	Inclusive Finance Advocacy Staff
> BRDB	Bangladesh Rural Development Board	> ICT	Information and Communication Technologies
> BSP	Biogas Sector Partnership Nepal	> IFC	The International Finance Corporation
> BSP	Philippine Central Bank	> IPO	Initial Public Offering
> BTM	Biometric Teller Machine	> IVR	Voice-Recognition Technology
> BWTP	Network The Banking With the Poor Network	> KfW	Kreditanstalt für Wiederaufbau
> CARD	MRI Development Institute	> LDKP	Rural Fund and Credit Institutions
> CARD-MBA	The Center for Agriculture and Rural Development Mutual Benefit Association	> LMFPA	Lanka Microfinance Practitioners Association
> CBSL	Central Bank of Sri Lanka	> LMPA	Lanka Microfinance Practitioners Association
> CDA	Cooperative Development Authority	> LPD	Village Credit Boards
> CDF	Credit and Development Forum	> LPG	Liquefied Petroleum Gas
> CDO	collateralized debt obligation	> LPJK	Financial Services Supervisory Agency
> CGAP	The Consultative Group to Assist the Poor	> MABS	Micro-enterprise Access to Banking Services
> CIB	Credit Information Bureau Limited	> MCPI	The Microfinance Council of the Philippines
> CIDA	The Canadian International Development Agency	> M-CRIL	Micro-Credit Ratings International Ltd
> CITSG	Core Information Technology Supervisory Group	> MFB	Microfinance Banks
> CNSP	Citi Network Strengthening Program	> MFC	The Microfinance Centre
> E4ALL	The Energy for All Partnership	> MFDB	Microfinance Development Bank
> EAF	Eko Aspire Foundation	> MFI	Microfinance Institution
> EU	The European Union	> MFO	Micro Finance Organization
> FDC	The Foundation for Development Cooperation	> MFP	Microfinance Provider
> FINCA	The Foundation for International Community Assistance	> MFWG	Viet Nam Microfinance Working Group
		> MFX	MFX Solutions

> MICRS	The Microfinance Innovation Center for Resources and Alternatives	> ROSCA	Rotating Savings and Credit Association
> MIFA	Microfinance Initiative for Asia	> RUFIN	Rural Finance Nepal
> MIS	Management Information Systems	> SBP	State Bank of Pakistan
> MIV	Microfinance Investment Vehicles	> SBLP	SHG-Bank Linkage program
> MNO	Mobile Network Operator	> SCC	Saving and Credit Cooperatives
> MNYL	Max New York Life	> SDC	Supervisory Data Center
> MRAA	Micro Credit Regulatory Authority Act	> SEC	Securities and Exchange Commission
> MSME	Micro, Small and Medium Enterprises Groups	> SEEDS	Sarvodaya Economic Enterprise Development Services
> NABARD	National Bank for Agriculture and Rural Development	> SEEP	The Small Enterprise Education and Promotion Network
> NBFI	Non Banking Financial Institution	> SELCO	The Solar Electric Light Company
> NBFI	Non-bank Financial Intermediaries	> SEWA	Self Employed Women's Association
> NDTF	National Development Trust Fund	> SfC	Saving for Change
> NEFSCUN	National Federation of Savings and Credit Union Nepal	> SME	Small and Medium Enterprises
> NGO	Non-governmental organization	> SMS	Short Message Service
> ODA	Official Development Assistance	> SPM	Social Performance Management
> OPIC	The Overseas Private Investment Corporation	> STK	SIM Tool Kit
> P2P	Peer-to-Peer Networks	> TIAA-CREF	Teachers Insurance and Annuity Association - College Retirement Equities Fund
> PAR	Portfolios at Risk	> UNDP	The United Nations Development Programme
> PCF	People's Credit Funds	> USSD	Unstructured Supplemental Service Data
> PCFC	The People's Credit and Finance Corporation	> VAPCF	Viet Nam Association of People's Credit Funds
> PKSF	Palli Karma Sahayak Foundation	> VBARD	The Vietnam Bank for Agriculture and Rural Development
> PPAF	Pakistan Poverty Alleviation Fund	> VBSP	The Vietnam Bank for Social Policies
> PMN	Pakistan Microfinance Network	> VDB	The Vietnam Development Bank
> POS	Point-Of-Sale	> VPSC	Viet Nam Postal Savings Company
> RBAP	The Rural Bankers Association of the Philippines	> WHO	The World Health Organization
> RMDC	The Rural Microfinance Development Centre Ltd.		

Introduction to *Microfinance in Asia*

The report aims to both provide an overview of the themes addressed by the Asia Microfinance Forum 2008 and to provide a snapshot of microfinance in selected Asian countries by drawing on various recent microfinance industry country assessments prepared by the BWTP Network and other country-level networks as a part of the Citi Network Strengthening Project.

In August 26 -29, 2008, the BWTP Network and FDC, with support from the Citi Foundation, convened the Asia Microfinance Forum 2008 in Hanoi, Vietnam. This Forum brought together over 500 leading microfinance practitioners, policymakers, financiers, academics and advocates from around the world to outline their visions and priorities, and explore new ideas and opportunities.

Microfinance in Asia reflects the input of presenters and participants of the Asia Microfinance Forum 2008 and provides an overview of the microfinance industry in Asia for both microfinance stakeholders and for those outside the industry wishing to learn more about the role of microfinance in Asia.

The theme for the conference was *Microfinance in the 21st Century: Future Trends & Opportunities* and had the following objectives:

- > To identify and target future challenges and opportunities arising from areas such as financing and investment, new technologies, and environmental issues;
- > To encourage the effective development of innovative microfinance products and approaches between and among stakeholders in the Asia region;
- > To encourage partnerships and cooperation in Asia among microfinance service providers, financiers and regulators in order to increase peer learning in microfinance.

In addressing these objectives, the BWTP Network identified five themes for the Asia Microfinance Forum 2008 which reflected the priorities and needs identified by BWTP Network members as well as areas of perceived future innovation and challenge. These themes consisted of: Financing and Investment; Savings and Asset Building; Microfinance Networks;

Technology; Microfinance and Sustainable Development. This report addresses each of these issues.

The Citi Network Strengthening Program is an \$11.2 million grant program launched in 2008 in collaboration with the SEEP Network and assistance from local employees of Citi and its affiliates (Citi) around the world.

The mission of the Citi Network Strengthening Program, the largest global grant program to be implemented in support of the Citi Foundation's microfinance strategy, is to increase the capacity and scale of the microfinance sector by strengthening the operational, technical, and financial capacity of twelve national and regional microfinance networks, addressing the challenges which the sector is facing and promoting growth and development in the sector.

Twelve microfinance networks have been selected to participate in the Citi Network Strengthening Program. In total they represent nearly 60 countries, over 1,300 MFIs and microfinance organisation members, and more than 36 million clients.

In the spirit of the CNSP, the BWTP Network hosted the inaugural Asia Network Summit (ANS) at the Asia Microfinance Forum 2008. The ANS was attended by eleven country-level microfinance network representatives from across Asia who spent a day participating on sessions focusing on social performance management, membership and member services, financial literacy and presentation from leading international networks the Microfinance Center (Poland) and the Association of Ethiopian Microfinance Associations. In the coming years, the BWTP Network proposes to facilitate further information sharing between regional networks by providing a platform for regional dialogue on microfinance network issues. Building on the increased exposure of microfinance networks resulting from the CNSP and the Asia Microfinance Forum 2008, the BWTP Network aims to play an ongoing role in explaining, highlighting and promoting the work of microfinance networks regionally. This will include a second Asia Network Summit to be held in Singapore in late-2009.

1. Executive Summary

Microfinance in Asia is an incredibly diverse industry reflecting the wide-ranging contexts - social, political and geographical - in which financial services for the poor are being provided.

As a regional industry however, microfinance in Asia stands out internationally with by far the greatest number of microfinance providers, the largest client base (with unmatched potential demand in countries such as India and China) and a traditionally strong focus on a social mission. Despite this, the microfinance sector in Asia has thus far only succeeded in satisfying a very small percentage of the total demand for microfinance services.

Although Asia has some of the largest microfinance institutions, including commercial banks such as BRI Indonesia and ASA Bangladesh (both BWTP Network members), and a range of diverse microfinance methodologies serving different market segments, the vast majority of the institutions are unable to expand outreach. The reasons are mainly due to a lack of financial resources and subsequent inability to invest in developing an adequate level of systems and human resource capacity to manage significant growth. Furthermore, there is a need for new institutions and innovations in microfinance technology to reach the unbanked, going beyond livelihoods to improving quality of life such as financing education, health, housing, insurance, and asset creation.

The countries described in this report operate under challenging and insufficiently conducive regulatory frameworks to accommodate sustainable microfinance initiatives that can intermediate a range of financial services, especially savings and insurance products to provide a safety net for clients. These factors result in the vast majority of poor people in communities across Asia being dependent on available local sources of capital at exorbitant prices. They also lack the opportunity to gradually move beyond survival by building sustainable livelihoods, creating businesses and building assets, and assuring the future of the next generation. The challenges are only

amplified by the current global financial crisis that threatens the impressive growth of the sector achieved in recent years. The solution to this demand/supply gap that many countries and industry representatives are working towards is the commercialisation and sustainability of the industry and the development of regulatory frameworks that facilitate the mobilisation of deposit and access to sources of funding.

The section which opens this report provides a summary of Microfinance Industry Assessments produced by Asian networks participating in the Citi Network Strengthening Program (CNSP). The Microfinance Council of the Philippines (MCPI), the Pakistan Microfinance Network (PMN) and China Association of Microfinance all produced industry assessments in 2008/09 under the aegis of the CNSP. In addition, the BWTP Network produced Microfinance Industry Assessments for Vietnam, Indonesia, Nepal, Bangladesh and Sri Lanka. For India, 2007's 'Microfinance in India: A State of the Sector Report' is used.

The 'Summary of Microfinance Industry Assessments' section provides a concise synopsis of the various assessments. For an in-depth understanding of the issues specific to each country it is recommended that readers obtain the complete version of these assessments through the websites of the various networks.¹

The various country industry assessments focus on core issues such as the structure of microfinance providers, regulations and government initiatives, products and services, meso-level organisations, funding sources and microfinance impacts. They highlight the diversity of the microfinance industry in the region amongst those countries described. These assessments document industries in some of the largest microfinance sectors in Bangladesh, India and the Philippines as well as nascent industries such as in Vietnam and China.

A story not told in this summary is that of emerging microfinance industries in countries such as Laos, Cambodia, Thailand and East Timor. Therefore, in 2009, the BWTP Network will publish country briefs on the microfinance

industries in these countries in order to shed light on the wider story of the growth, and potential, of microfinance in South East Asia.

The Asia Microfinance Forum 2008 was held in August, several months prior to the onset of the worst of the global financial crisis. Indeed, the crisis occurred just when it was being suggested that an oversupply of capital was being made available to the microfinance sector from both international and domestic sources. Internationally, the growth of microfinance investment vehicles has highlighted the growth of international capital available to the microfinance industry. However, even with the large flow of commercial capital to the microfinance industry, Asia as the largest market for microfinance in the world still receives only small percentage of investment internationally.

The first of the themes covered in this report, 'Financing and Investment', compiled by Asia Microfinance Forum 2008 partner organisation PlaNet Finance, reflects both the growth in financing and investment internationally and the challenges for Asia, tempered by the yet to be fully realised effects of the current global financial crisis. Of the new loan funds dispersed in South Asia, South East Asia and the Pacific for 2007, 75 percent were from commercial borrowings.² While the microfinance sector, as elsewhere, will undoubtedly be affected by the drop in available commercial funding during the 2008/09 global financial crisis, the microfinance sector's capacity in Asia to continue to attract investment is encouraging.

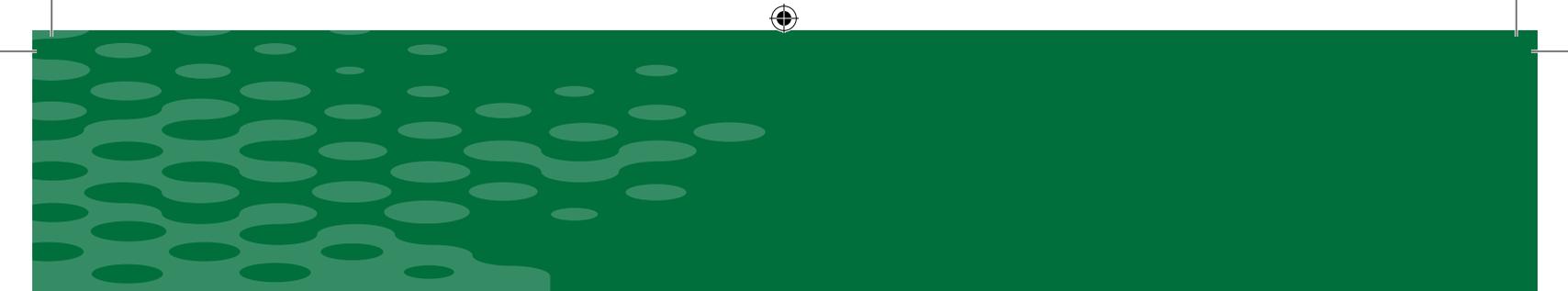
The third theme addressed in this report, contributed by Unitus whose work on savings featured in the Plenary Session on this issue in Hanoi, provides a summary of the issues and themes raised during the 'Savings and Asset Building' theme of the Forum and reviews several promising innovations. The capacity of the poor to accumulate savings and build assets is an integral part of poverty alleviation and sustainable economic development. Asset building, an important means to financial security, also relates to issues such as knowledge, education, health and housing. Savings mobilisation provides opportunities for MFIs

but the effective resolution of regulatory, legal, capacity and cost constraints creates future challenges for the industry.

Microfinance networks play an integral role as support organisations at both country and regional levels in Asia. Country-level microfinance networks are associations made-up of member institutions that work as support organisations on issues such as policy advocacy, training and capacity building and research and development. The BWTP Network sought to raise the profile of microfinance networks through the inclusion of 'Microfinance Networks' as a core theme of the Asia Microfinance Forum 2008. By making microfinance networks a central theme of the Forum's agenda, the intention was to raise their profile amongst regional stakeholders and the often undervalued work done undertaken in advancing the microfinance industry around such issues as advocacy, capacity building and technical assistance and the development of industry institutions and processes.

The 'Microfinance Networks' section provides an overview of the important role of microfinance networks in Asia and was completed by Kelly Hattel, microfinance consultant, in collaboration the SEEP Network team responsible for implementing the Citi Network Strengthening Project. While focusing on the important role of microfinance networks in Asia, it also addresses the challenges at hand within the global financial crisis.

New and better-applied technology is increasingly seen as a key strategy in increasing financial inclusion in developing countries. The future of e-banking will continue to see a roll-out of ICT-enabled systems with the aim of improving operational efficiencies and decreasing transaction costs. In addition, e-banking may enable commercial banks to deliver microfinance services more profitably. However, while innovations such as smart card services, biometric technology and mobile phone banking are well established in some contexts, MFIs in many Asian contexts are still grappling with how to best utilise technology to improve both their own performance and services to customers.



The 'Microfinance and Technology' section was prepared by Anna Bantug-Herrera and John Owens, Asia Region, Chemonics International, and draws on presentations in Hanoi which provided an overview of key technologies leading innovation in the sector, some of the key obstacles to their widespread uptake, and examples of successful implementation and partnerships.

The last section of the report, 'Microfinance and Sustainable Development,' was prepared Nicola Armacost of Arc Finance. This section highlights that a lack of access to modern, alternative sources of energy, clean water and improved sanitation in rural areas compromises the quality of life, health and economic opportunities of countless households in developing countries. While a vanguard of microfinance institutions is making loans available to increase linkages with suppliers to increase access to these, obstacles remain in convincing potential partners and funders as to the economic and financial benefits of energy lending.

As a non-traditional microfinance product, energy lending, like other microfinance innovations before it, challenges stakeholder perceptions and attitudes towards what microfinance can achieve. While it is recognised that, energy, water and sanitation microfinance lending must be built on sound business principles and strong consumer demand, the opportunities for innovation and consequent benefits to the unbanked billions make thorough investigation into the linkage an imperative.

Endnotes

- ¹ The Banking with the Poor Network: www.bwtp.org; Microfinance Council of the Philippines (MCPI): www.microfinancecouncil.org; Pakistan Microfinance Network: www.pmn.org.pk; China Association of Microfinance: www.chinamfi.net/en/index.asp.
- ² Asia Microfinance Analysis Benchmarking Report, MIX and Intellectap, March 2009.

2. Asia Microfinance Industry Assessment Summary

This section provides a summary of the microfinance industry assessments undertaken in 2008/09 as a part of the Citi Network Strengthening Program, as well as a report on the India Microfinance Sector published in 2007. The CNSP industry assessments considered are: Bangladesh, China, Indonesia, Nepal, Pakistan, the Philippines, Sri Lanka and Vietnam. Each of these assessments was completed by Asian microfinance networks and provides an in-depth analysis and description of the respective industries.¹ The purpose of this section is to provide a snapshot of the industry by comparing and contrasting various aspects of the each report; it is recommended readers access the respective industry assessments for further insights into each microfinance industry considered.

I. Regional Overview

Population and demographics

In 2007, the population of South, East and South East Asia stood at 3,298.3 million; just under half of the entire world's population.² Although 74 percent of this number reside in China and India, all countries in this report, with the exception of Sri Lanka, Vietnam and China, exceed the average international population growth rates of 1.2 percent. Nepal (2.1 percent) and the Philippines (2 percent) demonstrated the highest growth rates in 2007. Although life expectancy has risen across the board in Asia over the previous decade, poverty rates, especially in South Asia, remain high. Gains in poverty reduction achieved in many countries have been undermined by food and oil price inflation in 2008 alone, and will be further exacerbated by current global financial conditions.

All the countries considered in this report are net-loss migration countries, with Sri Lanka the highest, at just under -0.5 percent of the population in the years 2000-2005. Net migration rates for all other countries are between 1 and 3 per 1000 for the same period, with India being the lowest.³ Internal

migration from rural to urban areas continues on an upward trend, especially in China. The populations of all countries considered in this report, however, remain predominantly rural.

See Table 1: Population and Demographic Data (pages 5 and 6).

Macroeconomic Condition of Region

Up until 2007, Asia experienced significant growth, due primarily to the strong performance of the China and India. However, the impact of the global financial crisis in 2008/09 has resulted in a deceleration in regional growth from a high of 9.5 percent in 2007 to 6.3 percent in 2008.⁴ With regard to the two largest economies, India slowed to 5.3 percent in the last quarter of 2008 (down from an annual 9 percent for 2005 – 07), while growth in China slowed from 13 percent in 2007 to 9.0 percent in 2008, with forecasts indicating further slowdowns in 2009.⁵

See Table 2: Economic and Labour Force Data (pages 5 and 6).

There has been a reduction in growth across the board due to the global financial crisis. Declining private investment, a slump in exports and rising inflation due to the surge in global oil and food prices combined to have a negative impact on Asian economies in varying degrees. Although countries such as Indonesia and the Philippines are now structurally more robust than during the Asian Financial Crisis of 1997, the current global financial crisis is of another order, and the effects will remain uncertain in the short and medium term. Countries with less exposure to the global financial sector (such as Vietnam) and those less dependent on exports (such as India and Sri Lanka) have not been as severely affected.

The effects on development have not been fully realised but forecasts are gloomy with regard to the impact on the poor as exports continue to fall, unemployment increases and the flow of remittances decreases. There is a greater impact on high remittance receiving countries such as Sri Lanka, the Philippines and Bangladesh and will consequently further undermine poverty reduction efforts in the region.

Table 1: Population and Demographic Data

	Population (millions)			Population growth (percent)			Life expectancy at birth (years)	
	2005	2006	2007	2005	2006	2007	1995	2006
Bangladesh	137.0	138.8	140.6	1.3	1.3	1.3	58.1	63.7
China	1307.6	1315	1321	0.6	0.5	0.5	69.4	72.0
India	1101	1118	1134	1.5	1.5	1.4	61.4	64.5
Indonesia	219.9	222.1	224.9	1.3	1.0	1.3	64.0	68.2
Nepal	25.3	25.9	26.4	2.3	2.3	2.1	57.9	63.2
Pakistan	154.0	156.8	159.6	1.9	1.8	1.8	60.9	65.2
Philippines	85.3	87.0	88.6	2.0	2.0	1.8	67.7	71.4
Sri Lanka	19.7	19.9	20.0	1.1	1.1	0.6	72.5	75.0
Vietnam	83.1	84.1	85.2	1.3	1.3	1.2	67.1	70.8

Source: ADB Key Indicators for Asia and the Pacific 2008.

Table 2: Economic and Labour Force Data

	Labour force (percent)			Unemployment rate (percent)			Employment in Agriculture (percent)		
	2005	2006	2007	2005	2006	2007	2003	2004	2005
Bangladesh	...	58.5	...	...	4.2	...	51.7	...	...
China	75.7	75.4	...	4.2	4.1	4.0	...	...	...
India	39.2	...	...	3.1	...	...	...	...	56.1
Indonesia	66.8	66.2	66.6	11.2	10.3	9.8	46.3	43.3	44.0
Nepal	63.6	63.7	...	...	...	...	...	...	...
Pakistan	43.7	46.0	45.2	7.7	6.2	5.3	42.1	43.0	43.0
Philippines	64.5	64.5	63.2	7.8	7.9	6.3	37.2	37.1	37.0
Sri Lanka	48.3	51.2	49.8	7.7	6.5	6.0	34.0	33.3	30.7
Vietnam	52.5	51.1	51.2	2.5	2.3	2.0	59.7	57.9	...

Source: ADB Key Indicators for Asia and the Pacific 2008.

	Population < \$2 a day (percent)		Literacy rate > 15 yrs (percent)		Urban population (percent)			Human Development Index		
	Previous	Latest	1990	2007	1995	2000	2007	2003	2004	2005
	81.9 (95)	81.7 (05)	35.3 (91)	53.5	21.5	23.2	25.5 (06)	0.52	0.53	0.55
	64.5 (93)	37.8 (04)	77.8	93.3	29.0	36.2	44.9	0.76	0.77	0.78
	85.1 (93)	79.6 (04)	48.2 (91)	66.0	26.6	27.7	29.2	0.60	0.61	0.62
	64.2 (93)	40.0 (04)	81.5	91.4	35.9	42.1	43.1	0.70	0.71	0.73
	77.4 (95)	64.3 (03)	33.0 (91)	56.5	10.9	13.4	16.2 (06)	0.53	0.53	0.53
	74 (96)	59.6 (04)	42.7 (98)	54.9	23.7	33.0	34.9	0.53	0.54	0.55
	52.7 (94)	45.2 (06)	93.6	93.4	...	...	...	0.76	0.76	0.77
	45.5 (95)	41.5 (02)	...	91.5	16.4	15.7	15.1 (06)	0.75	0.76	0.74
	73.5 (93)	43.2 (04)	...	90.3	20.7	24.2	27.4	0.70	0.71	0.73

	Employment in Industry (percent)			Employment in Services (percent)			GDP per capita at PPP (current international \$)			Gross Domestic Saving (percent of GDP)			Growth rates of real GDP (percent)		
	2003	2004	2005	2003	2004	2005	2004	2005	2006	2005	2006	2007	2005	2006	2007
	13.7	...	...	34.6	...	...	1109	1195	1298	20.0	20.2	20.5	6.0	6.6	6.5
	...	...	...	...	...	...	3607	4079	4658	47.3	47.8	48.6	10.4	11.1	11.9
	...	...	18.8	...	...	25.1	2006	2217	2463	34.3	34.8	...	9.4	9.6	8.7
	17.5	18.0	18.0	36.2	38.7	38.0	2995	3207	3471	27.5	28.7	28.2	5.7	5.5	6.3
	...	...	...	...	...	...	990	1029	1079	11.6	9.0	9.7	3.1	3.1	3.2
	20.8	20.3	20.3	37.1	36.6	36.6	2030	2210	2395	15.2	13.7	14.7	9.0	6.6	7.0
	15.7	15.4	14.9	47.1	47.5	48.1	2769	2935	3127	21.0	20.1	20.9	5.0	5.4	7.2
	23.0	24.1	25.6	43.0	42.4	43.7	3260	3546	3930	17.2	16.4	16.9	6.2	7.7	6.8
	16.4	17.4	...	23.9	24.7	...	1943	2143	2363	30.3	30.6	29.1	8.4	8.2	8.5

Political instability and conflict remains an issue in several Asian countries such as Pakistan, Nepal and Sri Lanka. In 2008, economic growth in specific regions in Bangladesh and China was further hampered by the occurrence of natural disasters.

The Asia Development Bank suggests that because of structural reforms made following the Asian Financial Crisis, the banking sector is the one positive note on the Asian landscape. However, suggestions of an increasingly risk-averse banking sector and the subsequent 'flight to quality' have implications for the microfinance industry in the medium to short term.⁶

Recovery prospects for Asia will depend greatly on each country's ability to manage their own domestic challenges within the context of highly unfavourable economic circumstances. Regionally, this will depend on several factors: favourable monetary conditions; the maintenance of food supply levels, stable global oil prices and the speed and depth of recovery rates of the industrial economies in 2010.

Microfinance Data

Data from the 313 MFIs included in the recent MIX/Intellectcap Asia Microfinance Analysis and Benchmarking Report 2008 reveals that MFIs are reaching almost 47 million borrowers, managing over USD 10.2 billion in loans and have deposits totalling more than USD 7 billion.⁷

Asia's relatively high outreach internationally is predominantly bound up in the portfolios of a small number of MFIs in countries with high population densities such as Bangladesh and India. Nevertheless, recent growth rates have been spectacular in parts of Asia but have been inconsistent across countries. In terms of MFIs reporting to the Mix market, in 2007 India and Vietnam had rates of growth 50 percent higher than the regional average of just over 60 percent. On the flip-side, while Nepal grew at only half the regional rate, Bangladesh (24 percent) and Indonesia (16 percent) grew at rates of 40 and 25 percent the rest of the region.

Table 3: Overview of Asian MFIs reporting to the Mix Market

Country	MFIs	Borrowers (Thousands)	Gross Loan Portfolio (USD millions)	Deposits (USD Millions)
Afghanistan	14	358	106	5
Bangladesh	28	21,699	1,680	374
Cambodia	15	802	469	348
China	6	32	13	-
East Timor	2	14	5	2
India	80	9,910	1,359	31
Indonesia	33	3,712	3,558	5,728
Laos	1	<1	<1	-
Nepal	34	478	81	16
Pakistan	15	1,248	143	32
Philippines	55	1,921	365	222
Sri Lanka	14	943	263	189
Thailand	2	5	1	-
Vietnam	12	5,788	2,203	126
Total	311	46,910	10,245	7,073

Table 4: Growth Rate for Active Borrowers for Selected Countries and by region (2006 – 2007)

Country	Percent	Number of Borrowers
Nepal	13 percent	28,598
Bangladesh	20 percent	3,318,282
Vietnam	20 percent	965,045
Sri Lanka	22 percent	55,202
Afghanistan	32 percent	80,417
Cambodia	32 percent	193,408
Philippines	36 percent	438,417
Indonesia	36 percent	45,277
India	44 percent	2,895,159
Pakistan	57 percent	277,502
Regionally		
East Asia Pacific	24 percent	1,656,631
Asia	26 percent	8,311,791
South Asia	27 percent	6,655,160

II. Financial Sector

Compared to other developing countries, the Asian economies have ridden the financial boom of the last decade and now have well-developed and sophisticated financial, money and capital market systems. In every country commercial banks, both private and public, dominate the formal financial sector and operate under the direct supervision of the central bank, Securities and Exchange Commission/Board, Monetary Board, the treasury and other such financial regulatory bodies.

The microfinance sector in contrast has grown organically. In most cases, where the NGO sector is very strong, the growth has been outside the legal and regulatory framework that exists for the banking sector, with the exception of Indonesia where the commercial banking sector dominates. The Philippines is unique in that the development of the sector is the direct result of a concerted effort of the government, donors and

the private sector. Microfinance has been used by all countries as a tool for poverty reduction and financial inclusion, and as such governments in each country play a key role in the provision of microfinance services.

In Bangladesh, with Grameen and BRAC as pioneers in microcredit, NGO-MFIs dominate the provision of financial services to the poorer sections of the population, accounting for 86 percent of the 14.3 million active borrowers, according to a World Bank study conducted in 2005. Grameen Bank alone accounts for about 29 percent of market share for microfinance, with BRAC, ASA and Proshika making up the rest. Other players are the specialised financial institutions, Bangladesh Rural Development Board (BRDB), and government divisions and ministries.

In Sri Lanka, Nepal, Pakistan, China and Vietnam, government entities or government sponsored programs are the key suppliers of microfinance services.

In Sri Lanka, approximately 65 percent of microcredit is provided by the government, with the Samurdhi Development Program (introduced in 1995 under the purview of the Department of Cooperative Development) being the largest of such initiatives aimed at poverty reduction. The SANASA thrift and credit cooperative societies also a vast member owned network, and the Rural Development Banks (which are to be eventually merged into one development bank) are the other two major players.

