



**Microfinance through the Next Decade:  
Visioning the Who, What, Where, When  
and How**

**by:**

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## ***Paper Objective:***

This paper considers the key change agents and challenges that will shape the microfinance industry through the next ten years. The authors seek to anticipate the impact on the industry of various forces of change and to identify the key challenges facing suppliers of financial services to the poor.

The paper encompasses the global microfinance industry, and highlights regional variations.

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by  
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## *About the Authors*

### **Elisabeth Rhyne**

**Senior Vice President, Policy and International Operations  
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Elisabeth Rhyne directs ACCIÓN's work in research, publications, new product development and policy. The team she oversees creates new financial products for the poor, including remittances, housing microfinance and microinsurance, as well as financial literacy training for microfinance clients. Respected for her leadership in policy initiatives and her thoughtful voice, Ms. Rhyne has written extensively on microfinance. She has published numerous articles and four books on the subject, including *Mainstreaming Microfinance: How Lending to the Poor Began, Grew and Came of Age in Bolivia* (Kumarian Press, 2001). She and Maria Otero are co-editors of *The New World of Microenterprise Finance* (Kumarian Press, 1994). In addition, Ms. Rhyne co-edited *The Commercialization of Microfinance: Balancing Business and Development* (Development Alternatives, Inc., 2002).

Prior to joining ACCIÓN, Ms. Rhyne served as Director of the Office of Microenterprise Development at the U.S. Agency for International Development (USAID), where she developed and managed USAID's successful Microfinance Initiative. Projects developed under her guidance include Microenterprise Best Practices, the USAID Implementation Grant Program, the PRIME fund, and the AIMS Project. Elisabeth Rhyne holds a Ph.D. in public policy from Harvard University and a B.A. from Stanford University. Since 1998, she has been an adjunct professor at the John Hopkins School for Advanced International Studies (SAIS).

### **María Otero**

**President & CEO, ACCIÓN International**

Recognized worldwide as an important voice in microfinance, María Otero was named President & CEO of ACCIÓN International in January 2000. As President, she directs ACCIÓN's team of more than 130 professionals who

work with ACCION partners in 23 countries in Latin America, the Caribbean, Africa and South Asia. At the end of June 2006, the ACCION Network was serving over 2 million clients with an active portfolio of US\$1.43 billion. Ms. Otero also serves as President of the Board of Directors of ACCION Investments in Microfinance, a \$20 million equity investment company for microfinance, and is a founder of the Council of Microfinance Equity Funds, which ACCION coordinates. In addition, Ms. Otero serves on the Board of Directors of three regulated microfinance institutions in Latin America: Mibanco in Peru, BancoSol in Bolivia and Compartamos Bank in Mexico. Ms. Otero serves on several other boards, including that of the Calvert Foundation, the United States Institute of Peace, and BRAC Holding of Bangladesh.

Ms. Otero originally joined ACCION in 1986 to direct its microcredit program in Honduras, where she lived for three years. Prior to joining ACCION, Ms. Otero was a program officer with the Inter-American Foundation, and spent five years with CEDPA, a nonprofit training organization. With the Women in Development office of USAID, Ms. Otero focused on microenterprise development and women in Latin America.

Born and raised in Bolivia, Maria Otero has an MA in Literature from the University of Maryland and an MA in International Relations from the John Hopkins School for Advanced International Studies (SAIS). Since 1998, she has been an adjunct professor at SAIS. Among her numerous awards, Ms. Otero was named one of the 20 most influential women in the United States by *Newsweek* in its October 2005 edition on "How Women Lead."

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## **Part I. The Promise of Microfinance**

From its earliest beginnings in the 1970s and 1980s, microfinance has evolved a grand vision in which all people across the globe who need savings or credit have access to high quality financial services. Such services provide one powerful tool in the global fight against poverty. Low income and poor families can use financial services to improve their quality of life, protect against risks and invest in the future. In the process of building the institutions to supply these services, societies can open their economies increasingly to the less advantaged portions of their population.

As microfinance grew, especially throughout the 1990s, it began to become clear that this grand scale vision could one day become reality. Today, as the first decade of the Microcredit Summit ends, we can optimistically predict that in the coming decade the promise of microfinance will be substantially achieved.

This paper envisions the future of microfinance. It identifies the major factors that are already driving change in the industry, and examines the likely impact these forces will have on the shape of things to come. Some of these forces will propel microfinance forward, while others pose challenges to be overcome. This paper calls on every professional working in microfinance to consider carefully the likely effects of change on the industry and to respond proactively to ensure that microfinance realizes its promise.

This paper follows from the 2005 study, "The Profile of Microfinance in Latin America in 10 Years: Vision and Characteristics," by Beatriz Marulanda and María Otero, prepared for the Regional Microcredit Summit in Santiago, Chile. In this paper, the scope expands from Latin America to encompass the entire world. Like the earlier study, this also draws on published data sources (for hard numbers) and on personal interviews with 41 leading microfinance

practitioners (for vision), many of whom are quoted in highlighted boxes. The authors turned to the major sources of data that are generally accepted in microfinance and did not conduct primary data collection themselves, given what is available today.

## **The Scale of Microfinance Today**

We are beginning to understand the scale of financial services for low income people today, but cannot answer definitively the question of how many people are being reached. There are several competing data sources, all incomplete and most based on self reporting, and therefore not 100% imperfect. Each database reveals something slightly different about the scale of supply.

The Microfinance Information Exchange (MIX) collects data from leading microfinance institutions that are able to produce and willing to release complete financial statements.<sup>1</sup> These institutions generally consider themselves part of the microfinance community and may be thought of as the core of microfinance, with exceptions noted below. MIX data for 2004 shows a worldwide total of 30 million borrowers served by 675 organizations.

The Microcredit Summit publishes data on numbers of borrowers and includes institutions that are not direct providers of financial services but are microfinance movements, as well as data from some public sector development banks.<sup>2</sup> Its estimates for the same year are 92 million active borrowers, a difference from the MIX of 62 million. Exactly half of this difference (31 million) is explained by the Summit's inclusion of two self-help group (SHG) movements in India, the NABARD Self-Help Group Bank Linkage Program and the Society for the Empowerment of the Rural Poor. The SHGs are traditional women's savings and credit groups.

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<sup>1</sup> All data from the MIX comes from its website, [www.mixmarket.org](http://www.mixmarket.org).

<sup>2</sup> The 2005 State of the Microcredit Summit Report presents end of 2004 data on progress made toward the Campaign's goal. [www.microcreditsummit.org](http://www.microcreditsummit.org).



Much of the rest of the difference between the MIX and the Microcredit Summit is due to the Summit's inclusion of government-run programs, such as the National Family Planning Coordinating Board of Indonesia, the Vietnam Bank for the Poor and the Nigeria Agricultural Cooperative and Rural Development Bank. Such programs account for 16 million of the difference. Finally, the Summit has a few more programs reporting from South Asia, where numbers reached are often large, while the MIX has greater coverage of Latin America.

A broader view of finance for the poor comes from CGAP's survey of alternative financial institutions which was aimed at all financial institutions serving clientele of a level lower than traditional commercial banks.<sup>3</sup> The definition of Alternative Financial Institution (AFI) includes many institutions that would not consider themselves part of the microfinance community, especially public sector banks. The AFI study found 3,000 institutions and reported 152 million total current borrowers. While this number appears to be much higher than either the MIX or Microcredit Summit figures, nearly half of that total comes from public development banks in two countries, China (31 percent of total) and India (16 percent of total), and it is not entirely clear that the borrowers would be considered as part of the microfinance target group. Only one third of the total (50 million borrowers) in the CGAP study came from self-identified microfinance programs.

Comparison of these three databases reveals a surprising consistency, despite the differing totals. There is a core group of microfinance institutions reaching roughly 30 to 50 million borrowers. The core group includes banks, finance companies, NGOs and other types of institutions.<sup>4</sup> About 400 to 500 institutions form this core, although there are another 2,000 to 3,000 small institutions serving fewer than 2,500 borrowers each and making a negligible

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<sup>3</sup> "Financial Institutions with a 'Double Bottom Line': Implications for the Future of Microfinance," CGAP Occasional Paper Number 8, July 2004. [www.microfinancegateway.org](http://www.microfinancegateway.org)

<sup>4</sup> Table 4 provides a breakdown of MIX data by institutional type.

contribution to global aggregates. Another 25 million people are involved in the Indian SHG movement, and finally, millions more are served by government-owned institutions (especially in Asia), which are not directly associated with microfinance, but which do reach substantial numbers of lower income people. Credit unions play a minor role overall (about 7 percent of the MIX total) but are very important in certain countries.

These numbers reflect borrowers below the poverty line in their countries, as well as near-poor borrowers who are slightly above it. While some institutions reach lower income segments than others, the overall figures incorporate low income borrowers, including those who rise above the poverty level and continue to borrow from microfinance institutions.

Rough as these borrower numbers are, they are probably more accurate than the numbers available on savings services. Of the three databases, only the CGAP survey examined savings accounts. It found 573 million savings accounts globally, of which 318 million were in post office savings banks. Self-identified MFIs reported 104 million accounts, 18 percent of the total. There is no way of determining how many of these accounts are active.

Turning from supply to demand, we can only speak in the most general terms. All respondents in our study agreed that demand is much greater than current supply, but current estimates of demand reflect guesses rather than data, and the only consensus is that worldwide total demand numbers at least several hundred million families.

Related to the calculations of future demand are several social and economic factors that will likely prevail in the coming decade. These realities make it safe to assume that informal economic activity, the major source of employment and income for poor households, will continue to grow in all developing countries in the south.

Among the most important of these factors are:

- the high percentage of youth in the demographic make-up of many low-income countries;
- the inability of formal economies to absorb new entrants into the labor force;
- the limited education and skill formation of large segments of the population; and
- the continued rural migration into the cities.

Self-employment will remain the most common occupation for hundreds of millions or even for billions of people, the bulk of whom will be women, and they will need access to capital to run their businesses.

## **Questions about Scale**

As a prelude to thinking about the future of microfinance, let us pose some key questions about scale.

### *How Does Supply Vary Around the World?*

Microfinance has not developed evenly across regions. In each region microfinance has distinct characteristics that reflect the nature of regional population and economies (see Table 1 below). South Asia accounts for the largest outreach, followed by East Asia, Latin America and Africa. MFIs in the Middle East and North Africa (MENA), and in Eastern Europe and Central Asia reach the fewest clients. In the MENA region there are still not many MFIs. Average (typical) loan sizes show striking regional differences, ranging from less than \$100 in South Asia where poverty is deep and microfinance has been aimed at very poor people, especially women; to about \$850 in Latin America, where poverty is not as deep in absolute terms (few people live under \$1 per day) and microfinance has grown up with a microenterprise

development focus; to over \$2,000 in Eastern Europe, where incomes are significantly higher.

<b>Table 1. Current Scale In Microfinance – MIX Data<sup>5</sup></b>					
<b>Region (# of MFIs)</b>	<b>Active Borrowers (Millions)</b>	<b>Share of All Borrowers (%)</b>	<b>Loan Portfolio (US\$ Millions)</b>	<b>Share of Total Portfolio (%)</b>	<b>Average Loan Balance (US\$)</b>
<b>Africa (85)</b>	3	10	\$965	11	\$322
<b>S. Asia (94)</b>	16.3	57	\$1,334	15	\$82
<b>E. Asia (44)</b>	4.7	16	\$2,218	24	\$472
<b>LAC (94)</b>	3.2	11	\$2,708	30	\$846
<b>MENA (23)</b>	0.8	3	\$236	3	\$281
<b>Eur. &amp; Cen. Asia (37)</b>	0.7	2	\$1,682	18	\$2,420
<b>All MFIs (378)</b>	28.8	100	\$9,143	100	\$319

The picture becomes even more diverse when we examine individual countries, and in particular if we compare the market penetration in smaller and larger countries.<sup>6</sup> Within regions, some countries, most of them relatively small, have highly developed microfinance sectors (see Table 2). Bangladesh stands out as an exception on all fronts, as a large country in terms of population with many MFIs and extraordinarily small average loan sizes. With nine percent of all people in Bangladesh counted as microfinance borrowers, the penetration of microfinance in Bangladesh exceeds that of all other countries. We could take the nine percent in Bangladesh as an upper bound for very large national penetration of microfinance. This figure reflects the early start Bangladesh got in microfinance, as well as the high percentage of the population living in circumstances that make them

<sup>5</sup> Table 1 data includes all MFIs in the MIX database with more than 5,000 borrowers. Another 297 institutions in the MIX database reach fewer than 5,000 borrowers each. These smaller institutions are excluded here. They account for only a total of 1.5 million additional borrowers.

<sup>6</sup> For a breakdown of Table 1 data by country, see Annex 1.

potential microfinance clients. Other countries shown below also have significant market penetration, and the capacity for microfinance to continue growing. It is notable that aside from Bangladesh most of the countries with high penetration are dominated by bank and finance company providers of microfinance, reflecting policy environments that have been supportive of microfinance integration into the financial sector.

**Table 2. Countries with High Microfinance Penetration<sup>7</sup>**

Country	MFIs		Total Portfolio (US\$ Millions)	Borrowers (Thousands)	Average Loan Balance (US\$)	Borrowers / Population	Total Population (Millions)
	Banks & NBFIs	NGOs, Credit Unions, Other					
<b>Bangladesh</b>	1	43	995	13,600	73	9.20%	147
<b>Mongolia</b>	2	0	135	228	592	8.10%	3
<b>Bolivia</b>	5	4	437	391	1,117	4.40%	9
<b>Bosnia</b>	7	4	372	183	2,034	4.10%	4
<b>Cambodia</b>	9	0	145	479	302	3.50%	14
<b>Nicaragua</b>	1	9	112	192	583	3.40%	6
<b>Peru</b>	14	9	970	884	1,097	3.10%	28

The biggest gaps in meeting demand occur in some of the largest developing countries: Brazil, Mexico, China, India, Pakistan and Nigeria. Again, Bangladesh is the exception, as is Indonesia, which has significant penetration because of Bank Rakyat Indonesia (BRI). To achieve the same moderate level of penetration as Indonesia, India would have to add 12 million clients; Nigeria and Russia 2 million each. It is notable that most microfinance in the large countries, with BRI and Banco do Nordeste in Brazil as notable exceptions, is provided through NGOs. Policymakers in large countries have generally been less willing to support the integration of microfinance into the mainstream.

<sup>7</sup> Source: MIX. Note that in countries with high penetration of microfinance, customers may have loans from several MFIs, making double counting of customers possible.

**Table 3. Microfinance in Large Countries (Population over 100 Million)<sup>8</sup>**

Country	# of MFIs		Total Portfolio (US\$ Millions)	Borrowers (Thousands)	Average Loan Balance (US\$)	Borrowers/Population	Total Population (Millions)
	Banks & NBFIs	NGOs, Credit Unions, Other					
<b>China</b>	No MFIs reporting to the MIX						1,313
<b>India</b>	6	20	160	1,620	99	0.10%	1,095
<b>Indonesia</b>	1	5	1,816	3,158	575	1.30%	245
<b>Brazil</b>	2	0	43	173	248	0.10%	188
<b>Pakistan</b>	3	9	81	530	152	0.30%	166
<b>Bangladesh</b>	1	43	995	13,600	73	9.20%	147
<b>Russia</b>	1	1	273	54	5,064	0.00%	143
<b>Nigeria</b>	1	2	4	186	24	0.10%	132
<b>Mexico</b>	3	3	137	465	295	0.40%	107

There are major differences between urban and rural supply of financial services, with rural supply still representing a major challenge in most parts of the world. The rural population is hard to reach because it is in remote areas or spread thinly over a large region. Microfinance products have focused on working capital for trade or business, rather than for agricultural production. Expansion into rural areas is especially important because of the generally higher incidence of poverty in rural areas.

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<sup>8</sup> Source: MIX.

*How fast is microfinance growing, and is it on a track to meet demand within the next decade?*

Both the MIX and the Microcredit Summit report strong supply growth during the past several years. Although some of this growth is due to increased reporting, much of the growth is real: from both existing institutions and new entrants. Growth is particularly fast in certain segments of microfinance, such as regulated MFIs. A Council of Microfinance Equity Funds study found an annual increase in borrowers of 95 percent among shareholder-owned MFIs during the past two years alone, due to both growth of existing institutions and entry of new ones.<sup>9</sup>

Major international microfinance networks are also experiencing rapid growth. For example, during the past five years, the number of borrowers reached by ACCION partners and affiliates has increased an average of 33 percent per year. FINCA programs have grown at an average rate of 22 percent and Opportunity International at 31 percent over the same period.<sup>10</sup> If sustained by these and other microfinance organizations, growth would indeed meet demand during the next decade. If its recent growth rate keeps up, the ACCION network alone could reach 40 million people by 2016 and all three networks would reach over 60 million. General experience with growth patterns and the law of large numbers suggests that a tapering off of growth is the norm. But in microfinance, there is reason to believe that entry by new institutions, and especially new types of institutions using new technologies, will keep the total rate of expansion high for some time to come, provided policy environments for microfinance do not deteriorate. The likely effects of new entrants are discussed in Part II of this study.