In Nepal, a country with the lowest levels of outreach, the microfinance development banks (MFDBs) are the predominant direct providers of microfinance services. Financial-intermediary NGOs (FINGOs) and the saving and credit cooperatives (SCCs) are the other institutions that make up the sector. There has been a move to privatise the MFDBs, and as at the time of writing, five of the ten MRDBs have moved into private hands. It is hoped that the commercialisation of the sector will widen the outreach.

In Pakistan, the microfinance sector has three key categories of regulated microfinance providers (MFPs): microfinance banks, rural

support programs and specialised MFIs. All three providers service close to a third each of the gross loan portfolio. Not surprisingly the NGO MFIs serve the largest number of active women borrowers.

China is described as a 'multilayer of rural financial institutions', with Rural Credit Cooperatives (RCCs) as the major providers of microcredit and group loans in China; they operate with state funds as providers of policy lending. A range of other institutions, including policy banks (such as the China Development Bank (CDB) and the Agricultural Development Bank of China (ADBC)), state-owned commercial banks (such as the Rural Commercial Bank (RCB)), and the newly introduced rural financial institutions that include the Village and Town Banks (VTB), microloan companies and Rural Mutual Credit Cooperatives (RMCC's), all provide microfinance services.

Government departments directly implement subsidised microcredit operations and/or operate specialised institutions as part of the government's poverty alleviation strategy. Examples include poverty reduction projects operated by Shaanxi, Yunnan, Sichuan and Guangxi provincial governments. The NGO sector, operating in the less-developed provinces of mid- and west –China implement microfinance on a smaller scale, as project-based initiatives. It is estimated that up to 300 such projects have been implemented in China by various UN agencies such as the UNDP, UNICEF, IFAD, WFP, ILO, UNFPA, the World Bank, and microfinance projects of CFPA.

In Vietnam, three formal providers dominate the microfinance market: the state-owned Vietnam Bank for Agricultural and Rural Development (VBARD), the policy lender Vietnam Bank for Social Policies (VBSP) and the 984 People's Credit Funds (PCFs). They all provide services in rural areas for small loans and savings accounts but with very different approaches. The fourth, the Vietnam Postal Savings Company (VPSC)

has the potential to become an important deposit mobiliser with a large outreach and competitive interest rates. While VPSC currently cannot provide credit, it is seeking to be licensed as a commercial bank.

VBARD, the AgriBank, with its large subsidised credit lines from donors, is the largest bank in the country and provides a full range of services to rural households and SMEs involved in agriculture or off-farm enterprises. VBSP dominates the poverty microfinance market and runs a supply-driven socio-political agenda. PCFs, established in 1993, are community-based financial cooperatives that are owned, operated and governed by shareholding members. PCFs, as the name suggests, is the most demand-oriented of the financial providers; however it is not targeted at the poor. VPSC targets both poor and non-poor clients, however, its minimum deposit amount for clients at VND 50.000 ~ \$US 3.00 poses a significant barrier for the poor to access these services.

India's microfinance sector is dominated by self-help groups (SHG) and microfinance institutions. India is the leading proponent of the SHG methodology and through this model maintains outreach to microfinance clients on a scale not seen elsewhere in the world. The SHG model was initiated by the National Bank for Agriculture and Rural Development (NABARD); SHGs, which are usually formed by NGOs, government agencies and banks, are informal groups of women linked to the formal financial sector. The majority of India MFI providers are NGOs, ranging from for-profit regulated institutions which operate as Non-Banking Financial Companies (NBFCs), to transformed NGOs and traditional developmental NGOs.

Indonesia, one of the first countries to develop commercial microfinance in Asia, has regulated financial institutions providing the bulk of microfinance services. It has numerous subsidised government programs, local and community based financial institutions, cooperatives and NGOs, but these play a very small role in the microfinance sector. The

cooperative system, highly politicised under the Suharto regime, continues to suffer from political interference and weak regulation. It is paradoxical to see examples of populist microcredit and best practice microfinance operating side-by-side in Indonesia. It is notable that many of the microfinance institutions are owned by one of the various levels of government: central, provincial or local. Another significant player in the formal microfinance market is the state-owned pawnbroker, Perum Pegadaian, but this serves a predominantly urban clientele.

In the Philippines, NGOs, rural banks and cooperatives are the major providers of microfinance services. The Philippines National Strategy for Microfinance envisions a viable and sustainable microfinance sector operating in a market-oriented economy, where the private sector plays a major role and the government provides the enabling environment.

Country Specific Regional Focus

Microfinance, more specifically microcredit, as a tool of government poverty alleviation policy, has historically had a rural focus. With the emergence and subsequent dominance of the Grameen model in the last few decades, the industry currently targets the rural poor, and in most cases primarily women. In Bangladesh, Nepal, Pakistan and Sri Lanka well over 50 percent of the microfinance clientele resides in rural areas. In Bangladesh the government estimates that the FI-NGOs reach approximately 70 percent of poor households and that 90 percent of microfinance recipients are women.

In Nepal, with just 9 percent of the population living in urban areas, the MFIs operate primarily in the rural areas. Outreach in the hill and mountain regions is constrained by inhospitable terrain and limited physical infrastructure. The lack of local financial institutions and the unwillingness of large MFIs to operate there only underscores the limited outreach.

In Sri Lanka, almost 90 percent of the microfinance outlets are located in rural areas, with less than 10 percent of outlets located in

urban areas and only 1 percent in the estate sector. Clearly, the estate sector is underserved, as are the Northeast and Eastern regions.

In India, MFIs have historically operated in rural and semi-rural areas, with some working with the peri-urban population. There has been an upsurge of interest in urban microfinance primarily by three distinct groups - professionals with successful careers in banking and in some cases unrelated fields; microfinance professionals taking on the challenge of uncharted territory of urban microfinance and lastly the well established rural MFIs expanding into neighbouring towns and peri-urban areas. The majority of microfinance providers are located in the Southern states, followed by the Eastern and the Northern regions. The Northeast and Central regions are underserved.

With the commercial banks dominating in Indonesia, the population served is largely from the urban and peri-urban areas. NGO-MFIs and government cooperatives that serve the rural poor have limited resources and outreach; as a result the rural hinterland is underserved.

In the Philippines, NGOs and Rural Banks operate primarily in the rural areas; whereas over 60 percent of cooperatives engaged in microfinance are located in major urban areas. Women make up 63 percent of cooperative clientele.

In Vietnam all three major providers, VBARD, VBSP and PCFs serve the small rural loans and savings market. Women make up well over 50 percent of the loan portfolio clientele of VBARD, VBSP and other smaller providers.

Since 2001, RCCs have been the major supplier of rural financial services in China, building on its large branch outreach and coverage. The RCC began to use bank deposits and funds from the PBC to disburse microcredit loans and group loans to those rural households who could not offer collateral. The RCC operates on a set of policies based on the pilot microfinance projects of NGOs. It is estimated that although 50 million women would have had access to loans by 2008, the overall supply of microfinance products is still low in rural areas.

Access to Microfinance

Access to microfinance by the bottom of the pyramid is keenly scrutinised by the industry in each country. However, the key challenge across all countries is the fact that levels of financial inclusion for those at the bottom of the pyramid remains low. In each country certain geographic areas are clearly underserved and the non-existence of microfinance providers in these areas is the primary barrier. Availability of financial services remains crucial.

In Indonesia the commercial bank microfinance entities such as the BRI Unit Desa and the BPRs service the middle, lower and near-poor groups. NGOs and other semi-formal institutions (cooperatives, credit unions, Villages Credit Boards, rural credit fund institutions) tend to target the poor, but make up a very small segment of the microfinance sector. Therefore there is substantial unmet demand at the bottom of the pyramid (the 'BOP'). Bank Indonesia defines 'microfinance' as a loan with a maximum amount of 50 million rupiah (approx. USD 5,000), and it is this upper limit that a great deal of Bank Indonesia and BRI's lending is directed at. However, NGO, cooperatives and credit unions which specifically target the BOP have limited capacity due to the scarcity of funding sources available.

In Sri Lanka the Southern province is heavily over-served relative to poverty levels, whereas the absence of service providers in the estate sector and in the two central provinces is poses the biggest barrier to access. The estate sector is poorly serviced, despite the fact that the poverty rate is 17 percent higher than the national average for 2006-07.

In the rural frontier provinces of Pakistan the war along the western border means the availability of financial services is extremely limited.

In Nepal, over 50 percent of households do not have access to formal financial services, which include both the commercial banks and the whole range of micro-finance institutions. Most formal financial institutions are located in urban

centres; with 86 percent of the population living in rural areas it is no surprise that a large portion of the households are excluded. Location appears to be the one major barrier to access to financial services. In addition, migrant labour and dalits (those at the bottom of the caste structure) are two groups who find it difficult to access credit services.

In Bangladesh, the four large entities that dominate the sector have a vast network of branches and an excellent outreach among the rural poor. In the case of the other microfinance providers, geographic coverage varies. The less populous and remote North and Southwest districts have relatively few MFIs operating, in relation to the rest of the country.

Although 9.6 million clients receive access to financial services under the Self Help Group-Bank Linkage Program (SBLP) in India, only half of them are estimated to be poor; however strong progress made by the sector bodes well for financial inclusion. Other factors however indicate that the poor are perhaps being left behind are increasingly larger loan sizes in the quest for efficiency and profitability, and interest rate caps on small loans. Migrant populations in the urban areas in India are another group that have little access to microfinance services.

In Vietnam the policy lending window provides access to ethnic groups, the rural poor, and women as target groups. Semi-formal MFIs are the main providers of credit to the BOP, together with the vast array of informal players namely, traders, local merchants, money lenders, revolving savings and credit groups. VBSP is the primary lender to ethnic minorities and targets the rural poor and women in particular. The majority of poor and low-income households (80 percent) have access to some form of credit and to the formal banking system.

Access to financial services in China is reported to be relatively high, with approximately 31 percent of all the rural population receiving loans from rural financial institutions. It remains unclear how many of the estimated 13 million people living on less than \$1 a day are considered in the above figures. Statistics provided by the

China Banking Regulatory Commission suggest that of the estimated demand of 120 million rural households, 75 million (65 percent) have obtained microcredit and groups loans from rural cooperative financial institutions. However this figure includes all formal rural financial services and does not necessary indicate how these loans have been targeted. Official concepts of the poor in China may overlap with that of rural households in general (regardless of income), laid-off urban workers and start-up businesses.

In terms of access to microfinance across the region, India is the only study that explicitly addresses the issue of mission drift, with Bangladesh and China expressing doubts about reaching the “hard core poor”. In India, Bangladesh, Indonesia and the Philippines the strong growth of the microfinance industry, in terms of outreach and operational and financial sustainability and efficiency, is gradually pushing the commercialisation of the MFIs. The pressure to maximise returns by the new private equity, commercial and social investors is likely to result in the scaling-up of operations, the dampening of downward pressure on interest rates, and the increase in loan sizes. The desire to reach a massive scale may portend well for financial inclusion, but may threaten the quality of growth. In addition, increases in interest rates and loan size would result in limiting the BOP’s access to microfinance.

Trends in the Microfinance Sector

Almost universally throughout the region, there is increasing interest by commercial banks, registered finance companies and other large corporate entities to enter the microfinance business, which is seen as a new avenue of revenue generation. In India, Indonesia, Bangladesh and the Philippines, where the commercial profitability of microfinance institutions is well documented, there is a current trend towards moving down market. This is also the situation in Sri Lanka, Nepal and Vietnam. In India, Indonesia, Pakistan, the Philippines and China the reverse is occurring, with some of the large rural microfinance institutions seeking to commercialise.

In Sri Lanka, some corporate entities see microfinance as a Corporate Social Responsibility activity or an image building exercise. A few of these corporations are aggressively moving into the sector, and have the resources and infrastructure to scale up rapidly.

Despite a thriving microfinance sector in every country there has been little cross-border exchange or operation. Two examples stand out. BRAC of Bangladesh entered the Sri Lankan market after the tsunami and has rapidly scaled up to become a significant player. Additionally, three of the big Bangladeshi institutions, Grameen, BRAC and ASA, have all begun operating in Pakistan.

Savings

In the current global financial and economic climate, the source of funding will emerge as a crucial factor in the continued growth of the microfinance sector. With the exception of Bangladesh, all other countries have yet to harness the power of savings as a crucial source of capital. In Bangladesh, where NGOs dominate the sector, a large share (30 percent) of the sources of funds for microcredit comes from member savings, with Grameen funding 56 percent of its total loan portfolio from savings.

In most countries, unregulated microfinance institutions (and in some cases regulated institutions) are restricted in their ability to mobilise deposits from the public. Under the Grameen model of compulsory savings, MFIs are able to generate a limited pool of funds to on-lend. Legislation on mobilising deposits is high on the priority list of every country’s regulatory agenda. Almost universally, with a few exceptions like Grameen in Bangladesh, BRI in Indonesia and rural banks and cooperative rural banks in the Philippines, savings products are available only to members of microfinance providers, and those also come with restrictions on the amount deposited at one time, the time intervals of deposits and withdrawal limits.

Another trend in the microfinance sector is that technology is being used in a few countries to leap-frog and close the gap

between the commercial banking sector and the microfinance industry on two fronts. First, on the operational side, technology enhances the institutional capacity of the organisation itself. A comprehensive management information system (MIS) (registration, appraisal, disbursement, repayment and monitoring) is essential to achieve scale, improve efficiency, reduce costs and provide day-to-day decision-making support to management. In addition, the benefits of enhanced operational efficiency to financial management and governance are two fold, with an increase in profitability and investor interest.

Technology

Technology enables an organisation to provide a wider range of products and to tailor them to individual needs. The use of hand-held point of sale devices, smart cards, bio-metrics and mobile telephones can accelerate the growth and depth of outreach of the microfinance sector in the next decade.

The use of and access to technology varies from country to country. On one end of the spectrum is India, where most microfinance providers have computerised accounts and records. On the other end is Nepal and Sri Lanka where majority of the MFP in the country currently maintain their accounts and records manually. Limited infrastructure, which include (the lack of) electricity, telecommunications, hardware and software services, is a constraint in the application of computer technology to the microfinance sector in rural areas on a large scale in some countries.

Microinsurance

Practitioners and experts increasingly recognise that the poor require a wider range of financial services to manage risk and improve their welfare. In all countries the demands for microinsurance, remittances, individualised saving products and leasing far out number the supply of these products. No one country has the right mix, though India and the Philippines stand out in the microinsurance field with some MFIs (BASIX, SEWA, ICICI in India and CARD-

MBA, RIMANSI in the Philippines) tying up with larger commercial insurance companies to provide a range of products. In Pakistan both the microfinance providers and the Rural Support Programmes have experimented with, and piloted, insurance products. In Nepal, some MFIs offer some institution-based protection schemes related to livestock death and life insurance. Bangladesh, ahead in the provision of leasing (Grameen phone) and green-lending (Grameen Shakti), is still experimenting with insurance, primarily life insurance.

Remittances

Although the World Bank estimates suggest that global remittances will drop by 5 to 8 percent in 2009, which will no doubt impact microfinance clients in Asia, they are once again expected to continue growing as global markets recover. Complete data for 2007 suggests that developing countries in South Asia and East Asia/Pacific had combined inward remittances of US\$ 101.9 billion, making up 3.5 percent and 1.5 percent of GDP respectively. Six of the top ten remittance receiving countries in 2007 are amongst those considered for this report and they are: India (\$27.0 bn), China (\$25.7 bn), Philippines (\$17.0 bn), Bangladesh (\$6.4 bn), Pakistan (\$6.1 bn) and Indonesia (\$6.0 bn).⁸ The significance of remittances for a country such as the Philippines cannot be understated, where remittances from foreign workers consistently hover at around 10 percent of GDP. Remittances are one of the major sources of foreign currency in most of the countries. It is a service microfinance providers need to prepare for

Energy Lending

Few countries are taking the lead in 'green lending'. In Bangladesh, Grameen Shakti leads the way in a market-based integrated approach to promoting renewable energy technologies in rural areas. In Nepal, microfinance is being used to increase the ability of poor households to access cheap, renewable energy. The Alternative Energy Promotion Centre (AEPC), under the auspices of the Biogas Sector Partnership Nepal (BSP), was established by the Government of

Nepal in partnership with SNV and Winrock International. APEC provides loans for biogas systems for domestic use that replace firewood, kerosene and LPG. As of 2007, Nepal had the highest per capita number of biogas systems in the world, with 173,000 households.

III. Regulations and Government Initiatives

The regulatory and supervisory frameworks for the microfinance sector are weak in contrast to a well developed formal banking and financial sector, and in some cases, advanced securities and debt-capital markets that are well regulated by the country's Central Banks, Securities and Exchange Commissions/Boards, Monetary Authority, Treasury and other regulatory bodies. In most countries, the microfinance sector is marked by a fragmented regulatory and supervisory system and the absence of an overarching national policy. Pakistan and the Philippines stand out in their governments' commitment in pro-actively accommodating the evolving needs of a growing and increasingly diverse microfinance sector; Nepal also has a national policy on microfinance.

In 2007 the government of Pakistan, in consultation with sector players and led by the State Bank of Pakistan (SBP), set a reform agenda to achieve a target of reaching 3 million borrowers by 2010 (current volume being 1.3 million in 2006/7). The reform agenda has four key objectives: to bring the two largest players (Kushali Bank and the National the National Rural Support Program (NRSP)) into the regulated microfinance sector thereby expanding the outreach of the sector; restructuring of the Pakistan Poverty Alleviation Fund (PPAF) from a window of funding to MFIs to an institutional capacity builder in the management, performance, governance and operational architecture of the sector; facilitating the establishment of a market-based re-financing facility, and a 5-year tax exemption for MFIs to level the playing field for NGOs looking to transform into MFIs within the period of 2007-2012.

In Sri Lanka, the Department of Cooperative Development and the Central Bank of Sri Lanka (CBSL) regulate and supervise the credit cooperatives, thrift societies, development banks and the licensed specialised banks between them. The NGO-microfinance institutions are entirely unsupervised. The CBSL is currently working on drafting a Microfinance Institutions Act (MFI Act) that would bring the unregulated NGO institutions under some supervision, but it fails to take a comprehensive, macro view that would bring all entities engaging in microfinance under one unified regulatory and supervisory mechanism. Concurrently, the Lanka Microfinance Practitioners Association is in the process of formulating recommendations for a policy for the sector.

In view of the increasing demand for microcredit and its critical role in poverty reduction in the country, the Government of Nepal issued a 'National Microcredit Policy, 2007' with the aim of creating a conducive financial infrastructure and legal environment for the promotion and development of the microfinance industry through diversified microfinance tools. Despite the well intentioned policy, haphazard implementation and poor coordination with the sector players leaves much to be desired.

Bangladesh has been unique in that MFIs have been totally unregulated until the enactment of the Microcredit Regulatory Authority Act (MRAA) in August 2006. Unhindered experimentation after the success of Grameen Bank led to a massive expansion in microfinance programs through the 1990s and donors contributed by providing revolving loan funds and grant funding. The sustainability and commercial profitability of the larger MFIs has moved the sector from the margins to the mainstream of the financial system in Bangladesh, and the demand for a legal and regulatory framework has come from within the sector. There is, however, resistance to regulation by a few of the large, successful and now sustainable MFIs, despite the call for a regulatory framework coming from no less than the Nobel laureate Dr. Yunus. The larger population of small and medium MFIs would benefit from a legal framework, gaining legitimacy conferred by regulation.

In India the strong involvement of the public sector banks in microfinance is unique in that a relatively large (and growing) share of the sector comes under the purview of the Reserve Bank of India (RBI). Despite a prominent public sector role, India does not have a national microfinance policy. As elsewhere, microfinance-specific regulations and a comprehensive legal framework under which the sector operates are limited. The sector has thrived only because most of the innovative growth has been outside the purview of the government.

In Indonesia, the 1988 financial sector deregulation package, 'PAKTO 88' transformed the microfinance sector with the offering of new banking licenses for BPRs and relaxed regulation on banking branches and deposits. In response, Bank Rakyat Indonesia (BRI) restructured its rural Unit system and set out on the path of successful commercial microfinance. The 1990s saw a steady stream of financial sector reforms – reduction of subsidised loan programs, upward adjustment in refinancing rates, fully deregulated interest rates and greater control over non-bank financial institutions with a selective licensing policy. Nevertheless, the semi-formal financial institutions continue to be outside the legal framework of banks, resulting in a dichotomous microfinance sector. The 1997-98 Asian financial crisis saw a major restructuring of the financial sector and the MFIs emerged stronger. In 2003 banking supervision was transferred from Bank Indonesia (the central bank which retains responsibility for monetary policy and banking system development) to the Financial Services Supervisory Agency (LPJK).

Since at least 2001 efforts have been underway to pass comprehensive microfinance legislation, but vested interests have been able to stall it for years, and there is still no legislation in place. More recently the National Development Planning Agency (Bappenas) has assumed responsibility for the microfinance legislative agenda.

The Philippines is the only country where each category of MFP comes under at least one regulatory or government body. All banking institutions engaged in microfinance (rural banks, cooperative rural banks, thrift banks) come under the regulatory authority of the

Bangko Sentral ng Pilipinas (BSP). Through the General Banking Act of 2000, BSP has taken significant initiatives to enable the development of sustainable microfinance. The BSP's current supervisory approach allows for banks to take risks as long as the banks demonstrate the ability to manage, absorb and price for risks taken.

In addition, BSP is building its own capacity for regulating and supervising sustainable microfinance and branchless banking through several initiatives, and, as such, provide meso-level services to the MF sector. These initiatives include: Inclusive Finance Advocacy Staff (IFAS), an innovation unit, drawing on external learning to ensure optimal evolution of payment and banking models that can serve low-income groups; Core Information Technology Supervisory Group (CITSG), a central group within BSP to address electronic banking issues and supervise institutions engaged in providing e-banking services; Institutionalisation of the Micro, Small and Medium Enterprises Groups (MSME) in 2007; and the establishment of the Supervisory Data Centre (SDC). In 2006 BSP centralised the capture and reporting of data for microfinance within SDC. As a result of these initiatives, qualified rural banks now offer foreign currency deposit accounts, engage in trust activities and operate ATMs.

NGOs in the Philippines engaged in microfinance are required to register with the Securities and Exchange Commission (SEC) as non-stock, non-profit organisations. NGOs are required to disclose their microfinance activities in their annual submission of their General Information Sheet (GIS) and to file audited financial statements with the SEC, but they are not subject to prudential regulation and supervision by any government authority. Nevertheless, second tier organisations such as the Land Bank of the Philippines and the People's Credit and Finance Corporation maintain some credit supervisory authority over NGOs that borrow from them. In addition, the Microfinance Council of the Philippines Inc. (MCPI) a private sector umbrella group plays an important role in providing self-regulatory oversight of microfinance NGOs and is the repository of information on member NGOs.

Credit Cooperatives classified as non-bank financial intermediaries (NBFIs) are registered and supervised by the Cooperative Development Authority (CDA). The CDA, however, is a weak regulatory because of its dual role of promoter and developer of the cooperative sector.

In Vietnam, the State has been an active player in the microfinance sector, but does not have a coherent national microfinance policy. Microfinance is still seen as a poverty alleviation tool and operates outside the workings of the formal financial sector. The only legal basis to operate is to partner with a mass organisation, a local people's committee or a similar entity. The two major road blocks are: i) the regulation of interest rates, which limit the possibility of setting cost-covering interest rates and ii) subsidised, non-market led, supply-driven outreach, which undermine the sustainability of the microfinance sector and the entire financial system.

In China as well, despite the large involvement of the government in the provision of rural financial services, the sector lacks a coherent regulatory framework. Some important changes in China more recently include the *Guidance on Pilot Microloan Companies* and the *Guidelines on How to Greatly Develop Rural Microloan Business by Banking Financial Institutions* which has made some progress in clarifying the roles and obligations of microfinance providers in the country. This includes lifting many restrictions on the establishment of microloan companies, providing opportunities for NGO MFIs to register their operations, expanding the categories of borrowers permitted to take loans, increasing loan sizes and encouraging a simplification of loan procedures.

However, while the policy guidance has been developed by the China Banking Regulatory Commission (CBRC) and People's Bank of China (PDC) to promote institutional diversification and business innovation, there is still no clear definition on the legal status of institutions undertaking microfinance. Government decrees have also hindered the development of the sector by setting caps on microcredit interest rates, and placing restrictions on shareholder structure and sources of funding while expecting that this is proportioned within MFIs.

Availability of Financial Services for the Bottom of the Pyramid

Current efforts to design a legal and regulatory framework that is responsive to, and supportive of, the needs of the microfinance sector targeting the very bottom of the pyramid are a challenge in every country. Some countries have earmarks (Nepal and Sri Lanka) or subsidies (China and Vietnam) but in all, the objective of reaching the bottom of the pyramid can be achieved only with sustainable lending. Only in Pakistan and the Philippines have the policy makers successfully taken an active role in the development and promotion of the microfinance sector. In Pakistan, as MFBs continue to streamline their systems and processes, service delivery, operating efficiencies and compliance within existing regulations, the SBP has responded with a number of sector-specific regulatory changes, such as raising subordinated debt to meet capital adequacy ratio, branchless banking and Islamic banking. The latter two bring in target groups that have so far been outside the sector, either due to their living in geographically remote areas or to their religious beliefs.

In the Philippines, the government itself has been a promoter of meso-level institutions which enable and support the microfinance providers in increasing the range of products offered to low-income target groups.

In India, an interest rate cap on small loans and the prohibition on savings mobilisation from the public or even members outside of group 'compulsory savings' within the loan program work against the BOP market by limiting their access to microfinance services.

In Sri Lanka, with government controlled MFIs leading the sector, political agendas hinder long term sustainability and are a major barrier to reform and the scaling-up of MFIs and targeting the 'real poor'. NGO-MFIs that focus on the poor, and low income segments, are dependent on grants and subsidised credits from foreign donors, and have limited outreach due to legal prohibitions on accepting deposits.

The government in Nepal, in an effort to reach the poor, has directed all commercial banks to allocate 3 percent to the "deprived sector" and

all development banks and finance companies are required to disburse at least 1.5 percent and 1 percent of their loan portfolios respectively to the poor. Enforcement, however, has been weak, and the poor and lower income clients still have limited access to microfinance services.

Large-scale efforts to provide microfinance as a tool for poverty alleviation in China are overwhelmingly government-led, subsidised and implemented by the major state-banks in rural areas. These are often de-centralised and autonomous, and where implemented by the ABC have been undermined by poor rural outreach. The NGO MFI sector is completely dependent on external donor funding for programs targeting the poorest.

In Indonesia only government programs and NGOS target the low-income segment and they form a very small volume of total microfinance loans made.

Vietnam, on the other hand, has large government funded and subsidised entities that successfully target the poor.

Policy Support for Financial Access and Inclusion

In Nepal, Sri Lanka and Vietnam, regulatory reform has been well-intentioned but ineffective. In the cases of India, Bangladesh, China and Indonesia this has been inadequate (Bangladesh is unique in its experience as a country where the microfinance sector grew in an entirely unregulated climate). A lack of coherent government policy, limited and poor supervision capacity and indifferent participation are contributing factors to the low level of efficiency. In addition, subsidies and earmarks threaten financial discipline and the long term sustainability of microfinance institutions, hence compromising financial access and inclusion in the long run.

In Pakistan, the SBP, from 2007-2008, has demonstrated continued commitment in accommodating the evolving needs of a growing and increasingly diverse microfinance sector. The Government of Pakistan has shown an enlightened open mindedness which has contributed to the successful growth

in the sector. In turn, the sector is utilising the supportive policies put in place by the government. 2007 also saw the financial and operational separation of credit programs of multi-dimensional MFPs, the entry of BRAC and ASA of Bangladesh and the formation of the Aga Khan Agency for Microfinance, the first dedicated microinsurance company in Pakistan (providing both retail insurance and through agency-partnerships).

In Indonesia, government microcredit programs that target the poor are often implemented with little regard to microfinance best practices, as is the case of policy lending in Vietnam. Often this is due to the subsidisation of interest rates which distorts the market for best practice lenders. Sources of cheap funds, sustainable only so long as external support continues, have proliferated. These have resulted in unfair competition for commercial microfinance providers, and have discouraged potential new providers and undercut non-commercial entities seeking to operate sustainably.

In India, the proposed microfinance bill first introduced in 2005 is still being debated. The bill will enhance the legal status of the NGO-MFIs, allowing them to accept savings in the limited form of group savings; create a consumer protection regime through a Micro Finance Ombudsmen; create a national database in the public domain; set up a Micro Finance Development Council to advise the regulator and ensure continued funding of the Micro Finance Development and Equity Fund. The bill, however, excludes NBFCs and S 25 companies from its purview despite the fact that they comprise the larger and more rapidly growing part of the sector and comprise the majority share of total microcredit in the country. In fact the more successful NGO-MFIs are increasingly transforming themselves into NBFCs so as to compete with other NBFCs on a level playing field.

China's set of policy guidelines (such Guidelines for Pilot Microloan Companies) are also undermined by a lack of consistency. Although welcome as initial steps legitimising the work of several institutions providing microfinance, and enabling the creation of VTBs and micro

loan companies, they have been criticised as focusing on administrative regulations and departmental rules, rather than on the need for a framework which factors in the diversity of microfinance providers in China. However, the central government's No.1 document for 2009 has hinted at an increasingly liberal microfinance policy, emphasising the role of microfinance in 'achieving poverty reduction and supporting microenterprises' development as well as realising sustainable operation of MFIs'.

Savings Regulation

Moving forward, the microfinance sector in every region is acutely aware that savings mobilisation has the potential to provide the sector with an important source of funds internally, given the current economic and financial situation. In all countries only licensed institutions are allowed to accept intermediate deposits. Currently, savings products offered by MFPs mirror the conventional products offered by commercial banks. Almost universally, big market players have yet to offer the very short-term (liquid) and low threshold savings accounts that are popular globally among poor households.

In most countries, microfinance institutions are restricted in their ability to mobilise deposits from the public. Under the Grameen model of compulsory savings they are able to generate a limited pool of funds to lend, but realise that the market demand is in flexible, open access, and daily savings services. Legislation on mobilising deposits is high on the priority list of every country's regulatory agenda. Almost universally, with a few exceptions like Grameen in Bangladesh, BRI in Indonesia, and the rural and cooperative bank in the Philippines, saving products are available only to members of microfinance providers, and those too come with restrictions on the amount deposited at a time, the time intervals of deposits and withdrawal limits.

In Bangladesh, MFIs need express permission from the Bangladesh Bank to mobilise savings from the general public. Cooperative societies can mobilise savings from the general public under

the Cooperative Societies' Ordinance. NGO-MFIs can only mobilise savings from members as part of their disbursement programs. The Grameen Bank is unique in that under the Grameen Bank Ordinance of 1983, it is permitted to accept deposits from the general public as well as from members, and to sell bonds and debentures guaranteed by the government.

In Pakistan, the PMN is active in facilitating innovation in savings related services, and acknowledges that it is an area of microfinance that requires considerable thought and a concerted effort at innovation. Since 2005, MFPs in Pakistan have experimented with microinsurance products. Initially focused largely on credit-life insurance, they have diversified their insurance products to death, disability and hospitalisation (in some variations the product covers the spouse of the borrower); maternity-related hospitalisation; housing loans; and health loans.

In India, the absence of savings-related services in the operations of MFPs has distinguished it from the microfinance sector in most other countries. The highly restrictive legal framework for deposit taking has severely constrained the offering of savings-related products, and as a result savings form just 8 percent of outstanding loan balances, as against member savings making up 30 percent of the sources of funds for microcredit in Bangladesh.

In India, the proposed microfinance bill does little to change the current situation, as the bill limits the permissible savings to 'thrift' i.e. the small compulsory savings of uniform size for all members. Mandatory savings are illiquid, and, increasingly, do not meet the needs of the poor. The BOP would prefer to be allowed to save small variable amounts, with variable frequency. MFIs world-wide that have the requisite accounting systems are moving to voluntary savings, with flexibility in amount and timing of savings and withdrawals. Closer to home, Bangladesh, in its recently enacted MCRA 2006, explicitly allows MFIs to offer savings and withdrawals on demand.

In Indonesia, in the commercially dominated microfinance sector, Bank BRI successfully finances its lending through savings mobilisation. Rural fund and credit institutions (LDKP) are restricted in mobilising savings. Only Village credit boards (LPD) are allowed to accept deposits from members at the village level, and NGOs and others outside the legal framework are dependent on grant funds alone.

In Vietnam, the supply of savings products is equally standardised, as in other countries, but relatively widely available. Most MFOs and MOs, as agents of VBSP and VBARD, require compulsory savings as a partial guarantee for the otherwise uncollateralised loans. The VWU requires borrowers to deposit into a compulsory 'mutual assistance fund' from which funds can be accessed as emergency loans in case of illness or death (a precursor to credit-life insurance).

Savings products such as term deposits and current deposits are offered in China by formal financial institutions such as ABC, PSBC and RCCs; in the case of the latter these consist of compulsory savings in many cases. Registered MFIs, which are set up by banking financial institutions or private capital, are not permitted to mobilise deposits. Registered microloan companies promoted by the PBC are not allowed to mobilise deposits, but registered VTBs have are able to engage in fully licensed banking business, while lending companies cannot collect savings. Most NGOs and government departments require compulsory savings for their microcredit projects in the form of group fund pledging as collateral or guarantee.

In 2006, the CBRC issued the *Opinions of Pilot Management to Strengthen the Collateral-based Microloan Business of Postal Savings Bank* policy, which permitted the PSBC postal service to develop a collateral-based microloan pilot operation by allowing time deposits as the only collateral.

In Sri Lanka, NGO-MFIs are currently limited to giving credit because by law they cannot accept deposits; in some cases they can accept intermediate deposits from members only.

IV. Provision of Microfinance

Structure of Microfinance Providers

Across the board, with some exceptions in Bangladesh, India and Indonesia, the legal structure (or lack thereof) of microfinance providers is quite similar. Each country has microfinance development banks (MFDBs), government rural support and development programs run by various government departments and ministries, specialised MFIs such as farmers cooperatives, saving and credit societies, and lastly the NGO-MFI or financial intermediary NGOs (FINGOs). In Bangladesh the big four operational NGOs in microfinance dominate the sector; in India the public sector commercial banks play a major role; in Indonesia the commercial banking sector is dominant in microfinance provision; and in Vietnam policy lending predominates.

In Sri Lanka, the quasi-government MFIs dominate and tend to cater to a higher income bracket, while the NGO-MFIs and member-owned Samurdhi Bank Societies have a greater outreach to low income groups. The estates sector in Sri Lanka, despite a disproportionate level of poverty (32 percent as against the national average of 15.2 percent in 2006/7) is inadequately served, with just 1 percent of microfinance outlets located in the estate sector. The product portfolio is limited to primarily loans and savings in Sri Lanka.

In Pakistan the microfinance bank model is the most prominent, although there are a few larger NGO-MFIs based on the Grameen model. The rural support programs are not microfinance specific, and maintain a close link with government development efforts.

Nepal has a similar line-up in terms of MFDBs, government rural support and development programs, specialised MFIs – financial intermediary-NGO, farmer's cooperatives and saving and credit societies or thrift societies. The privately held MFDBs are perform better than the RRDBs with regard to outreach, portfolio quality, efficiency and profitability. Some of the MFDBs have also been providing remittance

transfer services to the clients in cooperation with commercial banks. Geographically the hill and mountain regions are under-served, the youth population is largely untouched and the informal sector, (i.e. money lender, friends, relatives, rotating savings and credit association) accounts for about 75 percent of the aggregate rural credit.

In Bangladesh the NGO-MFI model dominates the sector, with the Grameen Bank being the only MFB. It serves rural and peri-urban areas primarily, with the majority population served being women. It is estimated that 70 percent of the poor households in Bangladesh participate in the microfinance sector, with the exception of the remote North and southwest tribal areas. It is hoped the Microcredit Regulatory Act of 2006 will provide the legitimacy needed by the legions of small and medium MFIs outside of the few large MF-NGOs to emerge as players in the sector.

NBFCs, for profit companies registered under the Companies Act 1956, S 25 companies (not-for-profit companies under the Companies Act) are the primary microfinance providers in India, comprising nearly 80 percent of the total number of clients, followed by NGO-MFIs (societies, trusts, cooperatives) who serve the remaining clients. Public sector banks, through the direct priority lending window, have played a major role in providing credit to the low-income population. Geographically, majority of the MFIs are located in the South and West of India, with a smaller number in the North. The Central and North Eastern states have far fewer MFIs than is needed to meet the demand for microfinance services.

The majority of microfinance lending in China is undertaken by state-owned rural banks (including RCCs) downscaling to microfinance lending; government departments also provide subsidised lending. With the bulk of microfinance policy guidelines directed at RCCs, there remains a need for supervisory and regulatory guidelines to recognise the diversity of microfinance providers in China. As non-governmental MFIs and lending companies

are not adequately regulated under national policy, they come under the aegis of local administrations and departments, resulting in inconsistency, and consequently, insecure legal structures that undermine investor confidence.

Indonesia is unique, in that the formal financial service providers are the major players in the microfinance sector. In 1984, under the new financial reforms undertaken by the government, BRI transformed its sub-branch (Unit Desa) network operating at the sub-district level into commercial microfinance intermediaries. The BRI unit network is now the largest and one of the most profitable rural micro-banking networks in the developing world and account for approximately 40 percent of loans by value.

The general commercial banks and BPRs (People's Credit Bank) serve the top end of the microfinance market. The BPRs vary in regard to their interest in, and capacity for, micro-lending; those owned by local governments and cooperatives are often more micro-oriented, while those under private, for-profit ownership are often more focused on small and medium-sized enterprises. Most of the formal financial providers above also operate units, branches and products using Islamic banking principles.

Poor households and rural micro-entrepreneurs outside the main towns are served by the semi-formal and informal village-based institutions (BKDs), NGOs and cooperatives which are essentially outside the legal framework of banks, and have an unclear legal status in the financial system. NGOs have played a relatively small role in Indonesian microfinance. Government programs however, use NGOs to facilitate the formation of self-help groups for microfinance providers. There is no mention of gender focus within target groups in the industry study.

Three formal providers dominate the Vietnamese microfinance market: the state-owned VBARD, the policy lender VBSP and the 984 People's Credit Funds (all State entities). They all provide small, especially rural, loans and savings accounts, but with very different approaches. The fourth, the Vietnam Postal Savings Company

(VPSC) has the potential to become an important deposit mobiliser with a convenient outreach and competitive interest rates.

The semi-formal MFOs in Vietnam form a very small sub-section in comparison with the formal sector that has a reach of approximately 3 million clients as against the reach of the 25 MFOs which stand at 183,586 clients. MFOs are intrinsically linked to mass organisations that legally govern, sponsor or work in cooperation with INGOs to implement microfinance programs. The Women's Union, the Farmer's Union and the Youth Union all manage group loan and savings schemes, implementing INGO-supported microfinance projects and linking clients to VBARD and VBSP.

In all countries informal savings and credit groups are at the bottom of the microfinance ladder. These local, semi-structured, private entities are ubiquitous in the rural landscape and are a well-integrated part of the community safety net. ROSCAs in Nepal, Indonesia and the Philippines and Chit Funds in India are periodic savings contributions of members, pooled and disbursed to one member at a time on a rotating basis. As in most developing countries traders, shopkeepers and money lenders are an important source of informal credit. Interestingly, in Vietnam, money lenders are reducing their lending rates as a consequence of the increasing outreach of formal and semi-formal financial service providers.

Need for a Regulatory Structure

To date, in most countries the microfinance sector has grown on the margins of the formal financial sector and as an anomalous part of the civil society social sector. There is recognition in all countries that microfinance has come of age and requires a well defined regulatory structure and standardised institutional framework that can move the sector forward. In most countries the demand for a regulatory and legal framework is coming from within the sector. The growth, effectiveness and operational sophistication of the industry now demands a formal legal and regulatory structure for the sector to flourish and provide the innovative, expanded product and service range that the clients demand. The

lack of a legal framework is clearly a constraint for MFIs trying to access capital from both the commercial and grant monies.

Regulation on savings is universally seen as imperative for the sector to move forward. In the current economic climate, deposit mobilisation from the public will be an important source of wholesale funding.

The current global financial crisis underscores the urgent need for a supportive and effective regulatory framework. The lack of oversight and tight supervision of the global financial system is often cited as one of the major causes of the current debacle. For the microfinance sector to grow on several fronts – outreach, efficiency and profitability, scale and professionalism – a legal framework will provide both the clientele (savings, insurance) and investors (capital) with the confidence in the institutions they invest in.

Product and Service Gaps

In the last decade, outreach expansion in the microfinance sector in every country has been impressive (26 percent between 2006 and 2007 alone), but a majority of providers offer similar and standardised credit and savings products. In most countries, while credit is available to the BOP, the quality of these services and the range of products provided falls short of the demand for well-designed, affordable and customer responsive financial products delivered flexibly and conveniently. Moving forward, growth and expansion should concentrate on the product innovation front. It remains to be seen if the current financial crisis will reverse this favourable trend; illiquidity in the market may diminish the capacity of banks to finance microfinance. On the other hand, the success of the microfinance model has stirred the interest of commercial banks to downscale to the urban microfinance market.

On the savings front, almost universally the limitations on timing, amount saved and withdrawals of savings, are the main obstacles preventing rural people from opening saving accounts. With the exception of Bangladesh, where Grameen is a licensed bank, in the other countries studied most actors are prohibited

by law from mobilising savings outside of the compulsory savings within the group lending process. This restrictive stance on savings eliminates a ready source of wholesale funds to MFIs, thereby limiting their capacity to expand outreach and provide innovative and flexible products as demanded by the clients.

In recent years diversified savings products, microinsurance, money transfers and leasing have been introduced by a numbers of players. Beyond savings, the demand for microinsurance and remittances also remains unmet. In most countries, with the exception of India and the Philippines, insurance companies have yet to rise to the challenge of tailoring their current products for the microinsurance market. Pakistan has experimented with microinsurance products partnering with the private insurance companies to put out some pilot products. The microinsurance market currently focuses primarily on protecting the MFI from loan losses, but products covering health, maternity, disability, livestock, agricultural risk and enterprise insurance are slowly being experimented with in India and Pakistan.

Bangladesh, a pioneer country for microcredit, has been slow to innovate and offer varied products. Flexible savings, microinsurance, leasing, remittances are only just emerging as products offered by the MFIs. Currently the microinsurance offered is often disguised as 'loan security fund'. Almost every MFI in Bangladesh offers savings opportunities for borrowers. BRAC and Grameen have a wide range, with ASA and BURO Tangail more recently offering flexible savings services which enable members to withdraw savings.

In Indonesia, microfinance is essentially credit oriented. BRI, the dominant player, mobilises about two-thirds of the savings in the formal and semi-formal sector and offers a wide range of savings products with different degrees of liquidity. Savings accounts are used to build the client's rating and credit collateral. Despite the active participation of the commercial banks in microfinance, Indonesia could be said to have a supply-led microcredit program. Savings products and remittance services are

only offered by the bank BRI Units. Current regulations prevent rural banks and cooperatives from engaging directly in remittance services; some are, however, partnering with third parties to offer money transfer services. The microinsurance demand remains unmet, and insurance companies have not yet risen to the task.

Similarly, in Vietnam, the market for microfinance services remains undiversified. With a specialised agricultural bank, agricultural loan products are more easily available. VBARD offers investment and working capital loans for crops, as well as loans for fisheries, livestock, handicrafts, trade and rural infrastructure. Remittances form an important part of the formal financial landscape and are channelled through the formal system, either directly or through agent arrangements. Insurance penetration rate is low in Vietnam compared to elsewhere in the region, with more than 90 percent of the population not having any formal insurance policy. Most insurers target the middle-income market, and as this section is still underserved, there is little incentive to move down market.

In China, the rural banks and microloan companies operating on a commercial basis provide other traditional financial services, such as savings and remittances. However, these are targeted at the 'low hanging fruit' and do not cater to the needs of the poorer segments of the market. Also, as in other microfinance industries in past years, the adoption of a 'one-size-fits-all' methodology on a small-scale by NGO microfinance programs has not provided the impetus for innovation and diversification of products. The ABC, RCCs, and PSBC have all begun to offer insurance services using the partner-agent model. Generally, however, the outreach of insurance products into rural areas is extremely low, including general life and health insurance products. Non-bank financial institutions are offering insurance products; however, these are not offered as a part of diversified microfinance portfolios.

As mentioned earlier, India MFIs are handicapped on the savings front due to restrictive laws, but they have been creative in providing credit for a wide range of purposes, and are ahead (together with the Philippines) in the provision of microinsurance as compared to other countries in Asia.

The growth of microinsurance is such that a large portion of it as it exists today comprises credit life insurance which is automatically bundled with microcredit. Providing insurance as a standalone product for the poor has not been easy. Microcredit is demand driven whereas microinsurance requires significant marketing and sales effort and some changes to the existing institutional structures and capacity that serve the insurance market. Other issues that countries have to address are staff capacity and incentive structures, distribution channels within MFIs and most crucially the ability of insurance companies to provide suitable, sustainable microinsurance products and services.

In India, ICICI Bank has also been working closely with its insurance subsidiaries-ICICI Lombard General Insurance and ICICI Prudential Life Insurance on the microinsurance front, where the products offered include life insurance, health and personal accident insurance, weather insurance and loan care.

Microfinance in the Philippines has a long history of growth and innovation. The range of products and financial services provided are one of the widest, ranging from traditional microcredit to the several hundred microfinance institutions that operate throughout the country which provide microfinance for agriculture and agri-related risks, housing, services for Overseas Filipino Workers, microinsurance, mobile banking and business development services.

Use of Technology

In South Asia, India is the only country where the use of technology is wide-spread: from MIS, specialised auditing, account (loans, savings and deposits) tracking, internal accounting and financial reporting, to the use of PDA application to capture field transactions. Nepal and Sri

Lanka operate primarily on a manual system. In Bangladesh, the use of technology is limited to the large four MFIs and only at the headquarters level. In most countries limited infrastructure (the lack of electricity, telecommunications and mobile phone networks, and hardware and software services) are constraints to the application of computer technology by the MFIs. Consequently, operational efficiency in India is higher than in any other major region offering microfinance.

In South East Asia, the Philippines stands out in relation to branchless banking, of which mobile phone banking is a significant source, with its use tripling in each of the years between 2006 and 2008. The Rural Bankers Association of the Philippines Microenterprise Access to Banking Services (RBAP MABS) program has invested significant resources to establish mobile phone banking as a viable platform in the Philippines, and regulators have facilitated its implementation.

In all countries the use of ICT and mobile phone networks is recognised as the next big push and channel in creating more inclusive financial systems. Mobile banking and text-messaging are being used to leap frog the constraints of limited physical infrastructure and offer greater diversity in small-balance savings products, insurance, remittances and leasing. Technology is also spurring countries to test individual lending methodology, which moves away from the group lending model.

In India the sector has seen record growth rates in the last two years, and even as it increases outreach, it continues to be amongst the most efficient in the world. Pakistan is proactively working to achieve efficiency levels comparable to India. Increasing growth brings with it the need to maintain sustainable profit margins and the pressure to emphasise commercial behaviour and hence the charges of mission drift. The challenge is to achieve growth with equity and efficiency.

Mission Drift and the Missing Middle

The intended target population for the majority of the sector in each country is the agrarian rural poor, with a specific focus on women. However, various studies and anecdotal evidence suggest that the poorest at the bottom of the pyramid still have limited or no access to financial services to meet their economic needs. Youth, minority groups and migrant populations have historically been outside the purview of the microfinance sector, but should increasingly be given the attention they deserve.

In the rush to expand, most MFPs acknowledge the risk of 'mission drift'. The sector as a whole targets the poor, especially women, but it is unclear as to how deep the poverty outreach is in reality. In countries like Nepal, Sri Lanka, Vietnam and the smaller players in Bangladesh, where a larger proportion of MFPs are not operationally and financially sustainable, the focus is still on the poor. In India, Indonesia, the Philippines, China and perhaps Pakistan, the desire to reach a massive scale, maximise returns and commercialise operations has in some instances threatened to move the sector away from its original mission of microcredit to alleviate poverty.

The growth of the microfinance sector and its gradual move 'up market' has highlighted the demand for financial services outside the traditional BOP market by small and medium enterprises. This is increasingly being referred to as the 'missing middle' where the market is looking for more flexible and individualised credit services – loan size, loan terms and varied repayment – together with business development training and technical assistance. This group of small and medium entrepreneurs tends to be urban based and has insufficient access to the formal banking system. Its demand for individual customised loans is a challenge for the microfinance industry that has, to date, worked with the group lending model. However, increasingly, even the clientele at the BOP is demanding more flexible and individualised services. This suggests that in the push to move 'up-market' some successful MFPs will view funding SMEs as the next frontier for the microfinance industry.

With this rise in demand-driven service and the change in the mix of clients, there is an emerging demand for ancillary business development services by target groups. MFPs on the other hand, see the need for technical assistance and training for themselves and are coming together to create an industry infrastructure that supports capacity building within the sector, namely: standardised reporting, specialised auditing, organisational governance, rating agencies and client credit reference services. What is required in all countries is a strong meso-level infrastructure with direct contact and coordination between the semi-formal and the regulated providers who serve the market.

V. Microfinance Meso-Level Organisations

The microfinance sector in most countries is supported by a diverse set of institutions, comprising national associations, networks, apex institutions or issue-based entities all supported or promoted by governments, voluntary sector agencies both national and international, bi- and multi-lateral agencies and even the private sector. Ideally, the meso-level institutions seek to:

- > enhance the capacity of retail MFIs through training courses;
- > build up technical expertise and disseminating operational best practices;
- > develop and disseminate the use of performance measures and promote financial transparency in retail MFIs;
- > help create an enabling environment for retail MFIs; and
- > build a greater awareness among policy-makers as to the needs of the sector.

There is also demand for other support services – MIS/IT, specialised microfinance audits, organisational and institutional capacity building (finance, operations, human resources, governance) and product rating, credit reference and market research. Depending on local skills levels there are a few private companies that provide technical assistance and consultancy services to the sector.

In Asia as elsewhere, capacity building is essential for microfinance practitioners to consolidate their portfolios and prepare for significant expansion, and eventual transformation to fit into the legal and regulatory framework of their countries. Both microfinance practitioners and formal financial institutions have to develop their respective capacities to cooperate in forging successful partnerships for sustainable microfinance. In addition to ensuring the bottom line of profitability, both investor and client retailers of financial services for the poor have to be aware of their social responsibilities, and ensure a balance of financial, social and environmental impacts. Capacity building must be informed by the available knowledge on the ground and inspire innovation at the operational and policy levels. Practitioner-led, practitioner-informed research combined with rigorous scientific methodology of data collection and analysis can inform high quality curriculum and training materials that can be tailored and adapted to meet the specific needs of users. Particular emphasis is needed on improving the efficiency and productivity of financial service providers to manage growth in a sustainable manner.

Government support for building the institutional infrastructure is, for the most part, absent. This may stem from the fact that many of the government development programs that include a microfinance component are often managed without considerations of microfinance best practices, creating an unsustainable source of cheap funds, and unfair competition to commercial microfinance providers.

Pakistan is unique in that it has a few strong meso-level institutions that have been instrumental in proactively initiating and pushing the microfinance industry agenda forward. The Pakistan Microfinance Network (PMN) is dedicated to improving the outreach and sustainability of microfinance in Pakistan. PMN acts as a disseminator of microfinance information with the aim of enhancing the scale, quality, diversity and sustainability of microfinance providers in Pakistan; it also publishes the Pakistan Microfinance Review. It has gone even further by including research,

social performance management and the setting up of a Pilot Credit Bureau. It also seeks to become the voice of the different stakeholders in the microfinance industry and has been selected as one of the 10 partners under the SEEP Network Technical Assistance and Action Research Project.

The Pakistan Poverty Alleviation Fund (PPAF), a national apex association wholesales funds to MFIs, and also supports outreach and diversity of financial products offered, grants for small scale infrastructure projects; training and skill development and social sector interventions. PPAF is committed to market development and the emergence of a professional microfinance sector.

India also has a few strong meso-level institutions, and is additionally supported by quality private consulting firms that focus on the civil society sector. Sa-Dhan in India is the primary network of microfinance institutions and plays a crucial role in increasing the capacity and improving the quality of its member organisations. Sa-Dhan provides the platform for peer learning and exchange; policy advocacy and legal reform; training and seminars; market research and information dissemination; performance monitoring and benchmarking; and hosts an annual conference and other industry events. One recent highlight that advances the cause of transparency and timely reporting has been the publication of 'Quick Report 2007: A snapshot of Microfinance Institutions in India' within four months of the closing of the financial year.

The work of the China Association of Microfinance (CAM) seeks to address China's considerable challenges in establishing a best practice microfinance industry. As the network of a nascent microfinance sector, CAM has a broad membership consisting of stakeholders that include MFIs, government administrative departments, domestic and international organisations, as well as academics. While a key focus of CAM is to continue to encourage the government to provide a conducive and structured environment for the microfinance industry, it also focuses on raising funds for

MFIs in the absence of wholesale funds or guarantee institutions.

The Philippines has a wide variety of meso-level institutions. Each category of MFIs (NGOs, rural banks and cooperatives) has an apex body. The Microfinance Council of the Philippines, Inc. (MCPI) has a predominantly NGO membership but aims to become the national network. The Rural Bankers Association of the Philippines (RBAP) and the National Confederation of Cooperatives are the other two networks. On the training and technical assistance front, in addition to the above, the Asian Institute of Management, Bayan Academy, CARD MRI Development Institute (CMDI), Punla sa Tao Foundation and Social Enterprise Development Partnership, Inc. provide a combination of practitioner-led and more formal specialised training courses. PinoyMe, a private consortium of academics, MFIs, corporations, foundations and NGOs seeks to bring together stakeholders from multiple sectors to widen the access of the poor to financial services through capacity building, resources mobilisation, business development services and knowledge management. Lastly, there are the PCFC facilitated Regional Microfinance Associations, for its partner MFIs that share best practices and credit information of borrowers among the membership.

Bangladesh, Nepal, Sri Lanka, Indonesia and Vietnam all have meso-level resources of varying quality. The Credit Development Forum (CDF) in Bangladesh, a network of MFI-NGOs, acts as a common platform to share learning and information exchange on microfinance best practices and technology, training and research. As a sectoral advocate for the creation of a supportive regulatory policy environment, CDF also provides network linkages to regional and international micro finance bodies. The Palli Karma Sahayak Foundation (PKSF) is an apex microcredit funding and capacity building organisation that has played a major role in the growth of the sector in Bangladesh.

In Nepal, the Rural Microfinance Development Centre Ltd, a wholesale funder, has taken on providing intensive training and technical

assistance to promote and develop new MFIs and its partner organisations. RMDC has a strong relationship with the central bank and has played a vital role in developing a conducive legal and regulatory environment for the microfinance sector in the country.

Rural Finance Nepal (RUFIN), a joint Nepali-German project, provides technical assistance to the Agriculture Development Bank; The Centre for Microfinance (CMF) established in 2000 with support from CIDA and Ford Foundation conducts training and research on microfinance; the National Federation of Savings and Credit Union Nepal (NEFSCUN) established in 1988, is an apex organisation for savings and credit cooperatives in the country. The Credit Information Bureau Limited (CIB) is the repository of credit information of the customers and commercial borrowers of all banks and financial institutions and disseminates to them on demand.

In Sri Lanka, the sector is represented by the Lanka Microfinance Practitioners Association (LMPA), which was established in 2006 and supported by GTZ and Plan Sri Lanka. The network, with a membership of 80 MFIs, is still very much in the early stages of development. MFIs like SEEDS and SANASA have their own specialised training centres. Other technical resources that the microfinance sector can access are the formal banking sector, the University and international organisations.

Institutional support for the microfinance sector in Indonesia comes from a diverse set of institutions. Perbarindo, the long established national association of BPRs, has been providing training and technical support, and is now developing capacity building and performance tools in collaboration with GTZ and Bank Indonesia under the Pro-Fi (Promotion of Small Financial Institutions) project.

The Indonesian Movement for Microfinance Development, GEMA PKM, is an industry network which has been an active partner in drafting new laws and regulations on microfinance and in promoting awareness and adoption of best practices in microfinance as a tool for sustainable poverty reduction

and economic growth. A nascent Indonesia Microfinance Association (IMA), responsible for the annual Indonesia Microfinance Conference, is also being established.

The Credit Union Coordination Board of Indonesia, BK31 is the national apex organisation for financial cooperatives, and aims to strengthen the development of autonomous and self-reliant cooperatives.

In Vietnam the emerging microfinance sector is supported by the Vietnam Association of People's Credit Funds (VAPCF), the Vietnam Microfinance Working Group (MFWG) and the newly set-up M7 Network. The VAPCF, established in 2005, seeks to foster dialogue with state agencies and disseminates key legal information on new government decrees and decisions; facilitates training and consulting to the members; and maintains a website that facilitates information sharing within the membership.

The MFWG, revived in 2003, serves as a hub for lobbying and advocacy efforts. Like the VAPCF it facilitates dialogue with the SBV and other government authorities, facilitates regular sharing of lessons learned within the membership, works to raise the awareness of microfinance and links practitioners to microfinance training events, and maintains a database of microfinance programs in Vietnam. The semi-annual publication of the Vietnam Microfinance Bulletin has been a key achievement, providing outreach and financial data of 25 MFOs and VBSP.

Evidently, the meso-level institutions in most countries are young and still work in isolation with little information sharing and exchange and at varying capacity and skill levels. There are clearly no central microfinance training and support networks; further, there is little contact between the formal regulated finance sector and the microfinance (both semi formal and unregulated) sector. In some countries, there are only a few local private consulting firms that provide training and technical assistance.