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<sup>9</sup> To be published Oct. 1, 2006 & available at [www.cmef.com](http://www.cmef.com) or [www.accion.org](http://www.accion.org)  
The Council of Microfinance Equity Funds was formed in 2003 by several founding members and is coordinated by ACCION International. Its membership of 16 equity funds meets twice yearly to address common issues.

<sup>10</sup> Author's calculation based on ACCION, FINCA and Opportunity International Annual Reports, 2000 – 2005.

### *How big is the quality gap?*

What the scale and growth numbers fail to show is the quality gap. For an individual client, the quality gap is the difference between the services received and the ideal: an array of well-designed services delivered in a way that best fits the client's needs. A person who receives only a single loan product in a rigid group format cannot be said to have the same quality of access as someone who has a tailored loan, savings services, insurance and money transfers, especially if these services are delivered in a flexible way, at a convenient location, and without absorbing too much of the client's time and trouble. At present, many of the clients included in our outreach totals face such a gap.

At a global level, the quality gap represents the sum of these individual gaps: all those people who have access to a very limited and low quality financial service but are nevertheless counted among the success stories of microfinance outreach. The tracking of client numbers in the microfinance industry has focused on borrowers reached, without regard for quality. Going forward, the quality gap should be considered an integral aspect of the scale question. In fact, as microfinance succeeds in touching more and more people, we expect its focus to shift towards quality issues. Alongside the total count of people reached by microfinance, the quality of services received needs equal attention. The enormous gap here stands as a reminder of the work still to be done. We return to this issue in the discussion of products and services later in the paper.



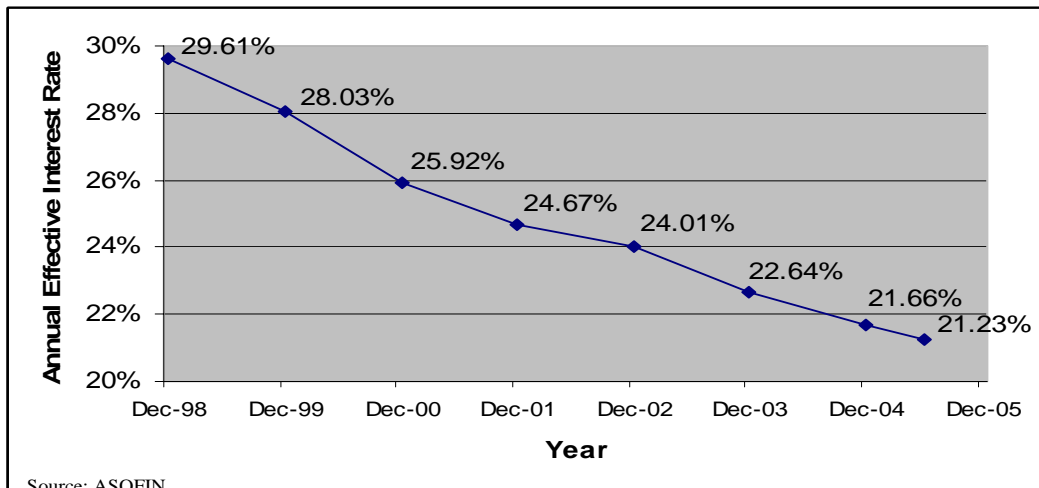
## Drivers of Change

Microfinance is affected by powerful change-producing forces. We focus on four major drivers of change, which are already unevenly present in all countries, and which we believe will continue to evolve and markedly change the way microfinance operates in the next decade. These four drivers are: competition, commercial entry, technology and the enabling environment.

### *Driver 1. Competition*

Competition has been a fact of life for several years in some countries, such as Bolivia, Nicaragua, Bangladesh and Uganda. In other countries, it is just beginning as evidenced by recent tensions among microfinance providers in India's state of Andhra Pradesh. For consumers, competition means greater choice. It puts consumers in a position to demand the range and quality of services they want at a price they want to pay. For that reason, competition has the power to force MFIs to rethink and reform.

**Figure 1. Interest Rates on Microfinance Loans in Bolivia  
1998-2004**



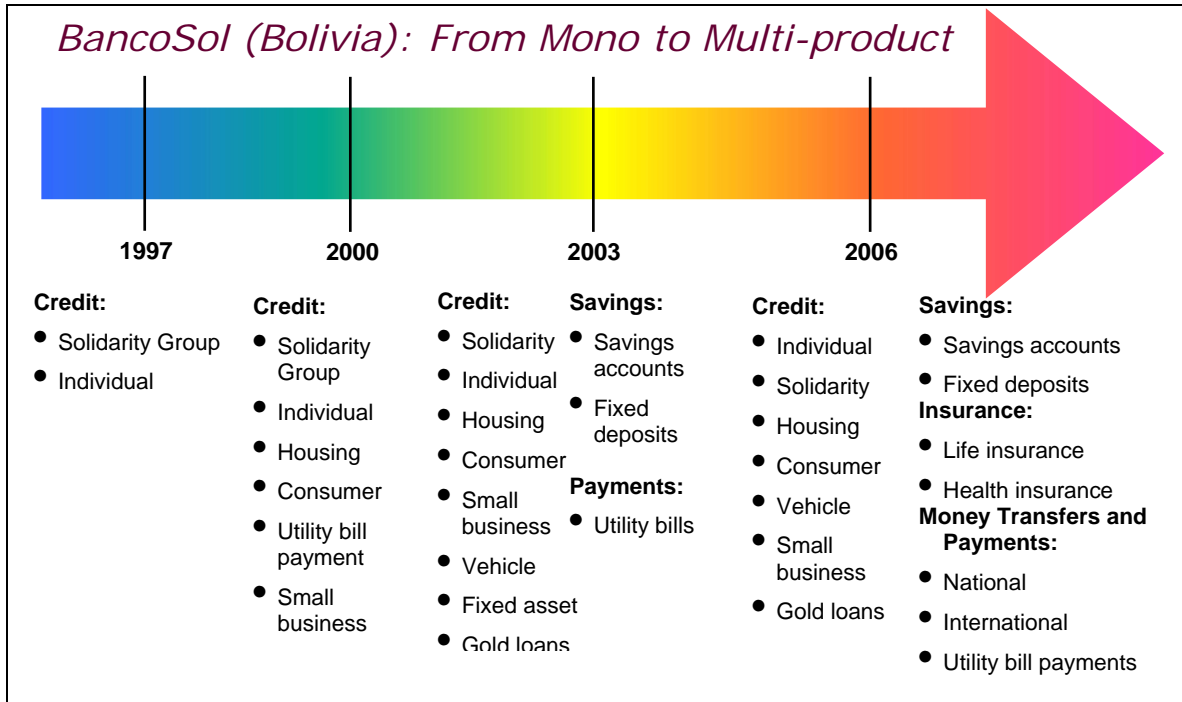
Bolivia provides an illustration of microfinance under competition. Its microfinance sector has been competitive for nearly a decade. In Bolivia, clients can choose from several microfinance institutions. They have become price sensitive, and this competition has driven interest rates down from an average of nearly 30 percent in 1998 to 21 percent at the end of 2004 (see Figure 1).

To offer lower prices, Bolivian MFIs have faced enormous pressure to become much more efficient and to broaden their product mix to include larger loans. BancoSol increased productivity, reduced costs, and increased loan terms to bring its operating expense ratio from the high teens in the late 1990s to the single digits today, a rate once considered unreachable.

As competitive conditions spread to other countries, competition will exert the same kind of pressure toward efficiency. With the help of another of our four drivers, technology, the cost of delivering tiny loans will eventually drop to little more than that of commercial banking. This process will greatly challenge those institutions which are unable to incorporate these efficiency gains.

A final effect of competition is greater client choice. When clients have more bargaining power, they ask for products and services that meet their needs more effectively, and microfinance institutions respond. For example, in the past few years, BancoSol diversified its product offerings dramatically in response to competition.

**Figure 2. BancoSol: Diversified Product Offering (1997-2006)**



As we will see below, competition most likely will not come only from existing or new microfinance institutions but from the second of our four drivers, the entry of new commercial players.

### *Driver 2. Commercial Entry*

The entry of commercially oriented providers will substantially change the microfinance field. After struggling for many years to attract the attention of the mainstream, microfinance is now experiencing a surge of interest from the private sector. Though aware of large unmet demand from low-income households, banks traditionally shunned them because of their perceived high risk. But the demonstration effect of the last decade, coupled with the success of the first movers into this market (especially early-adopter banks), is encouraging a growing number of private players around the world to consider microfinance.