Since the mid-1990s the Banking with the Poor Network has acted as Asia's regional network. Today, the BWTP Network brings together a diverse range of microfinance stakeholder institutions including MFIs, commercial and central banks, wholesale and support institutions, technical assistance providers and microfinance networks from ten Asian countries (Bangladesh, India, Indonesia, Nepal, Pakistan, Philippines, Sri Lanka, Thailand, Vietnam and Australia). The aim of the network is to expand the outreach of financial services, and to encourage innovative dialogue and productive linkages between microfinance organisations and formal financial institutions in Asia and the Pacific. FDC, in its role as Secretariat of the BWTP Network, is also working towards transforming the Network into a unique platform for cooperation and peer learning in Asia. The BWTP Network and FDC host biennial Asia Microfinance Forums and annual Asia Network Summits.

MFI Rating and Credit Risk Assessment

In the Asia region, India is the only country with a credible rating agency – M-CRIL: Microcredit Ratings International Limited. The Philippines has the Philippines Coalition of Microfinance Standards that provides a set of performance standards to serve as guidelines or benchmarks to assess the operations of Philippine NGOs involved in microfinance. In Vietnam PlanetRating, part of Planet Finance, a French organisation, has recently entered the market. In Nepal, wholesale lending organisations (like RMDC, SKBBL) appraise their applicant institutions themselves before making approval of a loan.

At a time when microfinance has enjoyed a great deal of success and exposure, MFIs face a distinct challenge when trying to encourage prospective donors and financial markets to support their activities. Although evaluations and assessments are available to MFIs from credible agencies, these tend to be expensive, and lack a common standard that can be applied to the entire industry. M-CRIL, India aims to be a regional resource to the microfinance sector.

In all countries there is little institutional infrastructure that addresses client credit risk. With expanding outreach and rising levels of competition, MFIs in every country need a sector-wide credit information sharing system. There are a few credit bureaus in some countries but they have limited membership within the microfinance sector, and do not span the entire range of microfinance providers.

VI. Funding Sources

As of December 2007, Microfinance Investment Vehicles (MIV), consisting of development investors (private sector arms of bilateral and multilateral agencies) and social investment funds (socially motivated privately-managed investment funds financed by both public and private capital) had assets under management of US\$ 5.4 billion. It is interesting to note that 81 percent of Microfinance Investment Vehicles (MIV) are in Eastern Europe, Central Asia, and Latin America.⁹

One possible explanation is that Asian MFIs have been able to secure funding from governments and regional multilateral lenders at subsidised rates more easily than MFIs in other regions. In addition many profitable MFIs in East and South Asia have successfully intermediated funding from domestic sources, including deposits and bank loans.

According to CGAP, 34 percent of donor and investor microfinance funding was directed at South Asia and East Asia/Pacific combined. Of this, 27 percent was attracted by South Asia, the majority of this towards India and Pakistan. Asia, the largest and poorest microfinance market, is therefore under-represented as a proportion of overall microfinance funding.¹⁰

In the current economic climate, domestic financing in the form of deposits and bank loans, will remain the predominant source of funding for microfinance. Mobilising deposits, both in savings and current accounts, is crucial to establishing a permanent and stable source of funding which is also cost-effective. Commercial banks moving down market will expand the industry, but it remains to be seen how much of that happens in the current global financial reality.

In Asia, Bangladesh stands out as the most self-sufficient because of the success of the big-four: Grameen, BRAC, ASA and PROSHIKA. Internal savings of members, and interest and service charges from credit disbursed, account for approximately 59.5 percent of funds for the microfinance sector in 2005. Other sources like local banks, government wholesale agencies and NGOs account for 32.6 percent of funds and external sources like international donors and NGOs contribute only 7.9 percent of funds for the microfinance sector. External donor grants, as a source of funds, have been declining steadily from 30.4 percent of total revolving funds in 1997 to 13.3 percent in 2003 to 7.9 percent in 2005. Loans from banks have increased in recent years from 8.3 percent in 2003 to 16.9 percent by the end of 2005.

PKSF has played a large role in the growth of the industry in Bangladesh. As an apex institution, PKSF manages to mobilise funds in the form of grants, loans and contributions from a wide variety of sources which include the Government of Bangladesh, private individuals and organisations, foreign governments, international donors and lending agencies and capital markets. It has played the role of both financial intermediary and market developer and continues to be an institution central to the Bangladeshi landscape.

In recent years, the Indian microfinance industry has become one of the most leveraged in the world, due to the rapid expansion of commercial bank lending and the enhanced interest shown by private equity funds, social investors and venture capital firms. Most MFIs started with grants and concessional loans from apex financial institutions, and have gradually made the transition to commercial funding. The lack of resource options (given that they cannot take deposits) and a decline in availability of grant funding has led the Indian microfinance sector to diversify its funding base. As of March 2006 lending from ICICI Bank had grown to constitute about two-thirds of total lending to the sector, with about 60 percent of its lending coming under the partnership model. SIDBI and FWFB are two other major sources of funding.

In India, two innovative examples stand out. The ICICI bank has forged a partnership with Grameen Foundation USA to set up Grameen Capital India (GCI). The partnership model enables the bank to service poor clients effectively, with substantial risk sharing between the bank and the partner NGO/MFI. Under this model, ICICI Bank forges an alliance with existing MFIs where the MFI is responsible for the identifying, training and promoting of micro finance clients and ICICI Bank then finances the clients directly on the recommendation of the MFI. Secondly, under the securitisation model, ICICI Bank buys out the portfolios from MFIs. The MFIs continue to service the clients and act as a collection agent. Here again, the MFI shares the credit risk with the bank. Under the on-tap securitisation model, the MFI receives an advance purchase consideration to create a portfolio of loans that could then be periodically sold to ICICI Bank.

In Pakistan, the performance of the microfinance sector is in sharp contrast to the wider macroeconomic context within the country and globally. Total funding available to the sector increased by 33 percent over 2006-07. The three sources of funding that make up the majority of funds available are paid-up capital, donor grants and subsidised debt. There has been a steady increase in savings (from 11 to 13 percent of total liabilities for the sector) and commercial debt (from 8 to 11 percent of the total capital available to the sector) as a source of funding for the sector. Experts in the sector are grappling with alternative trajectories, one direction being to innovate and gain efficiencies; the other to consolidate in the traditional mode, and survive the current global financial crisis at the same time.

In Indonesia, where commercial finance dominates, equity participation by private investors and savings deposits are the major sources of funds for the microfinance industry. Government and donors fund the rural development programs and the small number of financial service NGOs and other MFIs operating in the rural areas.

In the Philippines, Government Financial Institutions (GFIs) intermediate funds to the retail MFIs. The People's Credit and Finance Corporation (PCFC) is the only agency mandated by law to provide financial services to the poor through wholesale funds to retail MFIs. The Land Bank of the Philippines, also a GFI, lends ODA funds received from multilaterals. The NGO-MFIs receive program and technical assistance funding from USAID, UNDP, IFAD, ADB and the EU. In addition, large international organisations like Grameen Foundation, USA, Oikocredit, Plan International, World Vision, and CARE Philippines also provide wholesale funds and technical assistance. More recently, local commercial banks and two international banks, namely Citibank and HSBC, have opened loan facilities to retail MFIs.

Nepal, Sri Lanka, China and Vietnam are countries where the microfinance sector relies heavily on government subsidised funding and international donors.

In Nepal, the sources of funds for microfinance programs in the country are the Deprived Sector Credit funds from commercial banks, wholesale lending organisations and a few international donors. Commercial banks contribute to the microfinance industry as wholesalers and equity investors, and are required to disburse at least 3 percent of their total loans outstanding to the deprived sector.

There are three wholesale funding agencies operating in the Sri Lankan microfinance sector. These are the government owned National Development Trust Fund (NDTF), Stromme Microfinance, backed by the Stromme Foundation of Norway, and Consorzio Etimos, a funding agency based in Italy. The NGO-type MFIs are restricted by law from accepting public deposits and further restricted from obtaining off-shore debt and equity funding due to prevailing exchange control restrictions. Accessing local funding is also somewhat of an issue, as local banks and other commercial funding agencies are still reluctant to lend to or invest in the microfinance sector, due to the perception of high risk. Donor funding that surged in the aftermath of the 2004 Tsunami is after five years seeing a phasing out. There

is interest among the off-shore microfinance funding agencies, but a restrictive legal environment and a cumbersome approval process serve as deterrents.

In China, dependence on grants from external donors for microfinance funding has been steadily declining; from 30.4 percent of total revolving funds in 1997, 13.3 percent in 2003 to 7.9 percent in 2005. On the other hand, loans from banks have increased in recent years, from 8.3 percent in 2003 to 16.9 percent by the end of 2005.

Only in 2008 was the issue of funding of newly established microloan companies addressed in China in policy guidelines. These companies are now permitted to source funds from 'not more than two banking financial institutions' while also continuing to finance from shareholders and donated funds. This has resulted in an increase in the funding of Village and Township Banks (VTBs) and microloan companies. Despite these positive moves, micro lenders operating on a commercial basis still have restrictions on funding sources and the amount of funds borrowed (which cannot exceed 50 percent of net capital). ACCION International, ASA of Bangladesh, and IFC under World Bank have all participated in the bidding process of microloan companies.

In 2006 the China Development Bank provided wholesale funds to the China Foundation for Poverty Alleviation, which marks the first time a government institution has provided wholesale funding for NGO sector microfinance lending. However, commercial investment, especially from foreign sources, is restricted, as microfinance investment funds wishing to invest in China are not permitted to initiate the formation of VTBs that cannot own more than 10 percent of shares in an MFI. Also, foreign banks wishing to set up MFIs have been permitted to provide loans only and not accept deposits. There has been an increase in the number of foreign banks such as KfW, HSBA and Standard Chartered, and international financial institutions such as the IMF, purchasing shares in rural commercial and cooperative banks or setting up microloan companies to provide microcredit at commercial rates.

In Vietnam, the government is the largest source of funds for the formal financial service providers in the microfinance industry. They also have access to donor credit lines, but the semi-formal sector receives all its funding from key donors, namely GTZ, AusAid, Ford Foundation, CIDA and Belgian DGDC. Policy lenders (VBSP, VDB) and CCF, the apex institution that lends to PCFs, access government budget funds and ODA credit. Competition between the commercial banking sector and the specialised financial institutions has encouraged financial deepening as both seek to reach lower income clients.

VII. Impact of Microfinance Activities

With few exceptions, the spectacular growth of the microfinance sector in Asia has been fuelled by conscious efforts of national governments, NGOs, and the donor community (bi- and multi-lateral); all of these view microfinance as an effective poverty alleviation tool. Countries have attempted to examine the economic and social impact of microfinance, but there are few studies that accurately assess the benefits and probably none that can be compared over time and between countries. However, in countries where impact assessments have been reported in Industry Assessments (Nepal, Bangladesh, India, Vietnam, China and the Philippines), benefits identified vary widely:

- > better food security and nutrition,
- > better housing and health,
- > better school enrolments for children,
- > women's empowerment and mobility,
- > higher average household income and/or a more secure and consistent cash flow over the year,
- > higher levels of literacy,
- > building of human capital and assets and community participation,
- > self-employment and employment of family member,
- > employment creation- employment of non-family labour.

Impact assessments are however, plagued with methodological issues: the difficulty of obtaining a comparable control group, disentangling credit benefits from the benefits of complementary development inputs of social programs, and limiting the number of attributes that define an assessment are but a few of the constraints. The industry has yet to standardise the framework used for such assessments. Parameters and frameworks vary depending on who commissions the assessment – the government, donors, internal industry stakeholders or investors.

In India, the microfinance sector is one step ahead, distinguishing between impact assessments and social performance indicators. Here, the social impact attributes studied differ from those undertaken in Nepal and Bangladesh. Assessments in India are done more for the purposes of rating for external investors rather than assessing its impact on poverty alleviation. Poverty audits and gender targeting, the two essential attributes of microcredit, make up only a small component of social audits (mission drift, interest rate caps, restrictions on deposit mobilisation).

While the most MFIs in Asia consider themselves 'social' lenders focused on the rural poor, social performance, which takes into consideration the extent to which MFIs are making their social mission a reality, is yet to become a mainstreamed feature of the Asia microfinance landscape. However, Social Performance Management (SPM), the process whereby institutions monitor and assess progress towards their social objectives, is gaining increased attention in other regions such as Eastern Europe and Latin America. In the Philippines, MCPI is a part of the Imp-Act, the international consortium working on SPM issues, and has facilitated the implementation of SPM into several member institutions.

In contrast, financial performance indicators for the sector have, to an extent, been standardised and are almost routinely included in annual reports of MFIs. There are now industry systems to track financial sustainability with clear definitions and indicators for reporting on financial performance. Moreover, the interest shown by commercial banks and other private

investors in microfinance, will only further fine-tune and standardise financial reporting to bring it up to the corporate world's level.

In the current global financial climate the microfinance sector will have to guard against settling for a low-level equilibrium. Most impact assessments are silent on negative impacts and cautious in highlighting the limited success programs have. The limited number of impact assessments done reflect the broader difficulty the sector faces in conducting such studies.

VIII. Opportunities and Challenges

The microfinance sector has emerged as an effective strategy in addressing poverty and empowering the poor. The capacity, quality and range of microfinance institutions and the infrastructure that supports them varies widely within countries and from country to country. Financially sustainable, commercially viable MFIs co-exist alongside donor subsidised entities and basic community revolving funds. In every country, a few large institutions account for the bulk of outreach, with Bangladesh being the most prominent example, with Grameen, BRAC, ASA and Proshika accounting for 86 percent of the microfinance market. The market in India, Indonesia and the Philippines is more vibrant, where banks and non-bank financial institutions are gaining greater importance. In Nepal, Sri Lanka and Vietnam, there continues to be significant government involvement in service delivery, with microcredit used at a policy level.

Most countries face similar opportunities and challenges, some more so than others.

Opportunities across the region include:

- > Getting the long term policy and regulatory reform right
- > Access to commercial funding – banks, private investors
- > Number of successful MFIs graduating to join the leaders
- > Expanding outreach with the down-scaling of commercial banks

- > Savings / deposit mobilisation as a sustainable source of funding
- > New Products with the use of technology.
- > Partnerships across sectors

Challenges across the region include:

- > Organisational capacity of MFIs, outside of the few large and successful ones
- > Existence and institutional capacity of meso-level institutions – networks, credit bureau, financial and social rating agencies, training and TA, business development services
- > Limited product range, current clientele needs– microinsurance, remittances, savings, new products frontiers (agriculture and agri-based industries, housing, SME – historically credit for petty trade)
- > Access to technology
- > Mission drift
- > Policy lending as against market discipline
- > Legal and regulatory framework

The greatest opportunity for the sector is the attention it has received in the last five years, and the general acknowledgement that microfinance is an effective poverty alleviation tool. Governments, MFIs, the development community and private investors are all focused on creating a supportive policy environment, developing the financial infrastructure and viable institutions and supporting pro-poor product innovations to ensure permanent access to financial services for the majority, as compared to the exclusivity of financial systems in the developed world.

In all countries without exception, concerted action in changing the legal and regulatory framework to create an enabling environment has been under way for the past several years. Some countries, especially the Philippines, are further ahead on the reform agenda, but all see this as a major hindrance in the progression of the sector to the next level.

In Pakistan, India and the Philippines, country, and more recently, regional microfinance networks play an important role in creating

a conducive environment for the growth and expansion of the sector. The networks are almost invariably membership organisations that provide a wide range of services to the membership, as well as representing and advocating for the sector as a whole. The primary objectives of meso-level organisations vary but include all or a combination of the following:

- > To advocate policies which promote an enabling environment for microfinance
- > To develop the capacity of their members through training courses offered directly by the network or through partnerships with other training providers.
- > To facilitate information sharing and dissemination and exchange for the entire microfinance industry
- > To promote performance standards and best practices
- > To liaise on behalf of members with banks and investors and respond to their funding needs
- > To conduct research on issues and product innovation within the sector

In most countries, the meso-level institutions themselves need to build their capacity and technical skills to effectively support and represent the membership. There are structural and operational challenges that limit the scale and outreach of these institutions. Within the meso-level structure the biggest challenge is how to meet the ever-expanding needs of a very diverse membership.

In addition to the support infrastructure required, there is a need for collaboration among MFIs to share client databases in specific geographic areas, so as to reduce overlapping, and to strengthen credit ratings. Rapid expansion has resulted in over-indebted clients with multiple loans because of keen competition between MFIs. Client credit rating to avoid portfolio risk and rating of credit institutions from the perspective of investors are two services that the industry needs urgently.

In Asia, the sheer numbers pose a challenge. The phenomenal growth in outreach still leaves many without access to microcredit or microfinance

services. There is limited access to the remote rural hinterlands because of inadequate physical and economic infrastructure. In addition, the unwillingness of MFIs to operate in these areas results in the entrenching of poverty among the population. The marginalised castes, minorities, migrants and the destitute are still excluded. The 'mission drift' alluded to by the larger MFPs further jeopardises the basic objective of poverty alleviation. It is hoped that the use of ICT, namely mobile telephones and point of sale devices, can enable transactions in broader geographic areas.

In countries like Bangladesh, India, Pakistan and the Philippines the industry faces two dilemmas, the first being sustainability versus expansion in client base, and second being small versus larger loan sizes. To work towards sustainability, MFIs need to professionalise and upgrade staff skills (especially in finance), increase the use of technology, streamline operations with management information systems and achieve cost efficiency. MFIs would have to expand horizontally to service an expanded client base, as well as implementing the vertical professionalisation of all functions within the institution.

Sustainability, as well as interest caps (especially in India) on small loans, has prompted MFIs to provide larger loans and hence all together forgo the target population of the very poor. In such instances 'mission drift' becomes a default option, leaving the MFI little room to maneuver.

So far the focus of growth in the microfinance sector has been on credit and a very limited range of often rigidly designed products. Moving forward, it is envisaged that savings products will be pivotal in leading the sector. Product innovation on the savings front will provide much needed capital for growth, and a diversified range of savings products will automatically expand the outreach of the sector. Despite the clear role that savings products play, MFIs have been slow to respond to the need for the poor to save due to regulatory restrictions. With the exception of Grameen in Bangladesh and BRI in Indonesia, most MFIs are limited to compulsory savings of members as part of the microfinance

package and are unable to mobilise deposits from the general public. These restrictions ultimately raise the cost of doing business, as access to low-cost capital for on-lending is denied to the MFIs.

Microfinance remains primarily a supply-driven endeavour, applying a limited number of methodologies to provide mainly working capital to poor micro-entrepreneurs; there is limited response to client needs and demands through product innovation and flexibility. There is untapped opportunity that lies in responding to client demands for new products. ICT and mobile telecommunication can facilitate much progress with the introduction of services like money transfers, remittances, microinsurance and flexible micro-savings, together with more efficient deposit taking and lending activities. Innovations in ICT can also facilitate operational efficiency by reducing transaction costs for both institutions and clients, improve productivity and expand outreach. To take advantage of, and use, these innovations to improve their services, MFIs need strong and supportive meso-level infrastructure. ICT can be used to improve operations such as MIS systems; lessen information asymmetry between MFI and client and between competing MFIs; knowledge sharing among MFIs, investors and the government and increase impact and outreach with ATMs, mobile-banking, e-payments and loan collection.

Historically the microfinance sector in most countries has been resilient to external financial crises. In Asia, the microfinance sector in most countries has largely been funded by international donors, government development funds and individual deposit mobilisation, with India and to a certain extent the Philippines, being the exceptions. Hence the effect of the global liquidity contraction on the cost and availability of funding to MFIs is yet to be determined and will depend on the funding structure of the institution. In countries where domestic commercial banks have begun lending to MFIs, money will be tighter and slower to come by and will come with more conditions attached.

The current global financial crisis, and the food and commodity price hikes that preceded it, have left the microfinance clientele weakened. With purchasing power eroded, savings contraction will affect both the repayment capacity and the stability of future deposits. MFIs may in the medium term face a portfolio risk as the credit worthiness of their clients deteriorate.

Foreign currency exposure is an added dimension, though not so critical in Asia as most MFIs/NGOs cannot, by law, borrow in foreign denominations. In contrast, Latin American and Eastern European MFIs have had unhedged foreign exchange exposure in past years. With that in mind, the growing interest shown by institutional investors, private equity and venture capital funds is a double edged sword. In as much as it helps grow and expand the sector's outreach and efficiency it is good, but it renders it more vulnerable to external shocks of capital availability and investment interest.

The policy implications of the current global situation cannot be ignored. Short term government action (mass loan forgiveness, interest rate caps, state government credit programs, to name but a few) in response to the current crisis in the formal financial sector and economic downturn could roll back the successes of the last few years. A tighter and more conservative regulatory regime may thwart the progress made so far. On the other hand the current crisis may move governments to look at regulatory reform for the sector as a whole, rather than the piece-meal legislation being considered in several countries currently.

At the very least, the current crisis has highlighted the need for a secure funding base. The sector has to strengthen its balance sheet through local equity funding and deposit mobilisation. On the deposit mobilisation front, governments, in partnership with practitioners and experts, have to deliver a re-structured regulatory and legal framework within which the microfinance sector can flourish.

Endnotes

- ¹ The microfinance industry reports summarised for this chapter are:
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 - All FDC/BWTP Network publication are available from the BWTP Network website: www.bwtp.org
- ² Asian Development Bank, 2008, 'Key Indicators for Asia & the Pacific – 39th Ed.', ADB: Manila.
- ³ *ibid.*
- ⁴ ADB, 2009, 'The Global Economic Crisis: Challenges for Developing Asia and ADB's Response', ADB: Manila.
- ⁵ ADB, 2009, 'Asian Development Outlook 2009: Rebalancing Asia's Growth', ADB: Manila.
- ⁶ ADB, 2009, 'The Global Economic Crisis: Challenges for Developing Asia and ADB's Response', ADB: Manila'.
- ⁷ The Mix Market is the microfinance industries leading platform for microfinance data collection. Although the data collected by the Mix Market and published by the Mix does not reflect all microfinance institutions in Asia, its rigour in ensuring transparency and statistical accuracy ensure data included here is reflective of regional trends amongst 'best practice' institutions.
- ⁸ According to the World Bank's 'Migration and Remittances Factbook' the top 10 remittance receiving countries in 2007 were: India (\$27.0 bn), China (\$25.7 bn), Mexico (\$25.0 bn), Philippines (\$17.0 bn), Romania (\$6.8 bn), Bangladesh (\$6.4 bn), Pakistan (\$6.1 bn), Indonesia (\$6.0 bn), Egypt, Arab Rep. (\$5.9 bn), Morocco (\$5.7 bn). Remittances for other countries in this report for 2007 were: Vietnam (\$5 bn), Sri Lanka (\$2.7 bn) and Nepal (\$1.6 bn)
- ⁹ Xavier.R & Sananikone.O, Microfinance Investment Vehicles, CGAP: Brief April 2007.
- ¹⁰ CGAP, 2008 Microfinance Funder Survey: Global Results.

3. Financing and Investment*

I. Introduction

Globally, the microfinance sector experienced an extraordinary increase in cross-border investment in the half decade prior to the 2008 global financial crisis. CGAP estimates that the stock of foreign investment more than quadrupled between 2004 and 2007.

While the growth rate is startling, even more surprising is the source of this new capital. Traditionally, quasi-public sector institutions such as multilateral and bilateral development banks provided the vast majority of funds to microfinance institutions (MFIs). While indeed they doubled the amount of their investment between 2004 and 2007, the private sector provided even more capital to the industry over that period. Hardly existing as the decade began, these private investors now account for half of cross-border investment in microfinance institutions.

Of course, public and quasi-public sector institutions still play a vital role in the industry, providing seed capital and other forms of support when the private sector cannot or will not do so. An example of this is the Microfinance Initiative for Asia (MIFA), a joint effort by the International Finance Corporation and KfW. MIFA will provide capital support in the form of debt, equity and structured finance as well as manage foreign exchange risks for MFIs that have not been able to source all the capital they need from the private sector.

Nevertheless, in the half-decade before the recent financial crisis, it was private sector investors, including banks such as Citi and Standard Chartered, fund managers such as TIAA-CREF, private equity investors such as Blackstone and Carlyle, peer-to-peer lenders such as Kiva and MicroPlace, and nearly 100 investment funds scattered around the world, that made the headlines and began to alter the shape of microfinance investments.

As both the volume of investment and the sophistication of these investors increased, so too did the structures they are using. Straight debt investment still remains the primary modality for

channeling capital to microfinance institutions, but equity, guarantees, debt derivatives such as collateralised debt obligations, IPOs, bond issues and foreign exchange risk hedging structures have begun to appear on the landscape.

The diversification of investors and the methods they use is no doubt a positive development for the sector as it broadens the avenues through which MFIs can finance their expansion. Just as the clients of MFIs need a variety of products and services to manage their financial needs, so too do the MFIs themselves.

Yet at the same time there are some perceived problems caused by this new flow of capital to MFIs. The biggest debate surrounding the growth of private sector investment in MFIs concerns the fear that commercialisation may cause MFIs to shift away from their social mission of reducing poverty. The microfinance industry has reacted swiftly to this concern with, for example, the growth of social performance management training programs, which investors are beginning to require as a prerequisite for releasing funds.

A related issue is the fear that as investment moves toward a more commercial approach, fewer MFIs will qualify for financing. This creates two derivative problems: first, that too much money is chasing the few MFIs in the top tier, leading to overinvestment that will force those MFIs to loosen lending standards in order to make use of all the money being made available to them. Conversely, smaller MFIs may be shut out from financing, meaning they cannot expand outreach to the point that they can attain self-sustainability. This not only creates a self-fulfilling prophecy – smaller MFIs are perceived as risky so they do not receive financing, cannot grow and thereby continue to struggle – but also runs the risk of creating oligopolistic market conditions. In many countries the sector is already dominated by a few institutions. Further concentration may reduce the competition required to force down interest rates and prevent innovative approaches from being tried, which would stifle the sector as a whole.

*This section was prepared by Ron Bevacqua, Executive, Director, PlaNet Finance, Japan.

The result, therefore, is that the balancing act of maximising both financial and social returns, always a tricky issue for commercial microfinance institutions themselves, has now begun to be played out among the investment community as well.

Asia is not immune from these trends. Indeed, it faces its own particular challenges with regard to investment in microfinance. Asia is by far the largest current market for microfinance in the world, accounting for half of all MFIs reporting to the Microcredit Summit Campaign and 85 percent of the clients of reporting institutions. It also has by far the largest potential market judging by the number of unbanked people in the region, with China and India in particular having millions of potential clients. Nevertheless, CGAP figures show that the region receives only 7 percent of global investment – the least amount of any region save Africa.

The imbalance between market size and investment is partly Asia's own doing, both positive (many Asian MFIs fund themselves through client deposits) and negative (in many countries state-owned lenders prevent commercial microfinance from taking root and governments restrict foreign investment).

The result is either a national microfinance industry that is too underdeveloped (in countries where government intervention is strongest) or an industry that is characterised by a handful of dominant institutions and a plethora of also-rans. Neither makes for an environment that is attractive to investors.

A final issue the Asia region struggles within the area of microfinance investment is foreign exchange rate risk. Some countries ban their MFIs from taking foreign currency-denominated debt outright. Even where no such ban exists, however, many MFIs are acutely aware of the exchange rate risk and seek to avoid it. The emergence of foreign exchange hedging techniques like those offered by Cygma and MFX is one of the most important developments for investment in Asian MFIs.

Of course, all these trends took place up to the global financial crisis that struck in the autumn of 2008. At the time of writing it is difficult to determine what the long-term impact of the crisis will be on microfinance investment generally and in Asia particularly. There is some evidence that the credit crisis is leading to a reduction in the amount of capital available for investment, especially debt investment, as well as an increase in the cost of funds. On the other hand the vast majority of microfinance investment capital is in "socially responsible" funds which are (a) not expected to yield dramatic returns in the first place and (b) likely to be a very small portion of the overall portfolio of any single investor. For that reason the decline in the amount of capital available for investment in microfinance may not be as dramatic as some fear.

That said, there is little doubt that some of the more esoteric credit and credit derivative investment mechanisms will dry up in the wake of the credit crisis. Moreover, the extreme volatility in the currency markets, coupled with the projected slowdown in MFI's growth due to the downturn in global economic activity, is likely to put a damper on demand for investment as well.

In the long run, credit market jitters that are limiting the supply of investment capital will likely to abate, while MFIs themselves will no doubt find that the untapped demand for their services is still so enormous that they can project steady growth for years to come.

In fact, the current global financial crisis could be an opportunity for the microfinance sector if it is shown that the sector is indeed non-cyclical as its advocates often point out. Asia already has experience in this, having gone through its own financial crisis in the late 1990s. At that time, while banks were collapsing or being nationalised throughout the region, MFIs continued to expand. The best example of this is Indonesia's Bank Rakyat, which is the largest specialised micro-lender in the world. Its growth in clients and loans outstanding increased steadily through the period while the overall economy contracted 13 percent between 1998

and 1999.¹ Should that trend be played out again during the current global financial crisis, it would demonstrate conclusively that the risk-return profile for microfinance is extremely attractive, which would very likely lead to another wave of private investment in the industry.

II. Financing and Investment in Asia – recent trends

As noted above, until recently Asia has not been seen by funders as a fertile region for investment. Nevertheless, the potential growth of the region, coupled with the slow improvement in Asian MFI operations and regulation, are causing investors to turn their attention to the region.

The type of funding available to MFIs in Asia depends largely on institutional type and the macro-economic and regulatory environment in which they operate. Regarding institutional structure, in general NGO MFIs in Asia tend to grow through donations and equity obtained from retained earnings, formal financial institutions rely on debt financing and deposits, and cooperatives mainly grow through deposits from their members.

Regional differences, if patterns exist at all, mainly derive from the institutional structure and the regulatory framework prevalent in a given area. For example, South Asian MFIs tend to be formal financial institutions pursuing group-lending methodologies with compulsory savings. As such, they rely mostly on debt in the form of loans and compulsory savings to grow. In the case of Bangladesh, compulsory savings constitute over 30 percent of their funding, with much of the rest coming from locally sourced debt. In India the reliance on local debt financing is even greater.

In contrast, in East Asia, debt constitutes just a third of MFI funding. Equity and deposits fund more of MFIs' assets because the sector is dominated by cooperatives and deposit-taking financial intermediaries like rural banks. Nevertheless, these patterns have many exceptions. For example, the ability to accept deposits in Nepal and Sri Lanka makes the

funding structure of MFIs there look more like that of East Asian MFIs. On average nearly a quarter of their funds are derived from voluntary deposits.

III. Issues and challenges going forward

Although the variety of microfinance service providers across Asia is so vast as to make generalisations meaningless, there are some structural challenges that are common throughout the region. Namely, there are an insufficient number of large-scale commercial microfinance institutions to meet the demand of the population, and many of those that do exist may be approaching the limits to their capacity to increase outreach.

Partly, these challenges are the result of problems on the demand side, namely the dominance of state-owned banks and restrictions on deposit collection and foreign investment. However, the limited supply of investment capital is also a cause of these problems. While in some countries like India and the Philippines, local commercial banks have developed the capacity to finance MFIs, in other countries in the region this is not yet the case. Moreover, in almost every country, local capital markets are underdeveloped, leading to a lack of long-term investment capital from pension funds and insurance companies.

That said, over the past several years conditions for investment in Asian MFIs have, in fact, improved. New markets with enormous potential show signs of opening up, as in China and Vietnam, and MFIs from Afghanistan to Indonesia are increasingly attracting capital – local, global, public and private. Nevertheless, because profitability remains limited to the leading MFIs, so too does investment. Although they reach the majority of clients across the region, their capacity to take on additional financing is limited. There has been a growing concern that the flood of money pouring into these MFIs is encouraging uncontrolled growth and undermining lending discipline. Even the best-run MFIs may lack the systems, technology, management capability and other resources to

prudently deploy the tsunami of capital they are being offered. If imprudent lending leads to an increase in defaults at the biggest MFIs, it would cause a decline in confidence across the entire sector.

Meanwhile the smaller MFIs are perceived to be too risky to invest in because they must continually erode their capital bases to cover losses. In fact, the imbalance in funding is widening the disparity between the top tier MFIs, often created and supported by international networks and financial organisations, and emerging MFIs that rely on donor funding. Indeed, in the investor-MFI “matchmaking event” organised by PlaNet Finance in parallel with the Hanoi conference, it was clear that many promising but not yet self-sustainable MFIs were less likely to have access to the funds they need to grow.

With the largest MFIs reaching their funding limit and the smaller MFIs still unattractive to investors, total outreach in Asia remains significantly below what it needs to be. Overcoming these obstacles to expand investment opportunities – and therefore outreach to clients – is one of the key challenges facing the sector across the region and the funds that invest in them. Among the issues that need to be addressed in order to expand the range of MFIs receiving investment are:

Transparency for MFIs that have not yet received funding

1. Reducing the cost of funds to smaller MFIs
2. Improving the sustainability and viability of a broader range of MFIs
3. Maintaining a social focus as investment becomes more commercial
4. Overcoming regulatory barriers that prevent investment in the least developed markets

Transparency

Insufficient disclosure on revenues and expenses makes financial performance analysis of smaller MFIs difficult. Measuring efficiency depends on clear identification of all costs and actors in the service delivery chain. Often smaller MFIs

do not have the capacity to collect this data. In addition, a consistent framework for comparing institutions often does not exist. The lack of such information naturally makes funds hesitant to invest in smaller MFIs.

However, some initiatives have been launched to address this issue. Current initiatives in Pakistan and Bangladesh improve and standardise financial statement disclosures for microfinance in accordance with international norms. Ratings are also becoming more common, especially in leveraged markets like India.

Yet, in many other countries, the elements supporting transparency in microfinance often go unnoticed. Improving transparency demands focused support and attention on successful initiatives to disseminate reporting standards, improve financial disclosures and build performance information hubs. Many markets still lack this infrastructure, and financing to create it is limited.

Cost of funds

Due to the entry of new international funds and local sources of finance along with public sector investors who must aggressively seek new opportunities to expand their own portfolios, competition for good credit has intensified. High-performing MFIs now have the upper hand. They are making lenders compete and driving hard bargains on terms. In some markets, pricing has been cut by as much as 250 basis points in the three years before the global financial crisis began, according to CGAP. The crisis has pushed up funding rates for MFIs, but it is not apparent yet whether this is a short-term event or something that will affect the microfinance sector over the medium term.

Yet even when funding costs were low, the cost of funds in the sector – on average 10 percent -- is often too high for smaller MFIs that are striving to attain financial self-sufficiency. Standard debt and equity investment funds are unwilling to lower their cost of funds because they need to cover their own operating costs (private equity funds are expensive to operate, with total expense ratios ranging from 3 to 6 percent, and debt funds are slightly less) and because

they perceive the smaller MFIs as a greater investment risk. What is needed, therefore, are primary investors who have a different risk appetite and an operating structure that cuts costs to the bone.

One solution to both of these problems has come from on-line peer-to-peer lenders such as Kiva and MYC4. Lenders on such sites lean heavily in favor of social returns over financial returns. The on-line nature of these intermediaries reduces both operational and transaction costs. As a result, Kiva claims its cost of capital to MFIs is just 1-2 percent, although that does not include the exchange rate risk that the MFIs take.

Still, the benefits of this kind of lending are clear. MFIs have flexible repayment terms and limited liability. In most cases, losses are borne entirely by the lender. In fact, a survey of Kiva users found that 55 percent would lend again if their initial investment were lost.

Since Kiva's launch in 2005, more than 300,000 people have provided \$39 million in investment. In that time, only 10 percent of lenders withdrew their funds. This means more than \$36 million of capital has been provided to MFIs in just three years. While not entirely cost-free (in addition to exchange rate risk, MFIs that receive funds from sites like Kiva have reporting requirements that add to their cost structure), such investment sites can help provide much-needed low-cost capital to MFIs that are unable to borrow from higher cost and more risk adverse investment funds.

Improving the sustainability and viability of a broader range of MFIs

It hardly needs to be said that the capacity of many tier 2 and 3 MFIs – everything from governance and risk management to human resource policies – is lower than that of the best-run MFIs, thus making them less attractive investees for most funds. If the number and range of MFIs in Asia that are viable investment targets is to grow, the issue of capacity building of smaller MFIs must be addressed. While some initiatives do exist, they remain inadequate. Some of today's leading MFIs grew and developed when their home markets were less

competitive, and they benefited enormously from donor funding. Now that the market has become more competitive, it seems counter-intuitive that donor funding for capacity building has not kept pace with demand. Smaller MFIs are expected to become financially sustainable faster and with less support than the MFIs they compete with had during their incubation period.

There is no quick fix for this problem. Building the capacity and sustainability of an institution takes time and resources. And there is no guarantee of success. Understandably, donors and other funders seem reluctant to support this process when viable microfinance institutions already exist in most markets. Nevertheless, the dominance of a handful of MFIs can potentially stifle the competition needed to reduce interest rates and spur innovation. It also may limit outreach because even the largest and best-run MFIs have capacity limits. More effort in this direction is clearly needed.

As microfinance institutions have professionalised and in some cases transformed into regulated institutions, their ability to expand outreach has improved. Nevertheless, there are concerns that too much commercialisation can lead MFIs to loosen their focus on their social mission of reducing poverty. Many commercialised MFIs do show a distinct upward trend in their average loan size, suggesting a drift toward less risky clients and larger profits per client.

Naturally, the rapid increase in commercial funding for MFIs – from nearly zero at the start of the decade to half of all investment today – has reinforced these concerns. In response, the microfinance industry as a whole has begun promoting the concept of social performance management (SPM).

SPM institutionalises a process in which MFI quantifies social goals and then monitors and assesses the progress it makes toward reaching those goals. Even setting social performance goals is a unique experience for many MFIs, and the process of doing so has an impact on managers' thinking regarding their institution's operations. The new data that is collected may be insightful to management as well.

Many funds have endorsed SPM. Although it is still too new to be used widely, the launch of social ratings by microfinance rating agencies such as M-CRIL and PlaNet Rating suggest that funds will increasingly look at social performance as a criterion for investment.

Government regulation

Government restrictions that directly or indirectly limit foreign investment are of course critical to funders' activities, and the difference between microfinance industries in countries which have welcomed foreign capital and those that have not is palpable.

In the Asia region, Cambodia and the Philippines have had the most supportive policies, including central bank supervision, encouragement to adopt best practices as well as open access to international sources of investment funds. These two countries have arguably the most vibrant and developed industries in the region.

Indonesia also has a strong microfinance sector whose roots go back to banking reforms in the 1980s that abolished restrictions on interest rates, credit expansion, and the establishment of new banks. However, more recent regulations hamper further development of the sector by requiring MFIs to have high capital bases. Thus rural banks dominate the industry, and outside a few institutions even these are quite small. NGO MFIs receive little policy support and are not allowed to accept foreign investment.

Other markets in the region have suffered even more under restrictive policies, especially the three biggest potential markets, China, India and Vietnam. MFIs in Vietnam, for example, are barred outright from accepting foreign investment. Indian MFIs have been outlawed from borrowing from abroad since 2002 and while they can legally raise equity through foreign investment the minimum is set so high (US\$500,000) and must be matched by domestic equity that it effectively precludes any foreign investment. China has equally restrictive laws. Chinese policy restricts the involvement by financial institutions in microfinance to those with more than RMB 8 million (US\$1.16m) in

annual assets. Chinese law also forbids non-financial institutions, including NGOs, from supplying any type of financial service. Those involved in microfinance obtain a temporary legal status for their programs. For this reason such organisations have not been able to access investment, making grants their only source of funding.

Nevertheless, there are signs that conditions are thawing. The government in Laos, for example, has recently begun considering allowing foreign investment. In China, the authorities are paying more attention to the sector and in 2007, MicroCred, a subsidiary of PlaNet Finance, succeeded in establishing the first greenfield microfinance investment in the country.

IV. Financing innovations and their potential impact in Asia

The issues listed above mainly put the onus of increasing investment in Asia on the MFIs, their networks and their regulators. While indeed there is much room for improvement in order to expand investment opportunities, even if they were all addressed it may not matter if the investors themselves do not offer the kinds of funding opportunities that the MFIs need. Although straight debt financing remains by far the most common way to invest in an MFI, in the years before the financial crisis, some experimentation with new forms of financing began to be tried, though they made headlines mainly because they were so unique.

Debt

Fixed-income—the provision of loans to MFIs—has so far been the mainstay of microfinance investment, accounting for 78 percent of all funds supplied by private investment funds. In the Asia region, only a few countries have MFIs that are both able and willing to accept this kind of investment. The main countries in this category are Cambodia and Mongolia. In those countries the government has relaxed restrictions on foreign investment and the MFIs have been quick to adopt best practices in order to become attractive investment opportunities.

Moreover, because Cambodia is a partially dollarised economy and Mongolian MFIs lend in dollars, MFIs in those countries are willing to accept hard currency investment from foreign funds. In many other markets in Asia, however, either the government prevents local MFIs from borrowing in hard currency (China, India) or the MFIs themselves have made a strategic decision to limit hard currency investment because of the exchange rate risk.

Since, as a result, the number of funds is high but the number of MFIs they view as investment grade is limited, competition has increased. This has triggered product diversification and innovation. The range of debt products available to MFIs today is broad and includes subordinated loans, long-term loans, local currency loans, and guarantees, among others. Funds also responded by offering large and longer term loans.

However, there are limits to this form of investment. First, the pool of MFIs seeking, and able to service, commercial debt finance is relatively small. Most of the debt is concentrated in the largest 150 MFIs, of which only a few are in Asia. Because they had to offer more lenient terms, many funds increased further their risk concentration toward large, stable MFIs. Debt funds have, on average, 40 percent of their investment in only five MFIs.

Moreover, for these MFIs gearing—the ratio of long-term debt to total capital—has increased significantly. With the average debt-to-equity ratio now at 7-to-1 for large MFIs, additional borrowing will be limited by capital adequacy limits and prudential financial management. Finally, most foreign debt is denominated in hard currency. As MFI managers become increasingly aware of the risks of borrowing in hard currency and the costs and difficulty of hedging that risk, the appetite for more hard currency debt may decline, with a growing shift in currency risk toward investors.

More complex structured funds

Structured finance vehicles represent one of the newest forms of financing in microfinance. Most structured finance instruments pool and repackage loans to MFIs as marketable securities such as collateralised debt obligations (CDOs).

The first formal CDO was structured in 2004–2005 by BlueOrchard in partnership with OPIC and Developing World Markets. Fourteen MFIs received loans with a seven-year maturity, and investors were offered five risk classes of the same maturity. Since then, seven CDOs have been structured, and over US\$525 million in microfinance securities have been issued. Tellingly, however, the only Asian MFIs represented in Blue Orchard's 3 CDOs were from Cambodia and Mongolia, the only two countries in which MFIs are able and willing to accept investment in hard currency.

Equity

In the wake of the current financial crisis it is likely that investor appetite for structured funds that are derivatives of debt instruments will dry up. Moreover, as mentioned above, straight debt investors themselves may also be reaching their limits in some markets in Asia given the lack of investment grade MFIs. Some debt funds have responded by moving downmarket to lend to smaller MFIs. However, the added risk of lending to smaller institutions and the MFIs' own inability to absorb much debt given low capitalisation rates has limited this kind of investment. For smaller MFIs, equity is more needed than debt.

Overall, the supply of private equity finance has been increasing significantly. There have been a few cases in which as banks (both local and foreign) and mobile network operators, take partial stakes in MFIs, partly to gain access to their large customer base and delivery infrastructure. Most importantly, in the past few years eight specialised equity funds have been established in the past few years to invest directly in MFIs. The Council of Microfinance Equity funds currently list 18 members.

These funds have the highest share of their investments in Asia. Financial support for transformation into regulated institutions has increased the number of MFIs in Asia that can take equity. Meanwhile, exit options have begun to emerge. In large markets like India, for example, which has sufficient depth to allow for an eventual public offer, some private equity funds are beginning to take notice of MFIs. For example, Sequoia Capital, a venture capital firm that backed Google and YouTube among others, has invested in SKS Microfinance in India with the explicit expectation that an IPO will yield significant capital gains. Other investors, including those who spoke at the Hanoi conference, are exploring whether to consolidate the various MFIs they have invested in into a larger institution that could be sold to new investors.

Equity investors invited to the Hanoi conference pointed out that providing equity enables them to invest in tier 2 and 3 MFIs with promising prospects for growth and increased value, which has attracted new investors to the fund. Such investors are not put off by what debt investors would see as the risky financial conditions of the MFI as long as they perceive a strong growth trajectory. Developments in this area of financing are one of the most positive for the microfinance industry across Asia.

Greenfield investments

Nevertheless, investing equity in existing MFIs has its problems. The main stumbling block is often the concern about the governance structures of the smaller MFIs, which are not always fully developed. Additionally, there is an information asymmetry between the investors and the managers who have been running the business. Fostering change in operations can be difficult. As such some equity investors have turned to greenfield investments. While the commitment from the investor is higher, the creation of a best-practice MFI from scratch has its advantages. Indeed, global greenfield investors such as ProCredit and MicroCred have created MFIs that are viable in an exceptionally short period of time, adding to the depth of the institutional fabric in the regions in which they invest.

Foreign exchange hedging funds

Eighty-five percent of debt financing to MFIs is in foreign currency. MFIs' appetite for additional foreign currency denominated investment has been reaching its limit, especially for the smaller MFIs. Thus investors are increasingly developing hedging instruments to enable more local currency lending. Some large funds, particularly registered funds and CDOs, have already adopted hedging mechanisms to lend in local currency. ResponsAbility now offers loans in 15 currencies with the ambition to reach 40 in the next three to five years. Yet, most funds are still small and unable to afford the cost of hedging required for local currency loans.

Thus specialised funds that take on the hedging have been created. For example, Cygma, formed in January 2008 as an offshoot of Chatham Financial, a risk management group, has a hedge fund service that works with the funds to provide a larger currency range and deal with much smaller sums of money. Cygma will use their own \$50 million fund to take on the hedge exposure, the money for which is currently being raised, primarily from the major international development banks.

In January 2008, MFX Solutions was created as an offshoot of the currency exchange fund TCX, and specialises in offering cross-currency swaps and forward contracts as well as advisory services to help MFIs manage their currency risks. Similarly, in October 2008 PlaNet Finance, working with TCX, launched MicroFix, a US\$70 million fund that can take on the currency exposures of its participants. The fund is backed by technical assistance from BNP Paribas. The potential for such hedging strategies to increase the flow of capital to smaller MFIs or those in countries that prohibit foreign currency investment is extremely promising.

V. Fostering a more conducive investment environment in Asia: cooperation between public and private investors

Finally, even if the microfinance sectors across Asia create a more conducive environment for investment and the funds provide appropriate investment structures, a substantial increase in investment may not take place until public and private investors begin coordinating their activities more closely.

In many microfinance markets, public and private investors have been competing for the same microfinance investment opportunities. When this happens, public investors often undercut private investors by offering lower interest rates or more flexible terms. This retards the pace of capital market development and does little to address the imbalance between the haves and the have-nots.

It seems obvious that public funds should concentrate on the early-stage (“risky”) MFIs and hand over financing of the more stable MFIs to the private sector, but that is easier said than done. It is not always clear where the dividing line between stable and growing MFIs is. And while many public funders recognise that they should exit the most developed markets by selling their microfinance assets in large, profitable MFIs to private investors, it is not always clear when and how to exit. And exiting from mature investments can significantly reduce overall investment portfolios, conflicting with management incentives that often favor a high-growth strategy.

The MFIs are often equally reluctant to see the public investors sell. Not only do they often offer more lenient terms, but also the long-term commitment and brand value of public funds can be crucial to protect their social mission and provide comfort given the relatively unstable political and socioeconomic contexts within which they operate. Many fear that private investment will be the first to flee in times of crisis.

However, with growing investor appetite for microfinance, public investors have more exit options and greater opportunities to demonstrate their added value by investing where private investors will not.

VI. Conclusion: The Way Forward

The entire Asia region remains exceptionally under-represented in the flow of investment to MFIs given both the current size of the industry and its potential size. The causes for this are on both the demand and supply side. Regulation often limit foreign investment and, even when they do not, the number of MFIs that are willing and able to take investment is limited. Meanwhile, investors have only recently begun to develop the kinds of investment vehicles that can meet the needs of Asian MFIs.

By far the most promising trends for investment in Asian MFIs are the rise of equity investors coupled with foreign exchange hedging strategies. Equity investment provides capital to MFIs while improving their gearing ratios, thus making them able to take on additional debt financing as needed. It also brings a boost to management as almost all equity investors demand board representation.

Meanwhile, the rise of foreign exchange risk hedging strategies may enable investors to get around government restrictions on foreign investment. If proven successful, the number and geographical distribution of MFIs in Asia who can begin to accept investment could grow substantially.

That said, MFIs and their networks often lack the tools they need to facilitate investment. PlaNet Finance’s Asia Invest project of 2007-08 was designed to address these needs with investment readiness training, tips on how to approach and negotiate with investors, and by creating a database on investors for Asian MFIs. Similar initiatives by the SEEP network and others are continuing this effort, although much work remains to be done.

VII. Coda – the impact of the global financial crisis

All of the trends and challenges discussed above were in place before the global financial crisis struck in the autumn of 2008.² At this point it is difficult to tell what impact the crisis will have on the microfinance sector. Most foreign investment in MFIs still comes from people and institutions motivated more by altruism than profit and are primed to accept greater risk. It is unlikely that they will withdraw their funds, though in the current economic climate it is doubtful that they will increase the amount of the money they dedicate to the sector. Thus, it is likely that the growth rate of microfinance investment will come to a temporary standstill, a development that will be perceived as a credit crunch in the sector.

Nevertheless, the crisis may have two beneficial impacts on microfinance investments in Asia. First, it will bring home to the investors the incredible value of financial services. Because financial services - savings, credit, insurance - are intangible it is easy to miss that financial systems are essential economic infrastructure. Where power lines and water mains connect us physically, financial intermediaries link us economically, channeling savings into productive use, spreading and diversifying risk. As people in developed countries begin to imagine life without financial services - no checking account, no health or life insurance, no mortgage – their appreciation for how important financial services are to people rich and poor will likely increase.

Second, and perhaps more importantly, if the sector proves itself to be non-cyclical and therefore defaults do not increase, microfinance may become to be viewed as less risky than previously thought, especially against mainstream financial assets which are now showing enormous volatility. Only time will tell.

Endnotes

- ¹ For more information about Bank Rakyat's success during Indonesia's crisis, see Patten, Richard, Jay Rosengard and Don Johnston (2001), "Microfinance Success Amidst Macroeconomic Failure: The Experience of Bank Rakyat "Indonesia During the East Asian Crisis", *World Development*, 29 (6), pp. 1057-1069. For a general discussion of the non-cyclical nature of microfinance, see Krauss, Nicolas and Ingo Walter (2006), "Can Microfinance Reduce Portfolio Volatility?"
- ² For discussions on the effect of the global financial crisis on the microfinance industry see : Littlefield.E & Kneiding.C, *The Global Financial Crisis and Its Impact on Microfinance*, CGAP, 2009, available at : http://www.cgap.org/gm/document-1.1.1305/FN_52_percent20ENG.pdf and Magnini.B & Powers.J, *Will the Bottom of the Pyramid Hit the Bottom : The Effects of the Global Credit Crisis on the Microfinance Sector*, USAID, 2009.

4. Savings and Asset Building*

I. Introduction

This chapter summarises the ‘Savings and Asset Building’ theme of the Asia Microfinance Forum 2008 and reviews several promising innovations. Industry experts in Hanoi discussed the poor’s great need to save, the lack of appropriate ways for them to do so and the reasons for this supply/demand gap. While many of the challenges discussed have been at the centre of the savings debate for many years, some exciting innovations taking place in Asia were also shared. This chapter expands on these and describes some additional examples of innovation.

Individuals at all economic levels make an effort to save money. We save because we can’t predict the future and life is full of surprises. We save for circumstances such as unforeseen emergencies, retirement or improving our standard of living. For most of the world, savings is a luxury indicative of being able to plan for the future. For the poor however, savings can mean the difference between life and death. As Joy Deshmukh-Randadive from the Indian School of Microfinance for Women remarked in her presentation, “poverty is an experience of risk.”¹

Of all economic classes in society, poor people are the most vulnerable to risks and yet the least protected against its consequences. Like everyone, the poor face life-cycle risks, business risks, and emergency risks including health emergencies and accidents. But for the poor, these risks are compounded when they aren’t adequately prepared with a savings cushion to mitigate them. Most poor people have little savings and even less discretionary income. Without the ability to access savings or insurance, the poor are at grave risk of sinking deeper into poverty from something as seemingly minor as one illness in a family.

While the microfinance movement has focused primarily on providing credit to the underserved, savings is in fact a more critical need than credit has ever been. According to the MIX Market, the value of savings deposits in Asia in 2007 was just over \$7 billion versus a \$10.2 billion gross loan portfolio. However, of these deposits 91 percent is mobilised by institutions in East Asia and the Pacific, including 81 percent with BRI in Indonesia alone. Therefore, despite growth in countries such as Nepal and Pakistan, the challenge of responding to client need in regards to saving is far from being met.²

Internationally, the number of savings accounts reported on the MIX grew from \$18.2 million in 2006 to \$20.5 million in 2007, an annual growth rate of more than 12 percent. It’s clear that when given a choice, the demand for savings products is much higher than that of credit.

The need, desire, and ability of the world’s poor to save are well known and documented. More than any other economic class, the working poor need to protect themselves from financial and economic shocks. Financial and economic shocks impact upon the vulnerable non-poor by undermining productive capacity and taking households below the poverty line.

Financial and economic shocks can come in the form of medical emergency, death or illness, natural disasters, accidents, or a fall in commodity prices (such as oil and food), and can also include lifecycle events such as weddings, funerals and schooling. The consequences of having to pay lump sum fees outside of the daily needs can have a huge impact on the quality of life of a family.

Similar to the product needs of individuals in developing countries, the poor require savings instruments to protect themselves against financial shocks, financing asset purchases, and to smooth consumption.

* This chapter was prepared by K. R. Srikrishna, Natalie Barndt and Chevenee Reavis and of Unitus. Unitus, an international nonprofit organisation, fights global poverty by accelerating the growth of microfinance – small loans and other financial tools for self-empowerment – where it is needed most. Unitus partners with young, high-potential microfinance institutions helping them build capacity, attract capital, and unite with the greater partner network to achieve rapid, sustainable growth. In just 7 years, Unitus has helped its partners serve more than 7 million families throughout India and Southeast Asia, East Africa, Mexico, and South America. Unitus received Fast Company’s Social Capitalist award in 2006, 2007, and 2008. Unitus is a 501(c)3 with offices in Seattle, Washington, Bangalore, India and Nairobi, Kenya. For more information, please visit www.unitus.com.

When assessing the product specifications demanded by the poor, four general themes emerge:

- > Security and safety – both actual and perceived are very relevant to the poor. This segment perhaps more than any other, operate in their day-to-day lives based on trust. Institutions seeking to collect savings from the poor must earn the trust of this segment and a big part of doing so is ensuring the safety of deposits.
- > Convenience - including the timing and amount of deposits, ease of access and transaction costs including explicit costs and opportunity costs like travel time and expenses.
- > Options on terms – including frequency of deposits, degree of liquidity, fixed versus variable deposits and withdrawals.
- > Rate of return – this is generally the least important consideration to the poor but will likely increase in importance as more products become available and competition increases.

Looking ahead, while accumulated savings are considered formal assets, without the acquisition of tangible assets that help increase income, a poor family is likely to struggle longer and harder to lift themselves out of poverty. Like any family, a poor family must save to finance assets like housing or invest in their business livestock, machinery, and/or inventory. Savings for business assets and continuing education can facilitate expanded economic empowerment and eventually be a key driver for alleviating poverty as we know it. As Jamie Zimmerman from the Global Assets Project noted in her presentation at the Asia Microfinance Forum 2008, “lack of income means you don’t get by; lack of assets means you don’t get ahead. Assets are hope in a concrete form.” While this may seem like common sense, financial systems and products are not yet set up widely in Asia to provide adequate means for the poor to save.

While the reasons the poor save do not differ dramatically from the reasons other sectors of the population save, the consequences of no savings are disproportionate for the poor. As several presenters at the Asia Microfinance Forum 2008 noted, the poor overall can’t afford NOT to save. Without a formal support system to save safely, informal mechanisms continue to thrive. While this provides a reasonable short-term solution, long-term, the poor deserve less risky and higher value ways to save and build assets.

II. Issues and challenges going forward

Due to their keen awareness of the need to save, most poor people do so primarily through informal means. These include savings with neighbours, through employers, chit funds, community groups and within their homes. While these methods have been used for generations, they aren’t adequate for long-term, regulated and secure, savings. None of these methods provides an opportunity to earn interest, and in fact, many actually pay to save.

Despite the clear role that savings plays in lifting individuals, families, and entire communities out of poverty, there remains a large gap between the demand for savings instruments and the supply. According to CGAP, nearly 3 billion people in developing countries lack any access to basic financial services, including savings. MFIs understand the great need for the poor to save and are keen to fill this need through their existing relationships with and access to the poor. However, they have not been very successful in doing so due to regulatory restrictions preventing them from accepting deposits. In fact MFIs, co-ops and credit unions combined account for less than 10 percent of all savings accounts, while commercial banks dominate the space with 75 percent of all savings accounts.

To better understand the gap in supply and demand for savings instruments we examine some obstacles faced by microfinance institutions and example of regulations that affect them in the savings arena.

Institutional challenges

The biggest institutional challenges that MFIs face in offering savings products are developing appropriate products, achieving and maintaining profitability with these products, and adjusting their existing operations and infrastructure to support them.

Perhaps the most critical success factor for these institutions is a clear understanding of their customer’s wants and needs early on in the product development process. Like all products, savings instruments must be developed to meet the specific needs of their customers in their particular markets. This can be accomplished through extensive market research conducted on a regional basis.