The right conditions for rapid entry by new commercial players are now present in the marketplace: demonstrated profitability, business models that can be copied, and competencies for working with low income populations. The history of financial sector innovation suggests that once such conditions are present, spread can be very rapid. Change will not necessarily occur in the orderly way one might like, and the largest changes may not come from the expected sources. Consider, for example, the potential to amass large volumes of customers quickly when big box retailers like Tesco in the United Kingdom or Elektra in Mexico begin offering financial services. Or consider the implications for scale of telecommunications companies offering payments services by cell phone text message. These innovations have already occurred. They will spread, and more will follow.

### *Driver 3. Technology*

The technologies to transform microfinance already exist. Among the available technologies are magnetic stripe and chip (smart) cards, point of sale devices, ATMs, cell phones, satellite communications, the internet, credit scoring, data mining, biometric recognition and more. These technologies will require microfinance institutions to redesign their business models and educate their employees and customers to master new ways to deliver and receive services. Such changes will not always be easy, but the benefits will be dramatic. They include greater convenience and lower cost for customers, ability to reach more remote customers, and increased security. Innovation in technology will occur in three main areas: payments, credit underwriting and back end systems. And even while we work to apply existing technologies to microfinance, those technologies will themselves evolve, changing the way the financial system operates and making possible things we cannot even envision at present.

Breakthroughs in the use of technology require that microfinance institutions have already incorporated technology thoroughly into their operations. To date, technology in microfinance has served to manage information, that is, primarily on the back end. MFIs with strong MIS can standardize their operations, produce timely and transparent financial reports, and report on their operations as otherwise needed. These attributes will be *sine qua non* for future microfinance institutions.

While wider application of technology will reinvent microfinance, its incorporation will not be smooth for all. The wide variety and disparity in quality and design of existing back end software used in microfinance will delay the introduction and deployment of front end and other uses of technology. Additionally, new technologies will require fundamental changes in the way an institution relates to its clients, which to date has consisted of high cost, high touch contact, and such changes will most likely be met with both internal and external resistance. We will explore the implications of technology for microfinance further in Part II.

#### *Driver 4. Policy and Regulatory Environment*

Microfinance can only progress if the enabling environment is supportive. The policy environment will determine which regions and countries will close the demand gap most successfully. The trajectory of policy and regulatory environment has until recently been from state-controlled and distorted financial markets toward more liberalized financial markets, and this has been good for microfinance. Microfinance has flourished in settings where the government did not follow directed credit policies, allowed interest rates to be market-determined, kept credit allocation separate from politics, and was not itself involved in direct lending. In some countries, special microfinance regulatory frameworks have been very helpful, supporting the particular needs of microfinance institutions in countries like Uganda, Indonesia, Peru and Bolivia. This trend is under threat in some places,

however. Some governments want to turn back the clock, implementing interest rate caps, and politicians increasingly see microfinance as an attractive target for their attentions. Because scale brings high visibility, actions to restrain or interfere with microfinance are more likely to appear in exactly those countries where microfinance grows fastest.

## Thoughts from the Field: The Enabling Environment

- *Most MFIs in our region operate within unclear and often conflicting legislation that does not support the principles of best practices and hinders MFIs from prospering, growing or even transforming into regulated financial institutions. (Ahmed El-Ashmawi, Sanabel Network, MENA Region)*
- *The regulatory framework is helping our region, especially in Bolivia, Peru and Colombia, where the regulators have understood microfinance. (Rafael Llosa, Mibanco, Peru)*
- *On a policy-making level, we have seen some positive steps being taken in shape of the regulatory framework. However, the consistency is questionable due to the volatile and changing political scene in the country. (Khalid Kabeer, Kashf Foundation, Pakistan)*
- *If politicians or media call for an interest-cap (as they have), this will hamper the development of microfinance, but will only truly make a lasting effect if laws are changed at the national-parliamentary level. (Vikram Akula, SKS, India)*
- *At this stage, it seems that the regulatory framework is rather hampering the development of microfinance in the region. (Gagik Vardanyan, Kamurj, Armenia)*
- *The countries that have special legislation for microfinance institutions in the region are still at the infancy stage and one cannot gauge the impact yet. Clearly though the absence of such legislation hurts the industry. (Kimanthi Mutua, K-Rep Bank, Kenya)*
- *In Palestine, still we don't have an MFI law. Advocacy for a new MF law can be a very bad idea under the current situation and it could backfire on our programs. (Reem Abboushi, ASALA, Palestine)*
- *The regulatory framework is the main hindrance. (James Mwangi, Equity Bank, Kenya)*
- *China has 1.3 billion people, very low access to financial services, and very low amounts of microfinance, which would suggest that there's a huge opportunity. But with a very tight regulatory framework, it's very difficult to show how you can be profitable. For example, the interest rate is capped. (Rosalind Copisarow, ACCION International, USA)*
- *The Mongolian environment is friendly, stable and developing. There are no caps on interest rates, no restrictions on currency conversion or on repatriation of dividends. (Ganhuyag Chuluun, XACBank, Mongolia)*

## **Part II. Microfinance in the Next Decade: Our Predictions**

In the remainder of this paper we look ten years ahead and ask what microfinance will look like in 2016. Our predictions are made using current trends, our own judgments about the effects of the four drivers of change, and the thoughts of many other microfinance leaders.

The original vision of microfinance, extending financial services to the majority of the low income population, will be substantially accomplished during the next decade, and microfinance as we know it will be an established part of the financial system in many if not most countries. In these countries, it will be difficult to identify a distinct microfinance sector.

Having said this, the factors that will permit the merging of microfinance into the financial system will vary from country to country, from region to region, and from urban to rural areas. The absence of the necessary ingredients: commercial lending institutions with ample access to capital; the basic level of political and economic stability; and policy environments suitable for microfinance, to name the most important, will continue to restrict the growth of microfinance in certain countries. New countries will be added to the existing list where microfinance currently thrives, but others will still display much slower advance. MENA will remain a challenging region. Africa will show extremes: in some countries African institutions will be world leaders (for example, Equity Bank was the first private MFI to issue an IPO), while in countries with severe economic or political problems little progress will be made.

The gaps in meeting demand in the highest population countries (China, India, Brazil, Nigeria, Pakistan, Mexico, etc.) will substantially diminish. Most of these countries, while relative latecomers to microfinance, are showing dramatic progress in recent years.



Countries where demand will remain substantially unmet are those unable to provide the basic level of political and economic stability necessary to conduct business and those with policy environments unsuitable for microfinance. Also lagging will be countries where the bulk of the population is remote or difficult to access. Topography, infrastructure and other factors will also affect reach; for example, in China population is concentrated in the coastal areas, but the poor are in distant rural areas. The world overall will also become more urban in the next decade, with mega cities continuing to grow and medium-size cities growing in number. Microfinance will continue to flourish more in urban and peri-urban areas than in rural areas.

### Who Will Deliver Services?

The mix of providers of microfinance services in 2016 will change greatly from the current blend, which is shown in Table 4.<sup>11</sup>

<b>Table 4. Microfinance Scale by Institution Type - MIX Data, 2004<sup>12</sup></b>						
<b>Institution Type</b>	<b>Number of Institutions</b>	<b>Active Borrowers (Millions)</b>	<b>Share of All Borrowers (%)</b>	<b>Loan Portfolio (US\$ Billions)</b>	<b>Share of Total Portfolio (%)</b>	<b>Average Loan Balance (US\$)</b>
<b>Banks</b>	47	9.2	33	5.1	56	558
<b>Credit Union</b>	27	0.7	2	0.6	7	889
<b>NBFIs</b>	87	4.6	16	1.6	18	341
<b>NGOs</b>	196	13.9	49	1.6	18	117
<b>Rural Banks/ Other</b>	21	0.4	1	0.2	2	427
<b>Total</b>	<b>378</b>	<b>28.8</b>	<b>100</b>	<b>\$9.1</b>	<b>100</b>	

<sup>11</sup> The data in Table 4 and that in Table 1 are identical, cut into different categories. Annex 1 is also based on the same data.

<sup>12</sup> Excludes MFIs listed in the MIX with fewer than 5,000 active borrowers.

Today, NGOs are the largest group of providers with the deepest outreach (measured by loan size to the lowest income people). However, the prevalence of NGOs in the global totals is largely due to the scale of microfinance in Bangladesh and to the predominance of NGOs there. If Bangladesh is excluded from the MIX data, the picture changes dramatically. Outside of Bangladesh, NGOs serve 26 percent of total clients, banks 36 percent and finance companies 30 percent.

Formal financial institutions are increasingly important and the percentage of services delivered by banks is increasing over time. This is not surprising because of the banks' capacity to leverage their capital and grow their operations.