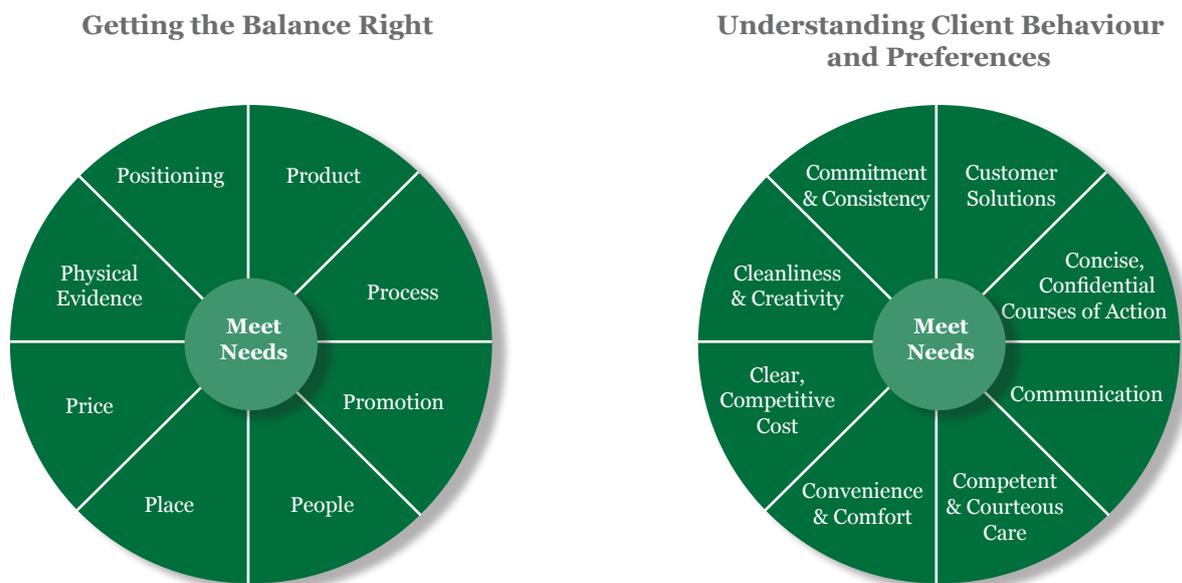
A presentation by MicroSave below points out that products should maintain a balance between the imperatives of understanding client needs, behaviours and preferences (Figure 1).

Once appropriate products are designed, the next challenge institutions will face is ensuring that they can be offered profitably. The low

value and high frequency nature of deposits from the poor makes this challenging. However, several examples of profitable savings products exist. These products should be studied and adapted based on situational and regional requirements. Additionally, financial institutions should consider looking at profitability on a per customer basis over a period of time as this may reveal that early losses are more than compensated for over the lifetime relationship with a poor client.

For those concerned about high costs of introducing new products such as savings instruments, advances in technology should be considered. The use of emerging technologies will likely reduce transaction costs for both institutions and savers. Use of mobile banking and POS (point of sale) devices can enable transactions in broader geographic areas. This will be especially important for serving the rural poor. Additionally, appropriate MIS (management and information systems) can significantly reduce costs as well.

Figure 1: Presentation by Madhurantika Moulik, MicroSave. ‘Savings Mobilisation: Building Assets and Futures’, August 2008. This diagram illustrates factors required in developing products: the right balance between understanding client needs.



In addition to the product development and financial challenges, MFIs also need to adapt their operations and infrastructure to facilitate savings. Collecting savings and performing the duties of a custodian for the public's money is very different from issuing and collecting loans. An MFI adding savings to their product portfolio is adding a new business unit. Accordingly, they need to develop appropriate infrastructure, staffing, culture, and processes for savings. In particular a strong focus on cash management, internal controls, and security is required.

Regulatory challenges

Perhaps more than any other product type, regulatory requirements for an institution to accept savings are extremely rigid and inconsistent across Asia. From the regulators perspective, ensuring the safety and security of the public's savings is critical. Regulators are understandably even more sensitive to this issue when it comes to safeguarding savings of the poor. Therefore, in most countries in Asia only licensed institutions are able to intermediate deposits and many are restricted in their ability to mobilise deposits.

In order to protect savers and ensure stability of the institutions where people save, various regulations apply across the region. In many countries, these include high capital reserve requirements, stringent reporting requirements, interest rate caps, and prohibition of certain financial institutions. In many cases these regulations exclude MFIs from accepting savings at all. Across most countries in South, East and South East Asia, legislation permits the availability of savings products to members of microfinance providers only and places restrictions on amounts deposited for each transaction, time intervals of deposits and withdrawal limits. Large exceptions to this are Grameen in Bangladesh, BRI in Indonesia and rural and cooperative banks in the Philippines.

For example, regulation in the savings sector in India is quite restrictive and most Non-Bank Financial Companies (NBFC's) are not permitted to accept public deposits. Currently, the majority of for-profit MFIs are incorporated and regulated as NBFC's and the restrictions ultimately raise

the cost of doing business in India versus other countries in Asia as they cannot access this low cost capital for on-lending.

Bangladeshi regulations vary across institutional types; to mobilise savings from the general public, MFIs require permission from the central bank, while cooperative societies are permitted to do the same under the Cooperative Societies Ordinance. NGO-MFIs can only mobilise savings as a part of their disbursement programs, while Grameen Bank operates under its own 'Grameen Bank Ordinance' that allows it to accept deposits from the general public and members.

In Vietnam, government regulations require that the largest institutions such as the Vietnam Bank for Social Policies and the Vietnam Bank for Agriculture and Rural Development require compulsory savings and this means that savings products are widely available. These however are also considered partial guarantees for uncollateralised loans.

At the other end of the scale, Sri Lankan NGO-MFIs are limited to credit by law and cannot accept deposits, although in some cases they can intermediate deposits from members only.

To overcome these restrictions, institutions conduct additional transformation into "deposit-taking entities". However, the requirements to becoming a deposit-taking institution are typically very challenging to meet. Transformation is virtually impossible in countries such as India and Sri Lanka due to the combination of discretion in the regulations and the regulator's conservatism, derived from past experiences in which unscrupulous lenders have accepted savings deposits and disappeared. These experiences provide little motivation for regulatory authorities to approve MFIs transformation.

In regions where transformation is not feasible such as in India, or highly restricted as in Bangladesh and Sri Lanka, "work-arounds" and savings surrogates are being developed. Some examples of savings surrogates include long-term endowment life insurance policies and lawful, unregulated programs that allow clients to save for future purchases for commodities like gold.

While regulation to protect savings is critical, more communication is needed between financial institutions and regulators to develop a balanced approach to regulation and policies that both enable and encourage the poor to save safely. In the meantime, financial institutions will continue to transform, where possible, to accept savings and find ways to enable savings where transformation is not feasible.

III. Savings and Asset Building in Asia – recent trends

Despite institutional and regulatory challenges, there are several encouraging trends emerging that will likely narrow the current demand supply gap in the coming years. These trends are occurring at the macro-environmental level, institutional level, and technological level.

Macro-environmental trends:

Both governments and the international development community are responding to emerging data which demonstrate the potential impacts of savings and asset building for the poor. This new awareness is influencing a shift in the international development community's concept of poverty and how to address it. Major funders are dedicating resources to savings. For instance, in August of 2008, the Bill and Melinda Gates Foundation announced plans to donate hundreds of millions of dollars over the next few years to programs designed to spur savings in poor countries. Increasingly, the development community and governments are recognising that asset building policies can provide efficiency, inclusion and opportunity.

Institutional trends:

Institutional trends are occurring in both commercial and microfinance sectors. Traditional financial services firms are increasingly entering new markets as they seek to broaden their base and establish relationships with the future middle class. These organisations are realising that this segment can be served profitably over their lifetimes. Some examples of organisations developing savings products for the poor, often in partnership with MFIs, include traditional banks and insurance companies.

MFIs are also evolving from pure microcredit organisations into true microfinance institutions. Sophisticated MFIs are increasingly seeking to diversify their product portfolios to meet client needs, attract new customers, retain existing customers, generate new revenue streams, and become more cost effective. Perhaps the most compelling reason for MFIs to mobilise savings in many markets is to fund their activities via local deposit mobilisation instead of relying on international grants, loans, or equity.

While adding savings to an MFI's product portfolio has many benefits, institutions need to carefully consider their readiness and the ramifications of doing so.

Technological trends:

Another promising trend impacting the supply of savings opportunities for the poor is technological advancements. The increased experimentation and use of mobile banking, POS devices, and other technologies reduce transactions costs for financial institutions. Some excellent examples of innovations utilising technology are highlighted in the following innovations section.

IV. Examples of Innovation

There are many challenges institutions must overcome when developing a portfolio of savings products, but because of this or despite this, some very innovative products and partnerships are beginning to emerge to fill the gap. Many examples of success are found in innovative partnerships between MFIs and the private sector.

Case study 1: Eko's Abhilasha

<p>The Challenge</p>	<p>Recognising the great need for the poor to save and their limited access to safe, appropriate products, and the desire but lack of knowledge of traditional banks to serve this group, a group of former bankers and payments industry executives formed a company to create a “bridge” between the two.</p>
<p>The Partners and Solution</p>	<p>This group formed, Eko, a New Delhi based financial services company whose objective is to extend banking facilities in untapped/unbanked areas through the use of existing branch networks and new technologies in combination with outsourcing. To fulfil this mission, Eko partnered with Centurion Bank of Punjab (now merged with HDFC Bank) and Airtel, one of India’s leading mobile telephone companies to develop a safe, accessible, no-frills savings product for the poor. To create the distribution network Eko partners with small retail stores regularly used by the poor in their own neighbourhoods (chemist, kirana store, etc) to serve as customer service centres. These are called Customer Service Points.</p> <p>Eko named the product ‘Abhilasha’ which means aspiration in Hindi. Eko’s mantra in developing this product was to keep it simple. The product is a savings account at a commercial bank which clients activate via their mobile telephones at Eko Cash Points. The merchants at these stores act as bank agents, receiving and dispensing cash to account holders and recording these transactions with their mobile telephones.</p> <p>To open an account, the customer provides some minimum proof of identity, such as a ration card or a driving licence at the Customer Service Point and receives a welcome kit developed by the bank. The kit contains operational instructions in local languages and a signature booklet that has a unique serial number. This number is sent to the system from the Customer Service Point tying in the mobile number of the customer to the serial number. The customer also creates a four digit PIN from his/her phone which is registered on Eko’s system.</p> <p>Once the client has an account, they can execute transactions at any Customer Service Point. The service point dealer accepts cash for deposits and dispenses cash for withdrawals. Transactions are performed on the customer’s mobile phone and he/she receives a confirmation of the transaction via text messages. The transactions are recorded on the Eko back-end system directly and then onto the bank account. At the back end, when the customer deposits money and gives cash to the Customer Service Point, the customer’s account is credited and the service point account is debited. The reverse takes place for cash withdrawals at the service point.</p> <p>There is no fee for opening Eko accounts. Transactions fees are no more than 1 INR on average and the client receives the prevailing bank interest on his/her savings.</p>
<p>The Results</p>	<p>Eko has recently completed a successful pilot rollout of the offering in a suburb of West Delhi. This pilot provided 2,000 people with access to new savings accounts. Eko plans to launch the program throughout Delhi and then move to other cities and states in India, targeting a customer base of 50 million in three years with average deposits of Rs. 2000 per customer.</p> <p>Eko is satisfied with the pilot and looking forward to rolling out the program further. “There is huge potential. If we want 30 crore (300 million) people, still out of the banking process, to be included we would need to open bank accounts at the rate of 170,000 a day,” says Sanjay Bhargava, Chairman of Eko.</p> <p>Eko believes that they are harnessing the success of the mobile revolution in India, especially the pay-as-you-go (prepaid) boom and bringing innovation to banking for the poor in India. Industry analysts are excited by the possibilities. Solutions like Eko can potentially revolutionise banking for the unbanked as well as provide significant cost advantages for mainstream banks wanting to tap this market. All this, while providing the poor with a much sought after, yet basic financial service.</p>

Case Study II: Max New York Life's "Max Vijay"

The Challenge	<p>In India, due to regulatory restrictions, microfinance institutions typically operate as non-bank finance companies (NBFCs) and are unable to meet the demand of their clients for savings accounts. Cognisant of this gap, life insurance companies in India have stepped in to create and offer savings proxy solutions linked to insurance policies.</p>
The Partners and Solution	<p>Max New York Life (MNYL) is one of India's leading life insurance companies that aspires to provide financial security to the large under-served millions currently untapped by financial services. To this end they have developed an insurance and savings product tailored for the needs of low-middle income Indians, including blue collared workers, small farmers, migrant workers, small business operators, and daily wage earners.</p> <p>To cater to the need gap in the market MNYL introduced an innovative new product called Max Vijay. The product offers life insurance coverage with a built-in savings component. Max Vijay breaks free of the existing paradigms in insurance with innovations in product and distribution. To purchase this policy, a customer pays a fixed initial amount of Rs. 1000 (USD 20), Rs. 1500 (USD 3) or Rs. 2500 (USD 50) depending on the product variant chosen. Forty percent of this amount is for the purchase of a life insurance policy which provides the client 5 times their life cover for a ten-year period. The remainder of the lump sum payment is invested by MNYL in government securities and equities. The policy holder can make additional payments as low as Rs 10 (\$0.20) into their account at any time. The additional amounts are split ninety percent into savings and ten percent to increase the insurance value.</p> <p>Max Vijay also opened a whole new chapter in insurance distribution with inclusion of the retail channel for sales, premium top-ups, and registration of claims. Customers can buy and top-up their insurance policy from their next-door retail shop, local NGO's, and MFI outlets, offering them unmatched flexibility to save as much they want, when they want and where they want. Additional payments are made by purchasing investment coupons in the form of scratch cards. The number contained on the scratch card is transmitted to the insurance company by the shop keeper through a mobile phone text message along with the customer account number. Once this is verified the stored value on the scratch card is credited to the customer account.</p> <p>Enrolment is also very simple with very basic documentation. The product is backed by IBM's robust technology that enables the premium payments using mobile phones and other point of sale terminals. The customer earns income on the savings portion of the account and the principal on savings is guaranteed.</p> <p>MNYL has partnered with IBM to develop the backend technology support to facilitate this distribution model. This includes development of GPRS enabled hand held terminals that allow instant issue of premium and top-up receipts, while automatically updating the customer account.</p>
The Results	<p>Max Vijay was recently launched in October 2008 and therefore is still at a nascent stage in its evolution cycle. However, the product is highly accessible and flexible, two aspects that the poor look for in savings solutions.</p> <p>The product has initially been rolled out in Northern India and MNYL estimates that Max Vijay has the potential to touch the lives of 10 million people over the next two years. "We truly believe that Max Vijay provides the underserved segment of society with a platform to save even the loose money that they carry in their pockets, in order to secure a financially secure future for their families. The flexibility, convenience and low investment option offered by Max Vijay has the potential to redefine the insurance industry, in the same manner as the pay-as-you-go mobile recharge model had redefined the telecom industry," says Anil Mehta, Sr. Director, New Markets SBU, Max New York Life of MNYL.</p>

Case Study III: Saving for Change

The Challenge	<p>Savings for Change (SfC) is an initiative developed in response to the need for large number of rural poor in Africa and Asia to save. These individuals have no access to banks or other financial services and that situation is unlikely to change.</p>
The Partners and Solution	<p>Saving for Change (SfC) is a joint Initiative of Oxfam America, Freedom from Hunger, and the Stromme Foundation. While Oxfam America is an international relief and development organisation that creates lasting solutions to poverty, hunger, and injustice, Freedom from Hunger is recognised for fighting hunger with innovative self-help programs and is committed to helping families achieve food security for the long term. The other partner, Stromme Foundation, aims at eradicating poverty with education and microfinance as the two principle areas of intervention to free people from poverty.</p> <p>This initiative was designed to serve the markets that institutional lenders are unlikely to reach, by taking an entirely different approach to microfinance service delivery. Instead of providing a loan to jumpstart a business, SfC trains small groups to save and lend to each other.</p> <p>The product works like this:</p> <p>SfC funds local NGOs who employ “animators” who train and support village agents who, in turn, teach groups to manage their own saving and lending activities;</p> <p>Groups of about twenty pool their savings and lend to members at an interest rate determined by the members;</p> <p>The Groups also loan money to members generating interest income, thus growing the group fund. (Most loans are for micro-businesses – generally trading and agriculture – with some loans used for emergencies, and annual events);</p> <p>The group fund is divided among members at the time of the “hungry season” when money is scarce and villagers need to buy seeds and enough food to tide them over until the harvest.</p> <p>Each group is trained to manage its own fund, operating autonomously within one year. Since members quickly learn how to keep their own records, and trained villagers organise and assist groups, the cost of running the scheme is low.</p>
The Results	<p>The first SfC group was trained in April 2005 in Mali. As of June 2008, more than 161,000 villagers had joined Saving for Change groups in Africa and Asia including 49,000 in Cambodia – with these numbers increasing by four thousand per month.</p> <p>Instead of losing money on their savings as they did before, SfC members earn 20 percent to 40 percent on their savings every year. When a small amount of excess cash is saved in a readily accessible fund, members often find that they don’t need to borrow from a money lender or depend on their husbands or relatives (or take out a loan from a microfinance institution) for their financial needs.</p> <p>One woman summed it up this way: “Hope is in the box,” referring to the box with a lock that each group uses to store the money between meetings.</p> <p>The surprising finding with SfC groups is that there is enough “excess liquidity” even in a very poor village to build a fund that is adequate for most needs. Villagers are “not too poor to save,” as has so often been assumed.</p>

V. Looking Forward

As we in the development world seek to creatively increase the poor's access to appropriate means of savings, we should consider the value of partnering to accelerate positive trends and overcome some of the challenges discussed here. Partnering will be an important tool for developing new and appropriate savings mechanisms especially in regions where regulation prevents direct savings. Increasing the role of technology to decrease transaction costs and improve services is an area ripe for partnership. We're already seeing a trend towards convergence and integration of players and fields which will lead to better and more impactful options for the poor to save.

Meeting the needs of the poor and overcoming the institutional and regulatory challenges to provide safe, accessible and appropriate products for the poor will be difficult but the impact of doing so will be great. Several examples of success already exist and experimentation continues. As was pointed out at the conference, it is important that we continue to experiment and share our successes, and perhaps more importantly, our failures.

Endnotes

- ¹ All presentations from the Asia Microfinance Forum 2008 in Hanoi, Vietnam, are available on the Banking with the Poor Network website at www.bwtp.org/amf-presentations-2008.html. This includes those cited in this chapter: 'Savings of the Poor: Balancing Opportunities and Opportunity Costs', Joy Deshmukh-Ranadive, Indian School of Microfinance for Women; 'Savings Mobilisation: Building Assets and Futures', Madhurantika Moulick, MicroSave; 'Savings and Asset Building: Global Lessons, Trends, Challenges and Opportunities', Jamie Zimmerman, Global Assets Project, New America Foundation.
- ² Microfinance Information Exchange, Inc. (MIX) & Intellectap, 2009, *Asia Microfinance Analysis and Benchmarking Report 2008*, MIX / Intellectap, March 2009.

5. Microfinance Networks*

1. Introduction

National and regional microfinance networks¹ are playing an increasingly important role in facilitating growth and development in microfinance. These networks are professional associations that represent a wide spectrum of microfinance providers and act as catalysts for change in the sector. This chapter will look at the specific role of microfinance networks in supporting the growth of microfinance and will discuss the importance of these networks. Issues and innovations unique to microfinance networks in Asia will be considered as well as the outlook for networks in this dynamic and ever-changing region.

Networks have been steadily gaining momentum over the past few years. Their growing influence in the sector is evident by the funding they have received and partnerships they have developed. In 2008, the Citi Network Strengthening Program was launched in collaboration with the SEEP Network. The mission of the three-year Citi Network Strengthening Program is to increase the capacity and scale of the microfinance sector by strengthening the operational, technical, and financial capacity of twelve national and regional microfinance networks, addressing the challenges which the sector is facing and promoting growth and development in the sector.

The SEEP Network estimates that there are 60 active development finance networks worldwide in 82 countries, representing a client base of over 16 million.

2. Role of Microfinance Networks – What Are They and What Do They Do?

Often, when people consider microfinance networks they think of networks that promote a particular methodology through their technical assistance (e.g. ACCION and Women's World Banking) and may have a partial or whole equity stake in their members or partners (e.g. FINCA and Opportunity International).²

Country and regional microfinance networks are different in that they do not promote a particular methodology and they do not own their members. Rather the members are part owners themselves of the network as they pay annual membership fees and normally govern the network through seats on the Board of Directors. Members of these networks have a range of structures (NGO, regulated, commercial, government, shareholder), have diverse target clienteles, employ diverse methodologies, and operate independently of one another.

The primary objectives of these networks are:

- > to **advocate** for policies which promote an enabling environment for microfinance;
- > to **promote MFI performance standards** and best practices;
- > to **develop the capacity** of their members through their services and products such as training courses offered directly by the network or through partnerships with other training providers;
- > to **facilitate information dissemination and exchange** for the entire microfinance industry.

In addition to these core objectives, many networks have responded to the funding needs of their members and have helped connect their members with funders and investors.

Across the globe, microfinance networks have successfully contributed to an increased capacity of their members to offer quality financial services to their clients, to help their members transform into regulated deposit-taking financial intermediaries and to influence important legislation that has helped microfinance institutions to service more clients with more products and services. Networks have been able to successfully prevent caps on interest rates, prevent taxation of NGO MFIs, and promote legislation to allow branchless banking.

Some examples of microfinance networks representing the interests of their members and that have helped to advance the understanding of, and foundations for, creating a strong microfinance sector include:

* This chapter was prepared by CNSP Consultant Kelly Hattel in collaboration with Nisha Singh and Diana Dezso of the SEEP Network.

- > The Pakistan Microfinance Network (PMN) has helped to develop the sector in Pakistan through financial performance monitoring which has helped to build capacity of its members and provides valuable information to external stakeholders. The network recently launched a new online service which allows users to do things such as track performance over time by category, region or institutional type and compare portfolio size.
- > The microfinance network in India, Sa-Dhan, has actively helped to create a facilitating environment for microfinance through its advocacy work. It has been continually engaged in the development of microfinance legislation working with the Ministry of Finance, the National Bank for Agriculture and Rural Development (NABARD) and the Reserve Bank of India (RBI) to provide information on the needs of the sector. Sa-Dhan also helped inform the framework of the microfinance bill in terms of content and was invited by the Parliamentary Standing Committee on Finance for representation from the sector. Their strategy was informed through a seven country study on regulation and supervision conducted by the network and provided as material for the draft process of the bill.
- > The Microfinance Council of the Philippines, Inc. (MCPI), a private sector umbrella organisation of microfinance institutions, has played an important role in providing self-regulatory oversight of microfinance NGOs. While microfinance NGOs in the Philippines are not presently required to report their outreach to any central institution or organisation; they continue not to be regulated but are encouraged to submit standard reports and information to the MCPI. While MCPI does not have the power or the authority to impose sanctions on member organisations, it acts as a benchmarking authority and promotes microfinance performance standards through strategic relationships with the inter-agency National Credit Council in the Philippines Department of Finance.
- > In Sri Lanka, the Lanka Microfinance Practitioners Association (LMFPA) is working with the Central Bank to inform and educate small microfinance providers in the rural and peri-urban areas on the proposed changes in the regulatory framework. The LMFPA is also helping them prepare for transformation from multi-purpose, integrated development approaches to focused financial service providers and so they can eventually apply to the Central Bank to be licensed microfinance institutions.
- > The Credit and Development Forum (CDF) in Bangladesh has been working with small and medium practitioners to help them manage their rapidly expanding portfolios to maintain quality and transparency. The CDF (refinancing) loan fund offers small and medium practitioners a refinancing facility to expand outreach when they are unable to attract commercial funding due to lack of collateral to meet commercial bank requirements. After successful repayments, CDF links these practitioners to commercial banks.
- > In Vietnam, the Vietnam Working Group and the M7 Network have also worked to promote a facilitating environment for microfinance through their advocacy work. They set up a forum and public bulletin with important information on microfinance service providers and trends in the sector. They have involved local leaders in the implementation of microfinance at the grassroots level. They organised field trips for high ranking officials to introduce them first-hand to microfinance operations. Finally, they organised conferences on specific themes and held workshops to address key issues and cooperated with mass media to promote and disseminate information about microfinance to a wide audience. One of the most important aspects of Vietnam's advocacy strategy involved working directly with the State Bank of Vietnam to:
 - > clarify the definitions for microfinance and its products and services;

- › identify eligible organisations to start microfinance operations;
 - › define what represents equity capital, the standard and norms of microfinance management and tax considerations for microfinance service providers.
- › The Banking with the Poor Network, Asia's regional microfinance network, facilitates the sharing of information on best practices and lessons learned regionally through Network-produced curriculums and workshops, as well as biennial Asia Microfinance Forums which focus on reflecting the increasing depth and diversity of the microfinance industry regionally and internationally. It also aims to provide a platform for regional microfinance network collaboration through the hosting of Asia Network Summits.

3. Challenges, Trends and Opportunities for Microfinance Networks

This is an exciting as well as difficult time for the microfinance sector internationally. The sector has grown tremendously over the last several years and has professionalised to a point where microfinance is slowly emerging as a viable asset class for investors. At the same time, anecdotal evidence suggests that the global economic crisis has taken its toll on clients' ability to repay and microfinance providers' ability to attract new capital and to grow their portfolios. Microfinance networks will thus have to rethink their role and strategy to meet the needs of their members in this changing environment.

Some of the biggest challenges faced by networks today include how to meet the needs of an expanding range of types of microfinance service providers – including downscaling banks and upscaling NGOs. This changing landscape requires a nuanced approach that can meet the needs of all members. For example, the Pakistan Microfinance Network (PMN) decided to extend membership to newly created Microfinance Banks (MFB's) once legislation was passed legalising their status. This required the network

to reorganise its governance structure (to include representation from all membership types), to diversify its services to respond to the needs of different types of organisations and to expand its advocacy agenda to include the interests of both unregulated and regulated microfinance providers.

With a number of high profile crises in the area of consumer protection, networks have been challenged to effectively articulate and enforce standards within the industry. Some networks have existing codes of ethics for consumer protection but few have been able to translate these codes into practice. Networks have also often had a difficult time communicating their mission, vision and purpose to their members as well as to an external audience. Funding and financial viability remain the greatest challenges networks struggle to overcome, once the initial seed money runs out.

Each of these challenges represents great opportunities for networks. With an increasing diversity of members, networks have the chance to develop new products and services and to think creatively about new ways to help their members increase and deepen their outreach and to do so in more cost effective and innovative ways, particular through the use of technology.

In the Philippines, mobile banking has allowed microfinance providers to reach further into rural communities. Networks also are in an important position to help their members increase the quality of the products they offer through new product research and testing. As competition increases, clients have more choices and MFIs must be able to respond to this demand with the best possible products they can offer. To support further innovations for example, the Microfinance Council of the Philippines (MCPI) is managing a product innovation fund, which was launched in 2008. The fund seeks to encourage and motivate MFIs to develop innovative microfinance products and services that will target poor individuals and households in hard-to-reach and rural areas. MCPI also promoted product innovations during their June 2008 conference, "Powering

Innovations in Microfinance,” held at the Asian Development Bank Headquarters in Manila. The conference brought together microfinance practitioners, regulators, government agencies, networks, and other support organisations and gave them a platform to share experiences and learning about innovations in microfinance.

Many governments, investors, boards and managers of MFIs are interested in tracking not only the financial performance of MFIs but also the social performance. Networks are well-placed to drive the development of appropriate tools to track social performance and to conduct research around the topic and test methods that can help MFIs better achieve and track their financial and social performance goals. The Microfinance Centre (MFC) in Poland has spent much time developing training and tools that do this and they are now sharing their experience with networks in Asia such as MCPI in the Philippines. Having reliable and credible data on social performance is a fundamental component of educating the government and the public about microfinance – the types of people who are being reached and how is it helping to improve their lives. This is a very useful and appropriate role for networks.

Networks around the world have an opportunity to work with their members to increase consumer protection of microfinance clients and help differentiate their members from unscrupulous financial service providers. Working with global initiatives such as Transparency International and ACCION’s “Beyond Codes” networks can hopefully find lasting solutions to the dilemma of putting theory into practice.

Crafting a strong brand for a network requires clarity of mission, vision, goals and objectives. Networks must learn how to communicate these effectively to members, government bodies and other important external stakeholders. With strong branding, a network can most effectively create a positive image of the sector, which in turn strengthens its ability to advocate effectively on behalf of its members and to increase its credibility in the eyes of government, members and funders.

4. Microfinance Networks in Asia

What makes microfinance networks in Asia unique? For the most part, networks in Asia face many of the same issues with which other networks contend. There is a range of well-established networks such as those in India, Pakistan, Bangladesh and the Philippines and a number of more nascent networks like those in Lao PDR, Vietnam and China.