Among the banks that do microfinance seriously today, there are three distinct types: the specialized banks that focus on microfinance, such as Mibanco in Peru and K-REP Bank in Kenya, many of them with NGO origins and strong social mission; the mainstream banks for which microfinance is one of several lines of business, such as Banco Caja Social in Colombia and Banco de Pichincha in Ecuador; and the state-owned development banks for which microfinance is a public mandate, like Bank Rakyat Indonesia and Banco do Nordeste in Brazil.

By the end of the next decade there will be a wide variety of service providers (see Table 5). Many types of institutions will contribute the innovations that will take us through the next ten years. NGOs, for example, will be social innovators, while regulated MFIs are likely to innovate in the financial products area.

Most services will be delivered by formal financial institutions. Respondents were nearly unanimous in suggesting that the field will move strongly toward regulated financial institutions. Most respondents in our study believe that the transformation of NGOs to regulated MFIs will continue through the next decade.

What may not be as obvious, however, is the likelihood of entry by new banks that are not now among the largest microfinance players. Throughout the next decade, banks of several types – specialized and mainstream; domestic and international – will become increasingly important and will dominate microfinance in terms of numbers of clients and amount of loans and deposits. Commercial banks, termed “downscalers,” bring important advantages versus other players. In addition to having vast infrastructure such as branches, tellers, and IT, they also have access to abundant and low-cost funding. They are in a good position to benefit from synergies between microloans and other services they already offer, such as remittances and credit cards.

Many of these banks will integrate microfinance into their ongoing commercial retail lending. Whether through a specialized company, a separate unit, or incorporated into other lending, the banks will not differentiate this portfolio from the rest of their financial transactions, except to understand its viability and profitability.

Today there are enough banks involved in microfinance that their experience provides strong hints of what is to come. For example, local banks -- small, large and regional -- will most likely be better equipped to integrate microfinance into their portfolios. Large international banks may be better at providing finance to other banks, MFIs or NGOs, using gradually more sophisticated financial instruments. The increasing engagement of banks is likely to come in waves, as the banking industry worldwide gradually learns how to implement and generate returns from microfinancial services.

Today in Latin America and Africa, forward-looking local and regional banks have already begun to provide retail microfinance whereas in India, banks are engaging mostly as wholesalers, on-lending to MFIs. One example of how quickly banks can reach scale with microfinance comes from Peru, where local mainstream banks, such as Banco de Trabajo, have become keen competitors of the specialized MFI Mibanco. According to the MIX data, Banco de Trabajo is now the largest provider of microloans in Peru, with nearly 200,000 clients. Eventually, the giant international banks will become involved, possibly by purchasing successful MFIs. We are already aware of numerous examples of mainstream banks offering to buy MFIs.

<b>Table 5. Current and Future Roles of Microfinance Providers by Type</b>			
<b>Type of Provider</b>	<b>Current Status</b>	<b>Advantages/Disadvantages</b>	<b>Future Role</b>
<b>Traditional MFIs</b>			
<b>NGO</b>	Most numerous group, especially in MENA, South Asia; Many in process of transformation; Deep outreach	Social mission, focused on poor, close to customer, non-financial services/high cost, smaller outreach, limited access to resources	Smaller role overall; more focused on poorest, non-financial services; testing high cost/risk products <i>social innovators</i>
<b>Specialized MF Bank or Finance Company</b>	Strong providers, many post-transformation NGOs, growing rapidly	Knows microfinance customer; financially sound, increasing access to finance, product innovators/lacking deep pockets for investing in future; higher cost	Major leaders in MF; must adapt to competition; will incorporate new private shareholders <i>product innovators</i>
<b>Credit Union</b>	Important deposit-takers; still lagging in loans	High trust by members; low cost structure/governance issues, lack of resources for investment	Niche players; will have to modernize to survive; important in rural areas
<b>Public Sector Bank</b>	Massive deposits; urban-rural money transfers; rural outreach	Widespread branch networks, social mandate/sluggish, subject to political capture	Increased efficiency through competition with private banks; high volume basic services
<b>Commercial Entrants</b>			
<b>Local and Regional Banks</b>	Active entry in Latin America; active as wholesalers in India; Major deposit-takers	Access to funds, good infrastructure, market recognition; agile/weaker in competition with big banks; thin management and governance; variable commitment	Increasing involvement as competition in financial sector continues; <i>service innovators</i>
<b>International Banks</b>	Limited involvement; see MF as part of CSR	Financial, human and technology resources; established brand and market position/hard to connect locally; do not know microfinance market; not agile	MF will be standard part of retail operations; may acquire microfinance through mergers or acquisitions
<b>Consumer Lenders</b>	Spreading worldwide; some consumer lenders trying microfinance; interest in buying MFIs	Know-how in financial service delivery, automation and technology, channels to customers/ Lacking social commitment	Integrated microfinance and consumer finance, massive scale; <i>technology innovators</i>
<b>Big Box Retailers</b>	Spreading throughout developed world; entering financial services in developed world, a few entries into microfinance	Channels to customers through infrastructure and database, known in marketplace, resources for investment/lacking social commitment; finance not main focus	Mass providers of services; will have banking licenses; <i>delivery innovators</i>  Could include telecommunications companies.

A new category of entrant only beginning to emerge are consumer lenders, of two types: consumer finance companies (GE Finance, Citi Finance) and so-called big box consumer retailers that are beginning to provide financial services (Wal-Mart, Elektra, Tesco). These major corporate players have massive outreach through their connections with consumers; they have the techniques for large scale financing, such as credit scoring. Their interest is not limited to traditional consumer finance, once they see the potential of microfinance. The concept of the “fortune at the bottom of the pyramid” has captured the imagination of many companies and is driving them towards financing the poor.<sup>13</sup>

Elektra in Mexico has formed Banco Azteca, which allows it to offer one-stop retail and financial services. Banco Azteca already numbers the microenterprises it finances in the hundreds of thousands. A related group of entrants will be large companies that add credit to their services to reach more clients, especially low-income ones. CEMEX, the second largest company in Mexico, provides loans to low-income clients so that they can build their own one or two-room houses. This program has similarities to supplier credit and could have enormous reach given CEMEX’s enormous international footprint.

The new entrants will continually challenge traditional MFIs, whether NGOs or regulated finance companies or credit unions. Nevertheless, there will be niches for all kinds of providers, even in very competitive markets. To succeed, they must stay close to the customer, provide flexible products and excellent customer service, and develop clear channels to the capital markets for funding.

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<sup>13</sup> Prahalad, C.K. *The Fortune at the Bottom of the Pyramid: Eradicating Poverty through Profits*, Wharton School Publishing, 2004.

Commercial entry challenges microfinance providers to re-evaluate their relevance in light of changed circumstances. In particular, it challenges us to re-invigorate the microfinance social mission. Socially motivated microfinance providers may decide to redouble their efforts to reach the very poor, to advocate for consumers rights within the newly inclusive financial sector, or to develop products to serve unmet social needs.

## Thoughts from the Field: Who Will Deliver Services?

- *I believe regulated institutions, commercial banks and credit unions are the MFIs of the future. (Kimanthi Mutua, K-Rep Bank, Kenya)*
- *We see some NGOs transforming into regulated financial institutions (in Morocco and Syria). We will definitely see more banks entering the market, yet not serving the very poor. We see limited roles for government programs, and microfinance projects initiated by donors. We also see stronger linkages and partnerships between banks and NGOs to provide diverse services. (Ahmed El-Ashmawi, Sanabel Network, MENA Region)*
- *Regulated, specialized MFIs and commercial banks. Delivery mechanisms will change but market orientation to clients and strong links with clients will be major advantages. (Aleksander Kremenovic, Mikrofin, Bosnia and Herzegovina)*
- *If we look at the big untapped markets, I wouldn't be surprised by new public sector interventions, especially in China. Another important structure will be commercial banks with "social banking" divisions—partly emerging as a response to regulatory dictates, as in India. (Jonathan Morduch, New York University, USA)*
- *In the next ten years in the Philippines all of the regulated financial institutions will be providing financial services (to the poor). We do need a really good credit bureau and with that, you will see huge growth of commercial banks in the industry. I think most of the NGOs are going to transform into banks. (John Owens, Chemonics, Philippines)*
- *The answer lies in something between commercial banks and specialized microfinance institutions. The commercial banks will have to move into that space, but I don't believe they will be able to do it with the current structures. In South Africa, a hybrid will be created between commercial banks and specialized MFIs. (Hennie Ferreira, Microfinance South Africa, South Africa)*
- *Commercial banks working through regulated, specialized MFIs will serve the majority of the market. Going forward, for-profit NBFCs (non-bank financial companies) will serve the majority of the market as they continue to expand at rates of 200-300% per annum. More government heavily-subsidized microfinance initiatives may arise, but they lack the bandwidth to serve large pockets of the microfinance market. (Vikram Akula, SKS, India)*
- *It will be very similar, if not exactly the same, as the current formal financial sector with room for a broad range of players, full-service banks, specialized niche players and NGOs. (Geoff Davis, Unitus, USA)*
- *Commercial banks, I hope, will have the major market share. And I hope too that delivery will move away from groups toward individuals, up the ladder from self-help groups. (Malcolm Harper, independent)*
- *Commercial banks or other profit-oriented institutions will dominate in the market as they do now. Some of them such as XACBank are transformed MFIs. (Ganhuyag Chuluun, XACBank, Mongolia)*



## Who Will Be Served?

While there will be microfinance institutions, mostly NGOs, which will focus their outreach exclusively on the poorest, most microfinance institutions will continue to reach the poor and the very poor, that is, those below the poverty line in their countries, but not in the lower half below the poverty line.<sup>14</sup> The increased role of commercial banks and non-financial institutions as channels of financial services will increase the focus on those hovering just below and just above the poverty line in their countries.

Nevertheless, banks and commercial microfinance institutions have demonstrated both interest in and capacity to reach lower income segments, especially if this approach opens new markets in which they can have a comparative advantage. Sogesol, the microfinance service company owned by the largest bank in Haiti, Sogebank, has recently rolled out a loan product, "Cash Rapide", seeking to reach even closer to the bottom of the poverty scale. Mibanco in Peru introduced the loan product "Chasqui," named after the famed Inca messengers, which starts at \$80 and has indeed opened a new market that its competition cannot reach. One could surmise that the competitive edge of microfinance institutions will play itself out in reaching increasingly poorer segments of the population, where first mover advantage could improve the competitive position of a microfinance institution.

Additional factors will influence how deeply into the poorest segments microfinance will delve. First, as levels of efficiency increase, the capacity to extend smaller loans in a financially viable way will also increase.

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<sup>14</sup> The Marulanda Otero paper on Latin America provided data that microfinance institutions, once regulated, continued to reach the same clients despite rising average loan size. The factors that contributed to the increased loan were: 1) long-term trustworthy clients obtained larger, longer-term loans; 2) the variety of products included some, such as home improvement, that were larger than working capital loans; 3) existing borrowers sought larger loans as their businesses grew; 4) institutions added small enterprises loans, which often constituted under 5 percent of total borrowers.

Considerable advances have been made in this regard in the last ten years as we have witnessed the costs of operation in relation to portfolio improve significantly. It is likely that we will see additional progress that will make reaching lower segments more financially possible for efficient microfinance institutions.

Second, as microfinance institutions seek to build loyal customer base, they will turn to the lowest income borrowers as one way of capturing and retaining clients. Building a strong base of clients, even if initially at a loss, could in the long term be a preferred strategy that would lead microfinance institutions into serving poorer segments of the population.

The common thread that ties together the above factors is the application of sound business decisions related to financial viability, productivity, and market share. That these business considerations will prevail as the key factors should not be a surprise, since these are the same ones that have led commercial institutions into microfinance in the first place.

Some microfinance institutions, led by their owners, will seek to reach lower income segments to address corporate social objectives of importance to shareholders. Some microfinance institutions, especially those transformed from NGOs, will be among those most likely to consider a social dimension as part of their mission, but such thinking could also extend to banks that enter this market. However, even these institutions will need to find financially viable ways to broaden their reach, since no shareholder will maintain a strategy that financially weakens the institution.

Those who value the social dimension of microfinance and see it not only as a business proposition but as one way to address poverty will have to focus their innovative talents on finding ways to make reaching the poorest attractive to commercial institutions. This is what microfinance has done already with people below the poverty line, and should be able to do as well with very low income segments and with rural populations.

The degree to which microfinance can apply technology and develop new products for rural areas will have a lot to do with how low on the poverty scale microfinance institutions are able to reach. The predominance of the poorest in rural and remote areas will attract more and more NGOs to push ahead in serving these populations. Most likely, the challenges of reaching the poorest, especially with agricultural loans, will require some level of subsidy because microfinance has progressed so little in this area. NGOs will have the opportunity to play a very significant role in advancing this portion of microfinance, which for many will mean an intentional redefinition of their current vision and strategy regarding their role in microfinance.

While major advances will be made in reaching people who are currently unreached, including many very poor people, we expect that at the end of the decade there will still be a challenge to reach the poorest, rural and most remote clients.

## Thoughts from the Field: Will the Poor Be Served?

- *Banks can serve the poorest people who do need microfinance, that is not the very poorest, as well as or better than MFIs. (Malcolm Harper, UK)*
- *Why wouldn't commercial microfinance be able to serve the very poor? Commercial microfinance will have to develop specific delivery channels and products, but there is no reason why commercial principles shouldn't be applicable to very poor people. But if by very poor you mean people who are very destitute and have absolutely no resources, then microfinance is not for them. The very poor should be helped by improving access to education, healthcare, charity, and philanthropy. (Jean-Philippe de Schreval, Blue Orchard Finance, Switzerland)*
- *It will be very difficult to serve the very poor because commercial banks need profitability and managing loans is expensive at the micro level, and credit bureaus are not around. So the poor will not be served. A \$100 loan is a group lending methodology and that is not the cup of tea for commercial banks. (Adrian Merryman, Opportunity International)*
- *We serve hundreds of places in Poland that are very poor, but oftentimes microlending institutions are still too expensive to reach rural areas. (Krzysztof Jaczewski, Fundusz Mikro, Poland)*
- *Commercial microfinance will always serve the poor who are economically active. In fact, those who are called "the poorest of the poor" are those who are completely poor and who are unable to have an active life or who do not want to do it. Microfinance, whether commercial or not, can do nothing for these people. It is precisely at this level that the government has much work to do. (René Azokli, Padme, Benin)*

## **What Products and Services will be Delivered?**

It is very significant that microfinance has changed from a focus on a credit mono-product to a full array of financial services, and that the target market has broadened from microenterprises to the low income household, including both business and family needs. The microfinance field now recognizes that the financial needs of low income people are potentially as wide-ranging as those of the middle classes. However, the reality of service delivery today lags far behind the full service ideal. This observation yields a key concept for microfinance practitioners to consider: the quality gap. Closing the quality gap will be one of the most important tasks for microfinance during the next decade.

An ideal array of services begins with a basic core package: savings, credit, insurance and payment products (such as money transfers). Most households need some mix of these basic products, and for that reason, these services should be widely available. A full service MFI should offer such a package in a flexible manner that works for a broad spectrum of its low income clients.

Beyond the basics are specialized products that appeal to certain segments of the target population, or to people at certain stages of their lives. For example, life cycle products might include education savings accounts or loans, home improvement loans, and pensions. There are specialized financial products for growing microenterprises or agricultural businesses: leasing, vehicle purchase, crop insurance. There are money management products like current accounts, bill payment and remittances.

The institutions that today identify themselves with microfinance remain strongly focused on credit, and in some countries inflexible group loans still predominate as the sole product offered by most MFIs. Few of the existing microfinance clients have access to products that are sufficiently flexible and varied. Today, as the numbers cited in this paper attest, scale in microfinance is still measured by borrowers and loan portfolios. A client that has access only to a rigid and time-intensive loan and a client who has a flexible loan, a savings account and an insurance policy are both counted as having been reached.

Microfinance during the next ten years must attempt to close the quality gap by increasing the range and coverage of products. The good news is that work toward that end has now gone on for several years, bringing some products to the point of take off, such as home improvement lending and basic microinsurance (see Table 6). Other products remain in the early experimental stages, such as pensions and health insurance.