In terms of their members however, there are a few characteristics that make microfinance in Asia somewhat unique from other parts of the world, particularly in terms of the structure of microfinance in the region. Many lenders in Asia have a strong social orientation coupled with a group based lending approach as opposed to a more financial and individual lending focus in other parts of the world. This kind of approach leads to higher outreach numbers, reduces costs, but limits the number of products which can be offered.

With massive populations and high concentrations of borrowers, Asia dominates microfinance around the world in terms of overall outreach. According to Mix Market, as of 31 January 2008 and reported in *2007 Mix Asia 100 Ranking of Microfinance Institutions*, the 392 MFIs surveyed were reaching more than 40 million borrowers with \$8.4 billion in loans and providing savings mobilisation services with over 50 million voluntary deposit accounts totalling more than \$6.3 billion. 75 of the top 100 MFIs in Asia surveyed came from South Asia including 29 from India, 26 from Bangladesh and 10 from the Philippines. 13 of the largest MFIs in the world, in terms of number of active borrowers, are located in Asia.

Considering the unique context of the microfinance industry and the fact that the sector has grown rapidly, Networks in Asia have a significant role to play in guiding the future direction of this growth. In order to meet the changing demands of the market and to respond to competition from a wide variety of players (both commercial and non-profit), microfinance providers in the region will need to look to diversify their products. In turn, Networks will need to diversify their products and services as well.

5. Opportunities and Challenges for Networks in Asia

Microfinance in Asia has been adversely affected by the global financial crisis, however the impact has varied by country in effect and severity. In areas where it hasn't yet had a visible impact, it is likely that an increase in food, fuel and other commodities along with a global recession will reduce demand for micro-entrepreneurial goods and constrict remittance flows and reduce many clients' ability to repay their loans.

Participants in a recent virtual conference hosted by CGAP on the impact of the financial crisis on microfinance indicated some more specific effects or likely expected effects of the crisis. Microfinance networks need to take all of these points into consideration when reviewing their strategies in light of the new challenges and seemingly overwhelming constraints this global crisis is bringing to their members.

1. Many MFIs are now facing or will soon face a liquidity crunch reflected by an increased cost and decreased availability of capital from banks and investors. There is also indication of an increase in the risk of withdrawals of deposits.
2. There has been an increase in the portfolios at risk (PARs) in many countries. Incentives to repay may be undermined and the ability to repay is threatened in some places.³
3. Foreign currency exposure brings additional risk and cost in addition to commercial bank failures and a drop in remittance fees.
4. In terms of investor inflows, contributions to microfinance investment vehicles seem cautious but steady.
5. Donor flows may shrink and be diverted to other sectors.
6. There may be policy implications of the crisis which may help or hurt microfinance (networks should take special note of this point).
7. Regarding the last point, one participant, Claudio Gonzalez-Vega of Ohio State University, noted,

“The crisis has the potential to trigger changes in regulation, either by distracting regulators from implementing helpful policies or by encouraging them to take more conservative/restrictive approaches to microfinance”. Citing other ways short term government actions could harm microfinance in the long run, he noted, “The risks include interest-rate ceilings, mass loan forgiveness⁴, the encouragement of delinquent borrower associations, the development of credit programs in government agencies that lack financial expertise, and the like. Several of these actions are already observed in a number of Latin American countries. On the positive side, the relative stability of deposit taking MFIs may motivate transformation or adaptation of regulatory frameworks allowing strong performing NGOs to mobilise deposits (e.g. current initiatives in Bolivia).”

With these multiple affects (real or likely) in mind, microfinance networks in Asia and elsewhere will need to reassess the needs of their members in light of these current and continuing economic challenges facing their members. One participant from the virtual conference, Mark Breij of Cordaid, outlined a number of sound suggestions for MFIs wanting to “maintain their operating margins and strengthen their operations during the crisis.” Networks have an important role to play in a number of these areas through research, training, direct support, or through partnerships. Some specific ideas of the networks could play include:

1. Tighten credit evaluation and utilisation checks;
2. Commit to a simple lifestyle (MFIs) – spending for wants and needs;
3. Adhere to code of ethics, minimise competition in the sector;
4. Review your portfolio, best time to take stock;
5. Sustain the confidence of microfinance clients – visibility of the leadership of the MFI should be more transparent, be in touch with the various needs of clients - this is an opportunity for them;
6. Lever with government and NGOs, get other investors to get involved;

7. Restrict services, however health and education are priority needs of families – MFIs need to address;
8. Recognise the risk/loss upfront rather than wait for the loss to happen.

Another set of concrete advice was offered by C.J. Agwu, Agric Banking FMFB, Lagos Nigeria, “What MFIs can do to mitigate liquidity risks? Be savings led and inspire your clients to save, match savings with loans, avoid funding mismatch, develop an array of savings and deposit products, be market and fund driven, never depend on bank loans, rely less on donors and oversee funds, do not compete with commercial banks, avoid high volume loans, lend short and lend small, slow down on lending-race up to savings.”

Recent studies and the CGAP virtual conference indicate that savings-led institutions are better able to cope with the crisis as they are less dependent on external funds to finance their portfolios.⁵ In this regard, networks have an opportunity to support their members in transforming into regulated deposit-taking financial intermediaries.

Stepping back from some of the specific ways that networks can respond to the needs of their members in order to best meet the needs of the sector, all networks must build their capacity and ensure their own viability.

While nascent networks such as those in Lao PDR (established in as a working group in 2007), the China Association of Microfinance (founded in 2005) and in Vietnam (founded in 2004) may have limited human resources and funding, it is important that they begin early to establish proper foundations for building strong networks. Even at this early stage of development they should draft strategic plans that lay out the mission and vision for the network and short and long term objectives for their work. They should develop business plans which put the strategies into practice, laying out more specific objectives, targets and activities to help them achieve their goals. While doing their planning, networks should prioritise their strategic objectives based on member needs and their own capabilities as well as availability of

resources. There are a lot of activities a network can engage in but it isn't advisable or realistic for a network to do everything on its own. Building strong relationships with external organisations and developing strategic partnerships will be important for growing the network over time. Conducting a base-line survey of member needs will help to inform the products and services that the network can offer its members. They will need to establish monitoring and evaluation systems to effectively follow their progress on a regular basis. Developing a budget that reflects the financial needs and goals of the networks is equally important.

As most of the founder members of microfinance networks are often members of rapidly expanding MFIs they do not have the time and often the capacity to develop strategic plans and design appropriate network services that can meet the requirements of all the relevant stakeholders. Often MFI leaders are influenced by their own methodologies and are not aware of the specific problems and challenges of other smaller and lesser known members, affecting network cooperation and congruence of vision, mission and objectives. In some cases, microfinance network board members assume responsibility for day-to-day supervisory work. They often do not have the time to focus on network issues as they have their own responsibility to their own institution. Recruitment of inexperienced staff that lack the technical knowledge and maturity to take initiative, communicate effectively with board and other internal and external stakeholders, and provide leadership for all network activities, without the board's immediate guidance limits the effectiveness and action of networks. Governance and management of microfinance networks is a different type of skill and expertise than managing microfinance institutions. It is therefore not surprising to find that in countries that are dominated by large and successful microfinance organisations, the microfinance networks are not as effective and efficient as they could be.

Emerging networks need to focus on expanding the foundation they have put in place. Establishing a strong governance structure that ensures regular and proper oversight of the networks with clear roles and responsibilities for board positions is critical. Strengthening the networks' operational structure is key at this phase of development. Further developing domestic and international connections can help networks to grow and evolve. Just as MFIs are encouraged to diversify their funding sources, so follows the advice for networks. With funding from different sources, including membership and training fees, networks can leverage these to attract new sources of funds and can expand the activities that they offer. When networks are not beholden to only one or two donors, they are better able to reduce the financial risk of losing one or two donors and can increase autonomy over their activity planning. Networks must invest time and energy into putting these pieces of a foundation in place in order to create a transparent and responsive network that is strong, dynamic and relevant.

Expanding networks have a solid foundation in place and a positive track record for performance. Networks at this point are likely ready to expand their membership or governance structure to bring in new types of members and in turn expand their service offering. This is the time to institutionalise systems and procedures that help the network to function effectively. Recognition by key stakeholders and members of the networks' achievements, reflect the strength of the networks' governance structure, operations, human resources, financial situation and its services.

Mature networks are vibrant and responsive institutions that have achieved a high level in each of the areas of network effectiveness. These networks must work to remain relevant, focusing on ways to help further grow and develop the sector, including serving their members with dynamic, demand-driven services.

6. Innovations in the Region

Innovations in microfinance are continuously taking place across Asia. These innovations help microfinance extend its reach to rural areas and to provide products and services to clients that are more accessible, secure, as well as highly cost effective.

One of the most exciting developments in microfinance is the growth of mobile and branchless banking. The Philippines has seen dramatic growth in this area. With over 60 million mobile phone subscribers and around 98 percent on prepaid services and with international remittances worth an estimated \$16 billion in 2008 (representing approximately 13 percent of the country's GDP), microfinance providers in the Philippines are tapping into an exploding demand for mobile banking services.⁶ One of the largest mobile phone service providers, GCASH has over 6,000 domestic outlets in the Philippines with 1.9 million subscribers. A partnership with The Rural Bankers Association of the Philippines (RBAP) is helping to further expand existing mobile phone banking services of rural banks. Rural banks have integrated GCASH into their operating systems using the GCASH payment platform developed with RBAP's Micro-enterprise Access to Banking Services (MABS) program. Mobile banking allows financial institutions to reach more clients with a much wider range of services which are accessible, convenient and quick.

Regulators in a number of markets do not permit operators to offer mobile payments services on their own.⁷ In Pakistan, the Pakistan Microfinance Network (PMN) contributed to efforts to clear the way for microfinance providers to be able to utilise branchless banking. In April 2008, The State Bank of Pakistan (SBP) issued Branchless Banking (BB) Regulations, applicable to all banks including Islamic and microfinance banks in order to encourage innovation and increase outreach of the banking system⁸

Also in Pakistan, PMN has succeeded in launching a pilot credit bureau in Lahore, where clients access loans from multiple sources. Based on a PMN study 'Dynamics of Microfinance Expansion in Lahore', the pilot credit bureau will provide the foundation for creating a national credit bureau for microfinance which will be informed by the PMN. In Cambodia, the IFC is working with local partners to develop a credit bureau for the entire financial sector.

7. Looking Forward

The microfinance industry in Asia, as in other parts of the world, will continue to be affected by the current economic crisis – some countries less than others. Nonetheless, all microfinance providers and networks that support them will have to adapt to the reality that capital will not flow as freely as it has in the past as investors tighten their due diligence and raise their expectations of social and financial returns. This means that the sector will need to strengthen and prepare itself for new challenges.

As mentioned earlier, a focus should be placed on supporting the development of more savings-led service providers and facilitating transformations of credit-only microfinance providers into regulated deposit-taking intermediaries. Not only will these institutions be able to weather future economic downturns better, but clients can utilise their savings to help themselves meet their financial struggles rather than only having the choice of a loan.

In terms of advocacy, networks need to be engaged, pro-active and relevant. Members look to their networks to lead the way based on member input but also based on a network's ability to anticipate market trends or legislative moves that might adversely impact microfinance. Or, networks need to be ready to react quickly to changes in the economic conditions in which microfinance providers operate. For example, in response to the global financial crisis, the Azerbaijan Microfinance Association (AMFA) is

lobbying to relieve some of the tax requirements for microfinance providers in the country. This is one way in which networks are working to reduce the burden of the crisis on their members.

In light of the current economic conditions, microfinance networks will have to rethink their member strategies and fundraising approaches. One of the greatest opportunities for the future success of microfinance networks will be in their ability to forge meaningful partnerships in a number of key areas, including training and fostering innovations and exploring the use of new technologies. So many past successes of networks have been ones which capitalised on the technical and financial resources of other key stakeholders. Partnerships will continue to be a key in maximising impact.¹⁰ Learning from the successes and mistakes made by other networks can also be a valuable opportunity to draw upon examples in similar financial markets. Most importantly though, microfinance networks must make sure that the fundamentals of network effectiveness are in place, building on strong foundations in order to create organisations that can best serve the needs of the members and the sector.

Endnotes

- ¹ Also referred to as microfinance associations (MFAs), network support organisations (NSOs), apexes and councils.
- ² For a discussion of types of microfinance networks see: Isern.J & Cook.T, 'What Is A Microfinance Network? The Diversity of Networks in Microfinance Today', Focus Note 26, CGAP.
- ³ Recent informal reports from Pakistan indicate that while some clients want to repay their lender because they want to be able to access services in future, in other parts of Pakistan, clients are refusing to pay back because they believe that the MFI won't be around for much longer and thus the likelihood of receiving the next loan is low (as is the incentive to repay).
- ⁴ A similar action was taken by the Indian Government in 2008 when approximately \$12.2 billion of farmer loans were waived, to the detriment of the microfinance sector.
- ⁵ This issue is addressed at the following websites: CGAP, 'The Global Financial Crisis: What does it mean for microfinance?', available at www.cgap.org/p/site/c/template.rc/1.26.4511.
- ⁶ Rosenberg, J, 2008, 'Mobile Banking in the Philippines: Interview with Globe Telecom's Rizza Maniego-Eala, CGAP Website <<http://technology.cgap.org/2008/11/25/mobile-banking-in-the-philippines-interview-with-globe-telecom-percentE2-percent80-percent99s-rizza-maniego-eala/>>
- ⁷ Mas. I & Kumar.K, 2008, 'Banking on Mobiles: Why, How, for Whom?', CGAP Focus Note, No.48, CGAP: Washington.
- ⁸ 'State Bank issues branchless banking regulations', Daily Times Pakistan, 2nd April 2008, <http://www.dailytimes.com.pk/default.asp?page=2008-percent5C04-percent5C02-percent5Cstory_2-4-2008_pg5_11>
- ⁹ A joint study looking to understand and document the multidimensional demand-side (microfinance service providers) as well as supply-side (microfinance clients) dynamics of the rapid growth experienced in the urban microfinance market of Pakistan.
- ¹⁰ The Banking with the Poor Network has developed a training module - *Capacity Building for Partnerships in Microfinance Trainer's Manual* - which focuses on building the capacity of microfinance providers to identify, develop and nurture effective partnerships.

6. Microfinance and Technology*

I. Introduction

Technology has the power to transform the microfinance sector and reach previously unbanked (or underbanked) clients. A wide range of technologies are available to help microfinance providers improve efficiency, track operations more accurately, increase transparency, and reach new customers. Yet the majority of microfinance institutions struggle to select the right technologies and get the most from their investments. What is the best way to leverage technological innovations to expand and deepen the impact of microfinance?

Overview of technology and microfinance

Traditionally, microfinance institutions (MFIs) have utilised technology in two main ways: for **information management** (client databases and financial management) and as a **delivery mechanism** to support electronic transactions using Smart Cards, POS systems, ATMs or mobile phones.¹ Information technology helps MFIs to track, analyse and report on operations, record client information and transmit data among branches. Strong information systems, including management information systems and financial information systems, are critical for sound financial institutions.

Non-traditional delivery technologies, such as automated teller machines (ATMs), point-of-sale (POS) networks or mobile phone banking (sometimes combined with the use of mobile money), are utilised by some large MFIs and banks. These technologies allow customers to make payments, transfers, withdrawals, and deposits outside branch offices and are described in detail below. While these new delivery technologies have the potential to reduce the cost of serving the poor and have in fact begun to demonstrate this in a few countries, adoption has been slow in many countries.

Increasingly “branchless banking” is demonstrating the potential to radically change the access to financial services for low-income households. Orthodox banking through branches is now complemented by branchless banking.

Branchless banking is an innovative way of making financial services available through the utilisation of information and communications technologies such as card-based networks or mobile phones through non-bank retail agents. It harnesses the power of technology to deliver financial services at a much lower cost to both the client and the financial institution. Branchless banking includes both the use of mobile phones to conduct remote transactions and card-based branchless banking networks². While historically the card-based model has been successful in South America, the newer mobile phone banking model has become the important model in many Asian countries, including Afghanistan, India, Mongolia and the Philippines.

Types of technologies

Forming part of the broader electronic payments or “e-payments” are **Point-of-Sale (POS)** networks. POS networks allow the exchange of electronic value through using means such as ATMs and internet-based payments³. POS technology typically refers to devices that have connectivity and are placed at retail outlets for payments and disbursements. MFIs can use POS networks to outsource a large number of routine banking transactions to a retail outlet. However, POS systems, ranging from \$400 to \$800 per device along with the overall total cost of ownership, including software licensing and maintenance, can make this option an expensive one for the average MFI. Banks using POS networks have demonstrated their capability to process transactions quickly, allowing infrastructure costs to be spread across a high number of transactions. Two important features of POS: they can print customer records of transactions and can allow customers to use their bank card to make payments using the existing POS and ATM terminals that are already deployed in a given country. Printed records have been found to be an important service for low income customers with limited trust in the reliability of financial service providers. POS networks have been the primary device used by banks in South America to provide branchless banking services.⁴

* This chapter was prepared by Anna Bantug-Herrera and John Owens, Asia Region, Chemonics International. Chemonics International implements the RBAP-MABS program on behalf of USAID. The paper draws both from what was presented at the conference as well as other material from Chemonics, USAID's RBAP-MABS program and CGAP, among other sources.

A **Smart Card** functions as a data storage and information processor, which can either take the form of a wallet-sized plastic card with an embedded microprocessor computer chip or a data-storing memory chip.⁵ Card technologies, like Smart Cards, can be used for such financial services as managing savings accounts, disbursing loans, or making transfers. During enrolment, all relevant client information, account balances, and individual credit or other limits are loaded onto the card through a recording device attached to a PC or connected to a network. Some unique form of personal identification (e.g. the numeric markers of the client's fingerprint) may also be stored on the card (see below on Biometrics). During visits to a branch office, the Smart Card functions as an electronic passbook on which transactions can be recorded once, speeding up the process and improving accuracy. Over the past few years, Smart Card technology has become prevalent among MFIs in India, such as SKS Microfinance⁶ and Janalakshmi Social Services⁷.

Biometrics applies biological authentication systems, such as fingerprints or voice pattern, for identification in transactions. Biometric authentication has proved useful in places where biometric teller machines (BTMs) can be installed and literacy rates are low.⁸ Customers no longer have to rely upon signatures or filling out documents - they can simply provide their fingerprints to authenticate themselves and access their accounts through BTMs, which reduces the need for MFI staff. It also increases efficiency for borrowers, particularly those less literate, because they can avoid signatures and paperwork. This technology has recently become popular in India (ICICI bank) and Indonesia (PT Bank Danamon)⁹.

Either bank-owned and operated or outsourced to a third party, **Automated Teller Machines (ATMs)** perform multiple transactions such as the provision of account information, accepting deposits, drawing down on pre-approved loans and transferring funds. This reduces the need for loan officers to undertake these transactions. ATMs however may not be practical for those MFIs that do not offer savings products or require flexibility in terms

of location or accessibility. ATMs are dependent on a constant and reliable source of electricity and communications and can cost as much as \$15,000.

Recently, however, third party ATM networks have become available in the microfinance sector. For example, ENCASH Network Services, the Philippines' first Independent ATM Transaction Processor, provides MFIs the full complement of user services associated with an ATM network.

ENCASH locates privately-owned ATMs at rural bank sites selected for their proximity and strategic locations, allowing customers to perform ATM withdrawals while charging a convenience fee that is shared between the third party and the bank. ENCASH provides the ATM, trains the rural bank, funds the maintenance for the equipment and by way of connecting the ATM to the ENS network transaction processor, will ensure the satisfactory operation of the device.

The rural banks provide the cash loading and perform day-to-day cash management, including the supply of "ATM-fit" currency notes, first-line maintenance such as ATM terminal balancing, jam clearing, and replenishment of all consumables and other related services, including reasonable care of the ATM and its customers. This model is extremely popular among several rural banks in the Philippines, with 49 rural banks in 30 provinces currently signed up as ENCASH partners.

Payment services on **mobile phones** are becoming increasingly popular in microfinance, partly due to the ubiquity of cell phones in the developing world. The concept of "mobile commerce" involves the buying and selling of goods through the use of wireless handheld devices.¹⁰ The development of new mobile money or "electronic currency," allows transactions to be stored, paid, received and sent using mobile phone. It is important to note the mobile phone based solutions for microfinance typically utilise USSD (Unstructured Supplemental Service Data) or STK (SIM Tool Kit) and SMS (short message service) and not internet platforms that require an internet connection on a mobile phone.¹¹

For MFIs, mobile phones offer a cost advantage over the use of POS systems since many more people have access to mobile phones and the cost of maintaining and deploying a POS-based system would be much more expensive than a mobile phone-based solution.¹² Using a mobile phone-based system is ideal in lower transaction volume environments (small or rural villages or with small merchants). Ultimately however, at any given transaction volume, the mobile phone can offer a lower cost infrastructure. In countries where mobile money is being rolled out in Asia, such as GCASH and Smart Money in the Philippines, MFIs are able to take advantage of these payment platforms to facilitate microfinance services.¹³

Various mobile phone banking models have enjoyed success in Kenya (M-Pesa), South Africa (Wizzit) and the Philippines (GCash).

Web 2.0 refers to a second generation of web development and design that aims to facilitate communication, secure information sharing and collaboration on the internet. Web 2.0 concepts have led to the development and evolution of web-based communities and applications such as social-networking sites, video-sharing sites, wikis and blogs. Web 2.0 tools, primarily peer-to-peer (P2P) networks, social networks and blogs are now used with some success in microfinance.

Since 2005, the advent of peer-to-peer lending sites like Kiva and Wokai have attracted thousands of individual investors to the sector and greatly increased the exposure of microfinance internationally by allowing the general public from across the world to invest small amounts with their credit cards. These platforms are not-for-profit and do not provide a return on lenders investments beyond repayment on the initial amount loan. MicroPlace operates as a broker/dealer and uses a model whereby investors purchase securities which are in turn invested in microfinance institutions. MicroPlace is registered with the US Securities and Exchange Commission and operates on a for-profit basis. Currently most P2P lenders are simply intermediaries between the “peers”, i.e. the lenders and the borrowers, and there is little direct contact between the two parties.¹⁴

Issues and Challenges in using ICT solutions for microfinance

Although there are a number of benefits in utilising technology in microfinance, there remain key challenges facing the further integration of technology into the sector.

Overall issues related to ICT and microfinance include infrastructure requirements such as a stable power and adequate telecommunications coverage and the country’s legal and regulatory framework related to some of the newer technologies, such as mobile phone banking. Most IT systems and equipment require a stable power supply to function, which may be an issue in some developing countries. Other technologies, such as ATMs and POS, might require regular telecommunications service to transmit information, which may not always be available, although the new development of wireless ATMs is beginning to show promise in addressing this issue. A challenge facing the development of mobile financial services in some countries is adequate regulation and the proper legal framework in which to operate. Some regulators, such as in South Africa and the Philippines, have been more open to mobile phone banking platforms and the use of mobile payment platforms than others.¹⁵

From a microfinance provider perspective, issues include budgeting carefully for IT infrastructure to focus on priorities, developing staff capacity and helping to raise awareness and educate clients about new technologies.¹⁶ MFIs need to plan carefully for IT systems and select an appropriate technology to meet client needs. Also, they need to invest in training their management and staff in these new technologies. Probably one of the most challenging tasks for the MFIs offering new technology solutions is to provide financial education for their clients in order to alleviate concerns related to lack of understanding of electronic banking services, lack of trust in new technology and low levels of technological literacy. It is critical to increase clients’ level of confidence to access financial services using the technology in order to address customer adoption hurdles.

II. Microfinance, Technology and Innovation in Asia

Opportunities and regional trends

The Asia Pacific region boasts a huge potential market of 4 billion people (over 60 percent of the world's population), which offers many opportunities. Youth is a fast growing segment and comprise approximately 18 percent of the total population or over 650 million people.

Asia houses some of the oldest and most vibrant markets for microfinance in the world, such as Bangladesh and India. In parallel, some of the world's most advanced technologies and cutting edge innovations are also being developed in Asia in countries like Japan, South Korea, Taiwan and India. In some countries, this proximity provides easy access to new and relatively inexpensive technologies. For example, mobile phones are nearly ubiquitous throughout many parts of Asia and many people utilise SMS (or text-messaging) on a regular basis. Some of the most intriguing locations – from conflict hotspots such as Afghanistan and Pakistan to the remote and sparsely populated countries such as Mongolia and Maldives – are also in the region. Being located in some of these more difficult environments forces people to innovate to reach rural areas and deliver financial services.

In terms of regional trends, there are some recent developments in technology and strategic partnerships (see partnership section below). Technologies such as biometrics and mobile phone banking have become increasingly popular in Indonesia, India and the Philippines, respectively. While P2P lending networks such as Kiva and Microplace are attracting international attention, there are also smaller players such as Wokai, which offers similar services focused exclusively on China. In Indonesia, MercyCorps has teamed with the Gates Foundation to launch a “bank of banks”, an innovative approach to poverty reduction that will support the growth of the microfinance sector. This \$19.4 million project includes the creation of a commercial

bank that will partner with thousands of MFIs and expand access to financial services for the poor. MercyCorps intends to use state-of-the-art platforms like mobile phones which will give struggling families access to savings, loans, insurance and other resources to help build financial security. Other partnerships are proliferating across the region, including strategic alliances between MFIs, private sector firms and MNOs.

Key Examples From Around Asia

There are a number of exciting innovations in Asia that were highlighted at this Forum, including mobile phone banking in the Philippines, smart cards in Sri Lanka, and web-based peer to peer lending in China. We will highlight these initiatives briefly, and then describe a few other cutting-edge developments in other parts of Asia.

In the Philippines, several innovative organisations are involved in the dramatic growth of mobile phone banking. USAID's Rural Bankers Association of the Philippines (RBAP) Microenterprise Access to Banking Services (MABS) programme, which provides technical assistance and training to rural banks, approached Globe Telecom in 2004 to propose banking services that could be facilitated using the GCASH platform.¹⁷ Green Bank¹⁸, which has 112 branches and kiosks, was one of the first rural banks to pilot mobile phone banking with RBAP-MABS and now offers this service in all of its branches. By introducing mobile phone banking services to its staff first through a payroll service and also enticing local merchants to accept GCASH, the number of transactions grew to over 44,000 - worth about \$3 million during 2008. GM Bank has opened a satellite office in a small town where loan officers can convert their collected funds to GCASH to send to the main branch via text. SMART Communications is also working on mobile money pilots with MFI NGOs. Finally, without the support and flexibility of the Philippine Central Bank (BSP)¹⁹ regarding electronic money and banking, none

of this would've been possible. BSP has issued a series of circulars outlining the regulations for e-money including issuer guidelines, technology risk management and consumer protection for e-banking.

In Sri Lanka, Hatton National Bank²⁰ has partnered with the government post offices to offer a range of financial services utilising a smart card. The smart card can handle savings transactions and loan disbursements and can also be used as a credit, debit and ATM card. The transactions are performed directly from the client's card to the agent card using a terminal in one of the 6000 participating post office branches throughout the country.

As mentioned earlier, P2P lending sites have been gaining in popularity since Kiva was launched in 2005. One of the few, Asia-based, P2P firms is Wokai²¹, which is headquartered in Beijing. Wokai provides an online platform via its website that connects contributors with rural entrepreneurs in China to help them start small businesses. The website houses information on the "community" including borrowers, contributors, field partners (MFI NGOs) and groups around the US that support the entrepreneurs. Wokai is unique since it focuses exclusively on China, where there are less than 100 MFIs - only three MFIs with more than 6000 clients - despite the fact that there are 300 million people living on less than \$1/day.

There are a growing number of other initiatives blossoming across Asia - even in some of the more difficult environments. In conflict-prone Afghanistan, Vodafone and Roshan have partnered to launch a service similar to the successful MPESA in Kenya called M-Paisa. This service enables registered customers to transfer funds via SMS using their mobile phone in a quick, easy, safe and cost-effective manner, for peer to peer transfer, repayment of microfinance loans and salary disbursement. In October 2008, M-Paisa introduced voice-recognition technology (IVR) to simplify the overall customer experience.²² The voice activated menu is functional in English, Dari and Pashto

and enables all clients to conduct transactions, regardless of their literacy level. The M-Paisa service is regulated and approved under the Central Bank Regulation and supports Sharia principles of Islamic financing.

In remote Mongolia, where population density is extremely low - at about one person per square kilometre - one of the largest MFIS, Xac bank²³ has partnered with local mobile phone service providers to offer multiple financial services and products via mobile phone. Instead of building new banking branches, XacBank created alliances with pre-existing networks of suppliers such as gas stations and post offices. Through these agents, XacBank will be able to provide several different services to these rural locations including deposits, withdrawals, loans, remittances, and cash transfers. In the future, XacBank plans to provide additional services to facilitate remittances, allow withdrawal services, transfer between accounts, micro-loans and micro-insurance policies.

In the Maldives, the World Bank has provided a loan totalling \$7.7M to fund an ambitious initiative to provide a single, automated banking and payment system to everyone in the Maldives through mobile phones.²⁴ This will enable people dispersed in the far flung islands to conduct financial transactions without having to travel long distances to get to a bank branch. The project also aims to work with the Monetary Authority to build a supportive enabling environment and the capacity to support successful mobile phone banking systems.