<b>Table 6. Beyond Working Capital Credit: New Products and Services</b>		
	<b>Examples</b>	<b>Prospects</b>
<b>Deposit and Payment Products</b>		
Current accounts	Widely available from commercial banks but often prohibitive minimum requirements	Enormous potential with new entrants, especially banks; current account becomes core for customer relationship
Investment products	Small scale investment in mutual funds + unit trusts; annuities	Will become available in countries with developing capital markets
Money transfers + remittances	Enormous flows, U.S.- Latin America flows through money transfer organizations; flows to Europe more likely to use banks	Seamless international banking through technology improvements, competition; banks will replace money transfer companies and reduce cost
Bill payment services	Net One in South Africa pays government pensions with SmartCards	Vast improvement in customer service; fewer, shorter lines
<b>Personal Loan Products</b>		
Home improvement	Micasa product of Mibanco in Peru is highly successful and growing	Will become a standard microfinance produce widely available
New home purchase	BancoSol in Bolivia and Banco Solidario in Ecuador offer mortgages to upper tier of their clientele	Innovations remain elusive to make whole-house finance affordable; some progress likely; key constraint title issues
Education	Uganda Microfinance Ltd. provides school fee loans; Equity Bank in Kenya makes loans to schools	Will become a popular product, important for a variety of markets
Consumer	Banco Azteca, Mexico provides loans to consumers buying appliances from Elektra stores	Over-supply likely; highly competitive with many mass providers
<b>Business Loan Products</b>		
Working capital	All microfinance	Will remain core product; more individual, fewer group
Agriculture	State development banks remain active providers	Much progress, but will continue to lag other areas
Leasing	Widely developed for small business	Niche product for upper tier
<b>Insurance and Other</b>		
Life insurance	Credit life widely available; standard life much less	Life insurance products will be tailored to client preferences: example: guaranteeing remittance continuity
Property and crop	Some crop insurance experiments in India, thanks to policy directives	May require continued policy support or subsidy
Health insurance	SEWA Bank, India provides health insurance	Will progress slowly; requires reform in health care & assurances of delivery channels
Pension products	Just beginning to be considered for low income people	Will spread rapidly if governments take lead

The bad news is that although it is easy to conceptualize the ideal product array, it is very difficult to deliver it. Institutions conceived around a mono-product have to reorganize their operations and develop new competencies. If they add savings services to credit, they have to change the way they relate to clients, their image in the marketplace, and their internal systems. For this reason, forward movement on narrowing the quality gap will not be smooth and predictable. Some MFIs, mainly those with commercial banking licenses, will become full service providers, while others will lean toward either savings (credit unions and savings banks) or credit (NGOs). We can expect to see new entrants playing a major role, for example retailers providing consumer loans or mobile phone companies providing payment services. Tension may emerge between specialized institutions that can be efficient, low cost providers of one particular product, and full service providers that attempt to meet most or all of a customer's financial needs. Those institutions identifying themselves as part of the microfinance community, to the extent that it retains its distinctiveness, will continue to see credit for microenterprise development as at the core of their missions even as they add new products and serve new market segments.

As momentum gains around new products and services, financial literacy training will grow in importance. Clients who are presented with an array of services can benefit, but they must also be provided with information that assists them to navigate this more complicated marketplace. The dangers of overindebtedness are well known, and one of the best defenses against it is a well-informed clientele that can assess their own repayment capacity and understand how to use financial services to reach their goals.



## Thoughts from the Field: Products and Services

- *In the future, we are going to see high-quality products offered to almost everybody.* (Eduardo Bazoberry, PRODEM, Bolivia)
- *Commercial banks will diversify their product mix and start offering products through specialized vehicles such as mortgages, leasing, insurance, consulting.* (Ganhuyag Chuluun, XACBank, Mongolia)
- *Insurance and savings are the most needed products, while adequate regulations still are the primary constraint to offering these products.* (Motaz El Tabaa, ABA, Egypt)
- *Currently, one notes the clear progression of demands for saving services, the transfer of money, and microinsurance.* (René Azokli, Padme, Benin)
- *Microloans (working capital and longer-term loans to buy fixed assets); savings; housing loans; loans for home/business improvement; micro insurance; remittances.* (Clara de Akerman, WWB Cali, Colombia)
- *Savings for retirement, pension funds, and to some extent insurance are not in as high demand as credit. There is still a lot to be done in terms of credit, including housing loans and maybe educational loans.* (Jean-Philippe de Schreval, Blue Orchard Finance, Switzerland)
- *All bankers here in Mexico are talking housing loans – home improvements loans are viewed as the future of the banking sector in Mexico. Even mortgages on some level will be relevant.* (Carlos Labarthe, Compartamos, Mexico)
- *Basic credit and deposit products will have the greatest demand. But at the same time, consumption loans and housing finance will be main areas of growth, and then other financial services, such as deposits, etc. Bangladesh indicates that there is a tremendous demand for liquid deposit services. The Grameen pension product spurred other similar products in last two or three years. Beyond that, micro-insurance will grow. Within the credit sector, consumption and housing loans will have exponential growth.* (Nimal Fernando, Asian Development Bank)
- *There will be an increasing need for individual loans, especially in Asia, where now the majority is group lending.* (Gera Voorrips, ING Bank, Netherlands)

## How Will Technology Change Microfinance?

Technology is the wild card in microfinance. Because the potential of technology is so revolutionary and the applications still so young, we can only guess at the face of the future. Nevertheless, we can predict that within a decade microfinance clients will use cashless banking through cell phone payments, ATMs, internet and card products. These changes will bring greater security and convenience at lower cost.

Many technology innovations are beginning to be applied to microfinance (see Table 7). Each innovation addresses one of three main aspects of the microfinance business process:

- ***Credit methodologies.*** Credit decisions will be automated as lessons from consumer lending and credit scoring are blended into microfinance and as credit bureaus are built in each country. This process will be hastened if consumer lenders develop enterprise-oriented microloans, because these lenders have already mastered automated lending techniques. The drive toward automated credit decisions will challenge the traditional central role of loan officers as the main connection to clients. Consumer lenders use a “credit factory” approach with several people performing segments of the microfinance loan officer role. Microfinance will have to decide whether to embrace automated lending. In the immediate future we will see more experiments with modified loan methodology that still use loan officers but increase their efficiency through the use of PDAs, cell phones and credit scoring.

- ***Back end processing.*** Better core information systems will enable MFIs to focus on the customer and to offer customers automated payments and customized products. Over the next decade the cost of basic core systems should drop dramatically, and smaller MFIs should be able to access off-the-shelf packages for a reasonable price. More advanced institutions wishing to offer automated payments will need systems that are “interoperable” so that they can connect to other multi-institution payment systems. Open source projects may have an important role in promoting simple standard packages and interoperability. Another possibility is that core information systems are outsourced to IT specialists through the internet.
- ***Automated payment technologies*** include mobile phones, ATMs, internet payment processors like PayPal and smart cards. With automated payments, clients can go cashless, which is more secure, and financial institutions can eliminate or cut back on expensive branch infrastructure, possibly leading to lower interest rates and fees for clients. Payments will be made in locations convenient to the client – grocery stores, pharmacies, or over the phone. In many countries the prerequisites underpinning these payment systems have not been established, but most of these issues will have been solved by the end of the next decade.

We have noted several times that the challenge of rural areas will remain one of the hardest and most important gaps in the future. Payment technologies may offer prospects here, as they promise deeper penetration at lower cost.

Table 7. New Technology Introductions for Microfinance	
Innovation	Current status
<b>PAYMENTS</b>	
<p><b>Mobile phone payments:</b> cell phones become electronic wallets, using SMS technology</p>	<p><b>Philippines:</b> <i>Globe Communications</i> and <i>SMART</i> have introduced cell phones to store and transfer electronic cash for payments. Being introduced to <i>Rural Bankers' Association of Philippines</i>.</p> <p><b>Kenya:</b> <i>M-Pesa</i> has partnered with <i>Vodafone</i>, <i>Faulu-Kenya</i> (local MFI), and <i>CBA</i> (local bank). The M-Pesa system supports money transfers, cash withdrawal and deposits at retail outlets, and disbursement and payment of loans.</p> <p><b>South Africa:</b> the <i>Wizzit</i> banking facility allows low income account holders to use their mobile phones to remit money to a friend, buy airtime, or pay accounts.</p> <p><b>Latin America<sup>15</sup>:</b> <i>Motorola</i> recently unveiled M-Wallet, a downloadable software application that allows users to pay bills, purchase products, and/or transfer money using their cell phones. The company is targeting the remittance market between the U.S. and Latin America.</p>
<p><b>Electronic payment systems:</b> deposits and withdrawals through plastic cards at ATM machines and at participating merchants. Debit, credit and prepaid cards</p>	<p><b>Guatemala:</b> <i>FINCA</i> and <i>VISA</i> are piloting the use of pre-paid cards for loan disbursements by partnering <i>FINCA Guatemala</i> and <i>Nicaragua</i> with <i>VISA</i> member banks.</p> <p><b>Peru:</b> <i>Mibanco</i> has become a <i>VISA</i> member bank, and has introduced <i>VISA</i> products including: <i>Miahorro</i> (a savings account with debit card), <i>VISA Empresarial</i> card which can be used at ATMs and a credit card, all launched in 2006</p>
<p><b>Point of sale devices (POS):</b> installed at local retailers, allow clients to make withdrawals and deposits closer to home</p>	<p><b>Uganda:</b> <i>Uganda Microfinance Limited</i> is piloting the use of POS devices to extend rural outreach.</p> <p><b>Senegal:</b> <i>FERLO</i> is piloting a similar POS initiative.</p> <p><b>India:</b> <i>ICICI</i> and <i>SEWA</i> bank are conducting a pilot whereby loan officers use POS devices at group meetings.</p> <p><b>Colombia:</b> 45 cooperatives with different core banking systems are using a single POS solution.</p>