Roles and Examples of partnerships

For MFIs planning to offer mobile phone banking solutions, a partnership or strategic alliance with Mobile Network Operators (MNOs), banks, and/or third party service providers is essential. Over the past decade, MNOs have been quite successful at establishing strategic alliances and partnerships by tapping into local networks that allow for mobile phone services to reach the bottom of the pyramid.²⁵ It should be noted, however, that forming strategic alliances

is challenging, especially when approaching MNOs, which tend to focus on volume first, and value-added services second. Hence, smaller banks and MFIs will generally need to collectively work together in order to attract the attention of MNOs and offer a large enough value proposition. Increasingly, MNOs offering mobile money platforms are also investing in or developing joint ventures with banks to more rapidly increase the range of services and uptake of mobile financial services. This can also create an opportunity for smaller banks and MFIs wishing to take advantage of mobile money platforms to facilitate access to banking services. Lastly, third-party mobile phone banking service providers will also continue to play a role for banks as well as small MFIs who would prefer to outsource certain banking functions and turn over much of the technical development and management of an agent network to a third party. Below are descriptions of some successful alliances around Asia.

In India, Eko India provides access to low cost mobile financial infrastructure including IT and non-IT services for financial institutions including banks and MFIs.²⁶ Eko India works along with Eko Aspire Foundation (EAF), which acts as a Business Correspondent for banks. Eko has developed a banking platform called "SimpliBank" which provides a low cost financial infrastructure that leverages the efficiency of the existing pre-paid recharge distribution network model and the customer behaviour associated with prepaid airtime top-up. The third-party platform operated by Eko is intended to operate as a hosted mobile phone banking platform for various banks, MFIs, non-banking financial companies, personal loan providers and remittance outlets.

Globe Telecom's G-Xchange Inc (GXI) realised the importance of strategic alliances and partnerships when they were approached by the RBAP-MABS programme that planned to help banks offer financial services that could be facilitated via the GCASH platform. RBAP-

MABS assisted with developing and piloting a robust suite of mobile financial services as well as linking GXI with rural banks throughout the country. GXI provided the platform, training on the technology, marketing expertise and access to its network of airtime distributors. This is a win-win partnership that has helped push forward mobile phone banking in the Philippines.

In Pakistan, Telenor and Tameer Bank developed a strategic alliance after Tameer Bank decided that mobile phone banking services would be the best channel to effectively reach out to rural clients. Tameer Bank chose to use a STK (SIM Tool Kit) solution which required an integrated partnership with the MNO. They co-branded the service, which was promoted and offered through Telenor's prepaid card distribution network. Ultimately, Telenor acquired a 51 percent share in Tameer Bank which is part of its strategy to offer financial services in Pakistan, according to Telenor's CEO.

III. Looking forward

Technology is rapidly transforming the way that microfinance is being conducted around the world, and particularly in Asia. With Asia's large population of youth and easy and inexpensive access to the newest technologies, the region is primed to take advantage of these technologies to move the microfinance sector forward. From internet-based lending to Web 2.0 to mobile phone banking, there are various innovations prevalent throughout Asia.

Branchless banking, particularly using the mobile phone has caught on in several countries in Asia. Since the mobile phone has become ubiquitous throughout most of developing Asia, it is a logical channel for delivering financial services. Partnerships between MFIs, MNOs and other service providers play an important role in successful branchless and mobile phone banking initiatives.

However, there remain significant challenges to customer adoption, including limited wireless connectivity and low levels of technological literacy. Many clients lack a basic understanding of electronic banking services and are wary of new technology. As MNOs rapidly expand their presence through Asia, connectivity is less of an issue. However, addressing clients' concerns is an issue that needs to be addressed up front through education and training.

Microfinance and technology is a rapidly evolving field that many hope will finally allow the millions at the bottom of the pyramid to gain access to financial services. Several of these new technologies have the potential to deliver microfinance quickly and easily to the masses, but many are waiting to see which models will be the most successful.

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7. Microfinance and Sustainable Development*

I. Introduction

Global awareness of sustainable development, driven particularly by the growing challenge of climate change, is at an all-time high and some microfinance stakeholders are trying to find innovative ways to be part of the solution rather than adding to the problem. While these stakeholders assess the social and economic development impact of their projects, their environmental impact is increasingly being evaluated in terms of greenhouse gas emissions reduction potential. The desire to mitigate the effects of climate change on the lives of micro-entrepreneurs is also raising interest in providing the necessary safety nets when crops fail, livestock die, food prices rise and homes are destroyed by natural disasters and environmental degradation.

Development efforts in the region are now more focused on financing cleaner energy, environmentally-friendly sanitation and water systems, and developing microsavings and microinsurance products that can mitigate some of the future impacts of climate change experienced by clients. Microfinance institutions (MFIs) are experimenting with innovative loan products that finance the purchase of cutting-edge pro-poor energy and water technologies. These products can therefore improve the lives of the poor and enable MFIs to show deeper social, economic and environmental impact.

Energy, water and sanitation are inextricably linked with one another – to have them is an indicator of prosperity and to lack them is an indicator of poverty. Researchers have found that there is a clear link between lack of access to energy and water and other inequalities in human development - and that promoting access to energy and water is central to poverty reduction efforts. For example, the UN Millennium Project has made an eloquent case that energy services have a direct impact on all the Millennium Development Goals and that enhancing access to energy services would greatly aid the process of achieving these targets.¹

Statistics and other data from the energy, water and sanitation sectors show both the magnitude of the problem and the opportunities that tackling them present.

Energy

About 1.6 billion people around the world lack electricity and more than 2.5 billion people are cooking with traditional fuels like wood, dung, and charcoal.² The World Health Organisation (WHO) estimates that 1.5 million people a year die due to indoor air pollution and 85 percent of these deaths are due to biomass use.³ Energy services, such as better lighting and cleaner cooking fuels, bring tangible social and economic benefits such as cleaner, brighter light for work, study and recreation, as well as increased study time and improved study environments for school children. There are also significant health benefits to switching away from kerosene lamps or biomass fuels for cooking, including less vision and breathing problems as well as increased safety in terms of fewer burns.

Economic benefits include extended hours for small businesses, improved productivity and job creation in manufacturing, service and sales as well as greater security. There are also important gender implications, since family energy needs are met largely by women and girls. Time spent in fuel collection by female members of poor households can range from 1 hour to 8 hours per household per day, limiting both the participation of girls in school and the ability of women to pursue other income-earning activities. Women and girls spend more time in the home and are more likely to be exposed to indoor air pollution resulting from cooking with biomass fuels. With access to cleaner, affordable energy options, women and girls benefit directly through improved health, enhanced educational opportunities, and increased incomes.

Over the past few years, energy costs for the poor have become increasingly unpredictable and sustainable energy such as solar or biomass, can serve to stabilise these cost fluctuations for individual households or significantly reduce

* This chapter was prepared by Nicola Armacost, Co-Founder and Managing Director, Arc Finance. The paper is intended to address the links between microfinance, sustainable development and climate change, with a particular focus on energy, water and sanitation. The paper draws both from what was presented at the Asia Microfinance Forum 2008 as well as other material. The author would like to thank Ellen Morris, co-founder and Managing Director of Arc Finance for her valuable insights and comments on this chapter.

their energy costs. Perhaps most compelling in terms of the climate change debate is the promotion of clean energy technologies as a measurable way to reduce CO₂ emissions, with the biggest emission savings coming from biogas plants and improved wood-cook stoves.⁴

Water and Sanitation

In a similar vein, around the world 1.1 billion people lack clean water supplies and 2.7 billion have no access to proper sanitation. Sickness from causes related to hygiene, sanitation and water supply is shockingly widespread. Each year more than five million people die from water-related diseases. Approximately, 30 percent of water-related deaths are due to diarrhoea and 84 percent of water-related deaths are in children ages 0 to 14. Millions of women and children spend many hours each day collecting water from distant locations, where the source is often polluted. Women and girls are vulnerable to violence if they are forced for privacy reasons to defecate after dark and in secluded areas. Sophisticated modern piped water networks are too expensive for most developing countries and poor people living in the slums often pay 5 to 10 times more per litre of water than wealthy people living in the same city.

Poor sanitation can be a major cause of lost work and school days because of illness. Experts argue that clean water and improved sanitation promote a healthier workforce and more economic productivity. They also make the case that improved sanitation facilities could reduce diarrhoea-related deaths in young children by more than one-third. If hygiene promotion is added, such as teaching proper hand washing, deaths could be reduced by two-thirds.⁵ In an interesting twist, the largest measurable emission savings are from biogas and improved efficiency for biomass stoves, which not only produce energy, but promote hygiene and cleaner water, and even create an income stream if the waste matter is used or sold as organic fertiliser - all while reducing CO₂ emissions.⁶

Poverty

Over 2.6 billion people (more than one-third of the world's population) live on less than US\$2 a day and at least 80 percent of the world's population live on less than US\$10 a day.⁷ Almost two in three people lacking access to clean water survive on less than US\$2 a day, and more than 660 million people without sanitation live on less than US\$2 a day.⁸ It's estimated that among those at the Base of the Pyramid (BOP),⁹ there is an unserved potential energy market of US\$205 billion (representing the energy needs of 1.86 billion people) and these BOP households devote an average of 7 percent of their total expenditures to energy purchases.¹⁰ Figures vary both on the number of people who are currently reached by microfinance services (ranging from 154 million to 190 million) as well as the percentage of these people who live on less than US\$1 a day (conservative figures report that this would be about 106 million people).¹¹ Irrespective of the figures relied on to estimate the current reach of microfinance services, it's clear that the unmet need for financial access by the poor is huge.

From the perspective of an MFI, the data on the lack of access to energy, water and sanitation by poor people is extremely compelling. It shows that the clients they are targeting for microfinance services are also highly likely to be those people who also want access to water, energy and sanitation services. In many cases, the "energy poor" or the "water poor" have the same profile as a typical microfinance client. For MFIs with a social mission, the data is particularly interesting as it shows the huge potential social impact of energy or water lending for poor households, especially for women and children. In addition, it shows that financing cleaner energy and environmentally friendly sanitation and water systems can have a measurable impact on reducing CO₂ emissions, which in turn may provide a potential source of income for MFIs in the form of carbon credits.

The Role of Microfinance: Demand and Supply

Until relatively recently, most MFIs have not focused on specialised lending for energy, water or sanitation. However, some of them are reporting a growing demand from low-income clients for loans to access energy, clean water and better sanitation options for their households and businesses.¹²

MFIs are experiencing demand from two sets of potential clients:

- > **End-users** who are people who have the profile of a typical microfinance client and need loans ranging from US\$50 to US\$1,000. These clients are asking for financing to purchase energy services such as lighting, refrigeration, mechanical power for running machinery used in agricultural processing, as well as for heat and cooking fuels. Some clients are looking for grid connection loans or loans for alternative energy options that are more reliable than the grid. Clients also want access to latrines and to cleaner water; in practice this means devices to clean the existing supply of water (through desalination, disinfecting and filtering), mechanisms to ease transportation of water including pumps, and means to store clean water. While many clients want these loans for business purposes, some clients want loans to purchase services that will enhance the quality of life of their families.
- > **Small and growing businesses** that are a key part of the energy or water value-chain and need access to microfinance for expansion. They not only manufacture or sell the technology themselves, but support micro-entrepreneurs who produce parts or install or transport equipment. A typical business might be a water filtration business that supports a number of smaller water bottling and transportation businesses. Alternatively, it might be a solar battery charging business that hires people to distribute the batteries to end-users such as street vendors who are renting the batteries to power lamps. These clients are usually big for microfinance (needing loans of US\$3,000 or more over

longer terms) but are among the poorest of the traditional bank clients and often get lost between the two sectors. This client group has great potential to generate income and assets at the bottom of the pyramid in terms of job creation and market development.

At the same time that MFIs are experiencing this growing demand for energy and water loans from their clients, energy and water companies are beginning to see a market in producing products tailored to low-income households. In order to grow their businesses these small energy and water companies need end-user finance options for their clients. The prospect of developing partnerships with MFIs to provide financing packages to their low-income client base becomes increasingly attractive. Some of these businesses are also looking for new financing options themselves in order to expand into new regions or offer a broader range of products and services to their clients.

Internationally, a small but growing number of private and public donors¹³ are looking to support environmentally-aware organisations. There are also a number of social investors¹⁴ who are looking for triple bottom-line investment opportunities (balancing economic, social and environmental objectives) and are interested in the promise of carbon trading and the large unmet markets for energy and water.

Challenges in Energy and Water Lending

While there is considerable promise in energy and water lending, microfinance practitioners have identified a number of challenges based on their experiences. For example, on the energy side, a comprehensive three continent study completed in November 2007 found that the major challenge that MFIs faced was finding a reliable energy partner and crafting a mutually beneficial partnership arrangement.¹⁵ The study noted that MFIs also encountered these challenges:

- > They negotiated partnerships with unreliable energy companies that either went out of business or chose mid way through the contract to service a different client base.

- > They failed to negotiate after sales maintenance or service agreements with their energy partners and were saddled with non-functional energy systems.
- > They agreed to risky arrangements with energy companies such as paying the upfront cost of equipment and installation but faced situations where installation was delayed or technology changed and clients decided to cancel their loans.
- > They did not design an appropriate energy loan product that met client needs.
- > They provided energy loans for products that were heavily subsidised by local government. When the subsidies were removed and the products were offered at market rates the clients were no longer interested in purchasing the products and the energy lending stalled.
- > The initial client appraisal process, the repayment cycle and the monitoring and evaluation systems were not adapted to energy lending.
- > The MFIs did not adequately train loan officers to promote and grow the energy portfolio.

From an investor perspective, the two biggest challenges are scale and sustainability. While there are millions of poor people who still need access to microfinance, the number of poor people who have received loans for energy related purposes from MFIs is miniscule; probably 500,000 people,¹⁶ which is not even 1 percent of the total number currently reached by microfinance. Only very recently have MFIs realised the potential market for energy lending. Nonetheless, investors who are interested in the triple bottom line want to be able to talk about real scale and may need to be patient in the immediate future as effective scaling models for energy and water lending are developed. Most investors also stress the importance of institutional sustainability and therefore need to understand that the risks of energy or water lending are somewhat different than those of a typical microfinance loan.

Currently, the Foundation for Development Cooperation (FDC) in partnership with the Asian Development Bank (ADB) is establishing the Energy for All (E4ALL) Partnership, which will support the scaling-up of successful existing approaches and encourage the implementation of promising new and suitable financing mechanisms to increase access to modern forms of clean/renewable energy to the poor in the Asia-Pacific Region.

II. Microfinance, Innovation and Sustainable Development in Asia

The biggest challenge in linking microfinance and sustainable development in Asia is the staggering numbers: most of the world's poor live in Asia and they typically lack access to energy, clean water and sanitation. However, Asia offers unique opportunities to address the challenge because it is a hotbed of innovation in cost-effective, pro-poor technology development and it has the most successful examples of microfinance organisations that have reached impressive scale. The largest microfinance organisations in the world operate in Asia,¹⁷ and the world's largest microenergy and microwater lending operations are also in Asia.

Energy

In the energy sector, a number of the innovations focus on improving the efficiency and performance of existing technology like solar lanterns, cooking stoves or bio-gasifiers. Solutions range from using cleaner fuel such as Liquefied Petroleum Gas (LPG) to designing more efficient stoves such as the sarai steam cooker and the wood-saving stoves marketed by TIDE.¹⁸ MFIs and their technology partners are helping poor clients find ways to leapfrog over intermediate energy technology and move directly to reliable alternative sources of energy such as solar. Not surprisingly, the innovations that seem to be most popular are those that most effectively respond to client needs.¹⁹

One of the pioneers in energy lending and one of the largest players in Asia is Grameen Shakti, which both sells energy services directly and provides end-user finance to clients through microloans. Grameen Shakti has installed more than 150,000 solar home systems in Bangladeshi villages since it was founded in 1996.²⁰ Currently, Grameen Shakti is the largest single installer of solar home systems in Bangladesh. More than 5,000 solar home systems are being installed per month. By selling these solar systems, Grameen Shakti provides lighting and communications (in the form of mobile phone charging) and has increased employment opportunities. Clients purchase their systems using microloans that have affordable terms and are tailored to their specific needs. In addition, 3,000 biogas plants and three solar thermal projects have been installed, and 9 solar-powered computer training centres have been created. The Grameen Shakti biogas program is linked to the emerging poultry and livestock industry in Bangladesh with a focus on slurry as a replacement for chemical fertiliser.

Another pioneer in energy lending is Sarvodaya Economic Enterprise Development Services (SEEDS), which is one of the largest microfinance organisations in Sri Lanka. Through its specialised energy lending division, SEEDS has financed the installation of more than 58,000 solar home systems in rural areas of Sri Lanka since 1998. The average rural family in Sri Lanka spends 19 percent of its income on energy, and many can afford off-grid electricity if they have access to end-user finance. SEEDS works through accredited solar installers to identify potential loan customers. The monthly repayments are set at a rate that the household can afford to pay, and the loans are paid back over a period of one to four years. Local field officers employed by SEEDS collect monthly repayments and also carry out checks and minor repairs to the systems. A SEED has also installed 14 micro-hydro schemes in rural areas and has provided 4,000 grid connection loans.²¹

One of the most innovative partnerships in the energy microfinance space links SELCO India and SEWA Bank in Gujarat.²² SELCO is a leading energy company that provides sustainable

energy solutions to under-served households and businesses. It has installed 85,000 solar home lighting systems since 1995. Starting in 2004, SELCO developed a partnership with SEWA Bank to provide energy services to its informal sector clients. SELCO has an innovation division that is focused on developing technology tailored to the needs of the poor. A vivid example is a solar powered headlamp developed for midwives who were delivering babies in rural homes with no electrification. The new lamps were safer and brighter than kerosene and did not pollute the air in the huts. As a result, the first breaths the new babies took were of clean, fresh air rather than kerosene fumes. The midwives promoted the headlamps to fellow SEWA clients, the rosebud pluckers, who also work at night. The rosebud pluckers discovered that the headlamps significantly improved their productivity and income levels by freeing them from holding kerosene lamps and enabling them to work twice as quickly. SELCO's innovation division is a gold-mine of market responsive energy solutions for the poor.

A very new area of innovation is in the potential link between the carbon markets and microfinance. Until very recently, these trading mechanisms have been complicated and expensive and have been geared at larger companies but there are some new players that are focusing explicitly on MFIs as potential clients. MicroEnergy Credits is a new company based in Washington DC that plans to buy carbon credits from MFIs lending clean energy loans. These carbon funds can be used by MFIs to provide financing to grow their energy portfolio and can potentially turn into an attractive source of future income. MicroEnergy Credits plans to sell the carbon credits it buys from MFIs on the Voluntary Carbon Market.

Another player is Sigma Global, an Australian company providing advisory services on the global carbon markets for about a decade. It helps companies develop a strategic plan to market their carbon assets in the most advantageous way and has recently begun to focus on helping MFIs develop competitive carbon strategies.

Water and Sanitation

One of the innovators on linking microfinance and water lending is WaterPartners International, which is recognised as one of the leading global activists focused on providing safe drinking water and sanitation to people in developing countries. WaterPartners is a US-based non-profit organisation founded in 1990 and operates in eight countries. WaterPartners not only offers traditional, grant-funded programs, but is also harnessing the power of microfinance to address the world water crisis. WaterPartners developed a unique initiative, WaterCredit, which facilitates loans for water and sanitation. In November 2007, WaterPartners helped to launch the Gramalaya Urban and Rural Development Initiatives and Network (GUARDIAN) in India, which is the only credit facility anywhere in the world whose core purpose is to provide water and sanitation loans to poor people. WaterPartners is also working with BASIX, an innovative MFI based in Hyderabad. Microfinance loans have been provided to purchase household water connections, clean water storage units like rainwater harvesting tanks and for the construction of household latrines.²³

Another important player is the Safe Water Network, which aims to bridge private-sector, academic, philanthropic and public resources to advance innovative safe water solutions. The Safe Water Network is working with MFIs to finance rainwater harvesting, village-level water systems and “water kiosks” that foster water quality assurance and focus on achieving sustainability, affordability and scale.

Another innovator and advocate on the importance of sanitation for the poor is the World Toilet Organisation (WTO), which is a non-profit umbrella group of about 130 toilet and sanitation NGOs in 44 countries, with headquarters in Singapore. It has a simple and clear mission: to improve toilets and sanitation globally. Established in 2001, the WTO broke the taboo on the subject of toilets by engaging the global media aggressively and is now building market infrastructure to promote its mission, including attracting financing for sanitation products and services.

Each of these innovators has faced challenges in implementing a vision of providing the poor with access to energy or water. Many of them have overcome those challenges by building solid, strategic partnerships that are focused on responding to client needs.

III. Looking Forward

The Asia Microfinance Forum 2008 offered an excellent overview of the trends, challenges and opportunities facing microfinance stakeholders in addressing sustainable development. Speakers provided rich examples of successes, failures and lessons learned based on their experiences,²⁴ and the audience raised interesting and provocative issues that need to be addressed in the coming months and years.

Key issues for MFIs that are committed to integrating sustainable development goals into their business include the following:

- > The challenges of scale and sustainability in energy and water lending. MFIs will need to consider whether lending to local communities in addition to individuals for energy and water is a viable way to reach scale, and if so, how to do this type of lending in a profitable way.
- > Critical assessment of the promise of carbon trading as an income stream. MFIs will need to consider whether there is a legitimate role for “smart subsidies” in relation to energy and water lending and whether carbon financing provides a viable solution to the subsidy question. MFIs will also need to critically evaluate the challenges of accessing the carbon market – efforts to date have been extremely difficult and more applicable methodologies and validation methods are needed before carbon can be relied on as a potential source of income.
- > Critical evaluation of whether or not their potential partners are promoting technology innovations that are truly pro-poor.

- > Analysis of whether they should be offering savings and insurance products that mitigate the risks of climate change experienced by their clients.
- > Consideration of whether their business models are attractive enough to the growing green investment community that wants a triple bottom line for investments.

The field is still very new and there is tremendous potential for innovation on several fronts including: developing new business models geared at achieving scale; crafting strategies to enter the carbon markets effectively; building affordable technologies that meet poor clients' needs; developing risk mitigating products for clients affected by climate change issues; and developing and promoting green investment opportunities at the bottom of the pyramid. An appropriate and meaningful attempt to address climate change through sustainable development is one of the most critical and stimulating issues for the microfinance sector to tackle in the next decade.

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- ⁴ 'Opportunities To Achieve Poverty Reduction And Climate Change Benefits Through Low Carbon Energy Access Programmes', by Tighe Geoghegan, Simon Anderson and Ben Dixon, Ashden Awards for Sustainable Energy, April 2008, page 19.
- ⁵ The Global Water Crisis Fact Sheet 2008, published by WaterPartners International.
- ⁶ Opportunities To Achieve Poverty Reduction And Climate Change Benefits Through Low Carbon Energy Access Programmes', by Tighe Geoghegan, Simon Anderson and Ben Dixon, Ashden Awards for Sustainable Energy, April 2008, page 19.
- ⁷ World Development Indicators 2008.
- ⁸ United Nations Human Development Report, 2007, page 7.
- ⁹ See: *The Next 4 Billion: Market Size and Business Strategy at the Base of the Pyramid*. (Washington, DC: World Resources Institute and International Finance Corporation, 2007). The Base of the Pyramid is defined as those people with a per capita income of less than US\$3,000 per year.
- ¹⁰ 'Chapter 7: The Energy Market', *The Next 4 Billion: Market Size and Business Strategy at the Base of the Pyramid*. (Washington, DC: World Resources Institute and International Finance Corporation, 2007), page 77: the measured market for energy among those living at the Base of the Pyramid is about US\$228 billion, representing the annual spending of 2.1 billion people in 34 countries. The total BOP household energy market in Africa, Asia, Eastern Europe, and Latin America and the Caribbean is estimated to be US\$433 billion, representing the spending of 3.96 billion people.
- ¹¹ State of the Microcredit Summit Campaign Report 2009, page 3 and CGAP website 'Global Estimates'.
- ¹² See Morris.E et. al., 'Using Microfinance To Expand Access To Energy Services: Summary of Findings', The SEEP Network, November, 2007 (also see in-depth studies on Asia, Africa and Latin America).
- ¹³ The Citi Foundation has been a pioneer in recognising and supporting the link between energy and microfinance and more recently the Pepsico Foundation has been a leader in supporting the link between water and microfinance.
- ¹⁴ E+Co has been investing in energy enterprises for the last 25 years and has recently begun to consider investments in MFIs that have energy portfolios.
- ¹⁵ See Morris.E et. al., 'Using Microfinance to Expand Access to Energy Services: Summary of Findings', The SEEP Network, November, 2007, pages 22-29.
- ¹⁶ Ibid.
- ¹⁷ ASA, BRAC and Grameen in Bangladesh, BRI in Indonesia, and SKS, SHARE and SPANDANA in India together reach about 25 million clients.
- ¹⁸ See: <<http://www.hedon.info/SaraiCooker>> and <<http://www.ashdenawards.org/winners/tide08>> .
- ¹⁹ For example, LED lamps that were advertised as reading lamps but which really only function as night-lights are not selling.
- ²⁰ <<http://www.ashdenawards.org/winners/grameen08>>
- ²¹ See Morris.E et. al., 'Using Microfinance To Expand Access To Energy Services: The Emerging Experiences in Asia', The SEEP Network, November, 2007, Chapter 3 'SEEDS - Sri Lanka'.
- ²² See Morris.E et. al., 'Using Microfinance To Expand Access To Energy Services: The Emerging Experiences in Asia', The SEEP Network, November, 2007, Chapter 2 'SEWA Bank-India'.
- ²³ 'Microfinance for Water, Sanitation and Hygiene: An Introduction', by the International Water and Sanitation Center (IRC), October 2007.

Coordinating Organisations

The Banking With the Poor Network

The BWTP Network (www.bwtp.org) is a distinctive, Asia-centred organisation with a unique diversity of membership that works towards building efficient, large-scale sustainable organisations, through co-operation, training and capacity building with the aim of achieving innovative, appropriate and demand-driven financial services for the poor. The BWTP Network consists of 47 microfinance stakeholder institutions from 11 countries across Asia.

The Foundation for Development Cooperation

The Foundation for Development Cooperation (www.fdc.org.au) is an independent, not-for-profit international development organisation. Established in Brisbane, Australia, in 1990, the mandate of FDC calls for it to conduct policy-oriented research, foster public awareness, mobilise broader Australian and overseas development cooperation, and support non-governmental development efforts. Through partnerships and alliances, FDC undertakes a range of initiatives which seek to improve the lives of poor people in developing countries, foster innovative approaches to development, and connect policy work to self-help efforts at the grass roots level. FDC's work includes economic development and assessment, policy analysis, grass-roots community-based initiatives, strategic research, partnerships and leverage, advocacy, consulting and advisory services, project design and implementation, secretariat and network management, and training and capacity building. FDC's headquarters is in Brisbane, Australia. FDC has an Asia regional office in Singapore and a Pacific regional office in Fiji.

Citi Foundation

The Citi Foundation is committed to the economic empowerment of individuals and families, particularly those in need, in the communities where we work so that they can improve their standard of living. Globally, the Citi Foundation targets its strategic giving on its priority focus areas: Microfinance and Microenterprise, Small and Growing Businesses, Education, and Financial Education and Asset Building. The Citi Foundation works with its partners in Microfinance and Microenterprise and Small and Growing Businesses to support environmental programs and innovations. Additional information can be found at www.citifoundation.com.

The SEEP Network

Established in 1985, the Small Enterprise Education & Promotion (SEEP) Network (www.seepnetwork.org) is the international network of practitioners working in microfinance and microenterprise development. Its 74 institutional members are active in 139 countries and reach over 25 million microentrepreneurs and their families.

SEEP's mission is to connect these practitioners in a global learning environment. It is through this member-driven, collaborative platform that SEEP collects and shares best practices, and fosters technical innovation and progress for the industry. SEEP also specialises in the development of regional and national microfinance associations, or networks. Networks are critical agents because they have the potential to advocate for an enabling policy environment, promote best practices and contribute to the growth of the microfinance industry at large. Over the past decade, SEEP has worked with over 30 networks on institutional strengthening activities, and has recently added 12 networks from Europe, Africa, and Latin America to its membership.

Other Publications

Microfinance Industry Reports in this series



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Other BWTP Network / FDC Publications



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 Jamie Bedson (Ed.), 2008
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Microfinance in Asia: Trends, Challenges and Opportunities
 Jamie Bedson (Ed.), 2009.
 Available on CD ROM and online.



Microfinance and Disaster Management Trainer's Manual
 Stuart Mathison (Ed.), 2006
 Available for purchase and online.



Getting the Framework Right
 Paul B. McGuire, John D. Conroy, Ganesh B. Thapa (Eds.), 1998
 Available for purchase through the Foundation for Development Cooperation website.
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