<sup>15</sup>[http://www.usaid.gov/our\\_work/economic\\_growth\\_and\\_trade/info\\_technology/tech\\_series/Rural\\_Connectivity\\_508.pdf](http://www.usaid.gov/our_work/economic_growth_and_trade/info_technology/tech_series/Rural_Connectivity_508.pdf)

Table 7. continued	
Innovation	Current Status
<b>CORE SYSTEM</b>	
Management information systems for client tracking	<p><b>USA:</b> the <i>Microfinance Open Source (Mifos)</i> project established by the Grameen Technology Center is pursuing the development of a management information system using Open Source Framework.</p> <p><b>India: FINO,</b> an initiative of <i>ICICI Bank</i>, is a private company established to provide outsourced MIS services to MFIs, including core banking system and distribution set up.</p> <p><b>Andean Region:</b> ACCION has coordinated an effort by <i>BancoSol (Bolivia)</i>, <i>Banco Solidario (Ecuador)</i>, and <i>Mibanco (Peru)</i> to create a unified credit methodology supported by a common MIS with technology by <i>BanTotal</i>.</p>
<b>CREDIT UNDERWRITING</b>	
PDA's assist in on-site credit assessment	<b>Latin America:</b> At <i>Banco Solidario (Ecuador)</i> , loan officers use Pocket PCs to conduct loan evaluation on site with client; at <i>BanGente (Venezuela)</i> , they use PDA's.
Credit Scoring assists in automating credit decision	Credit scores are being used for specific MFIs, but generic credit scores are not yet used and credit scoring has not been used to re-invent lending methodologies

## Thoughts from the Field: Technology

- *We're working on using your phone like a debit card/ATM/credit card/ POS and other such hardware. We can basically move money from one phone to another. MFIs can offer lines of credit and deliver them to a phone. The problem with PDAs, smartcards and POS is the cost. You can get a phone for \$40 and \$2 a week here in the Philippines. Technology is the thing that will help leap-frog the industry.* (John Owens, Chemonics, Philippines)
- *Technology will advance microfinance in our region. The infrastructure is relatively advanced and there are limited cultural impediments especially among youth. We just need some practical experiments for technology to spread.* (Ahmed El-Ashmawi, Sanabel Network, MENA)
- *Technology has to be the key to cut the cost of delivery and decrease the amount of actual cash being handled. Some of the biggest MFIs in the world are still issuing drafts and lots of clients having to stand in line to get money. Do we want to go to the bank and stand in line? No. Well, neither do our clients.* (Bob Annibale, Citigroup, UK)
- *Delivery mechanisms will be located in malls, pawnshops, post offices, bus terminals, but the clients will take time to change because not every person is ready to do their banking with a computer terminal or an ATM.* (Yusuf Nawawi, BRI, Indonesia)
- *Just now, we're going to buy a new software system and new hardware for 41 of our micro-branches. We do not have resources like commercial banks and we have to gradually improve our technology. In a 130 person company, we expect to spend over \$500,000. This is a huge investment for us.* (Krzysztof Jaczewski, Fundusz Mikro, Poland)
- *You can't talk about technology without talking about infrastructure. Even within finance itself, the impact of technology can only be highly leveraged with good financial infrastructure that facilitates retail delivery of financial services. There must be a platform for connection among financial institutions to transfer money quickly, for example.* (Marilou Uy, World Bank)
- *Problem is that technology is not cost effective. No economies of scale with technology yet.* (David Richardson, WOCCU)
- *Delivery mechanisms will certainly change with a great bias toward technology based delivery mechanisms – point of sale devices, multifunction ATMs and cell phones, with air time as currency.* (Kimanthi Mutua, K-Rep Bank, Kenya)
- *Technology is a key factor in reducing the high operating costs associated with microfinance operations. In the field, the availability of easy and cheap communication with MFI servers will significantly increase the flexibility and the speed of information tracking and decision making, hence reducing the operation costs and making services more affordable to clients, particularly in remote rural areas.* (Gagik Vardanyan, Kamurj, Armenia)
- *Technology will be helpful as it may result in lower transaction costs, which could in turn result in profitable operations even for very small loans.* (Clara de Akerman, WWB Cali, Colombia)
- *IT can help, but not as much as some of its sales people suggest. It can also fiercely marginalize the poor, if not very sensitively applied.* (Malcolm Harper, UK)
- *There is a mindset that poor people can't appreciate or leverage technology and that it is only for the middle class. My experience is that at the initial contact people like to deal with a human being and look him in the eye and be introduced to the technology, but once they understand and see the technology work, it makes a huge impact.* (Hennie Ferreira, Microfinance South Africa)

## How Will Microfinance Be Financed?

### *Debt Financing*

Commercial sources, including deposits, will provide nearly all the debt and equity needed to fund microfinance. Banks already have access to plentiful sources of funds through deposits and the capital markets; as their role in microfinance grows they will draw on these resources for financing.

Specialized microfinance providers have made great strides in accessing the capital markets to fund their portfolios. For example, the bond issues by Compartamos/Mexico, WWB Cali/Colombia, and Mibanco/Peru, which were bought by institutional investors such as pension funds and insurance companies, represent the savings of ordinary people. Local market bond issues have the advantages of avoiding foreign exchange risk for the institution and of strengthening the local capital market. The degree to which the local capital market has developed will affect an institution's capacity to tap into it. In Mexico, for example, Compartamos faced a well-developed financial system which could respond very effectively to its various bond issuances. One can expect that as capital markets evolve from infancy in a growing number of countries, these opportunities will expand for microfinance. Additionally, one can expect that microfinance institutions will issue paper in international bond markets, where the enhancements now necessary for this type of paper will slowly decrease and disappear.

Rating agencies, such as Standard & Poors, Fitch and other raters recognized worldwide, are already identifying microfinance institutions as a growing market for their work. Over the next decade, these raters will integrate microfinance institutions into their portfolio of activities. Their capacity to generate risk assessments and ratings for microfinance institutions will play an important role in the extent to which microfinance can tap local and international bond markets and in the capital markets in general.

Specialized providers have also been successful in capturing savings deposits, which in the future will serve as the most important source of funding for microfinance institutions. Today we find that some of the most advanced microfinance institutions fund their loan portfolio mainly with savings deposits. We can expect that these institutions and others will develop additional savings products geared to the general public, which will not only increase their access to funds but will also improve their standing in their countries as trustworthy and financially viable banks.

We can expect that additional ways of engaging the capital markets will develop, which will create exciting new paths to additional resources. These are difficult to predict, particularly because over a ten-year framework the capital markets themselves will change and evolve considerably. We have already seen the first steps into securitizing microfinance, with private placements and wholesale purchases of microfinance portfolios taking place in India. The recent BRAC issue of securities in Bangladesh has advanced microfinance securitization because the securities did not remain with the sponsor bank, as in previous issues in India, but were passed on other investors. We can expect more such instruments to develop, making securitization a standard tool for raising funds in microfinance. Once these tools are developed, capital will flow from both local and international markets and will integrate whole new groups of investors into microfinance.



Socially responsible investors have become key players in providing financing to microfinance; they are the pioneers opening the way for more traditional investors to engage with this sector. The many debt funds created by social investors, mostly in Europe and the United States, will continue to grow. But gradually, they will yield to institutional investors, such as international banks and insurance companies that will launch multi-million or billion dollar debt funds for microfinance.

### *Equity and Ownership*

Specialized microfinance institutions will face additional challenges in attracting private sector owners. The major sources of equity for microfinance institutions will progress along a continuum that will over time see a decrease in the presence of public sector investors and an increase in that of private sector sources. Public sector investors, such as the bilateral and multilateral development banks have been playing a very important role as strategic investors in microfinance and have exercised that role using commercial principles. In the last decade, they have channeled their investments both directly and through equity funds. The performance of the early equity funds – ProFund and IMI – has led to a proliferation of equity funds in the last few years. The Council of Microfinance Equity Funds, organized in 2003 as a means of best practice development for this emerging sector, currently has 16 equity funds as members.

These early experiences have gathered considerable learning about investing in microfinance and about the returns one can expect. They have laid the groundwork to attract a growing number of private players made up of investors that seek both a social and a financial return. The experience of these pioneering private investors is currently paving the way for microfinance to access mainstream capital markets.<sup>16</sup> Once they do, the

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<sup>16</sup> Among the leading private equity investors today are Gray Ghost Microfinance Fund, Andromeda Fund, and Unitus with MicroVest Fund moving into equity.

range of investors in microfinance will be democratized so that ordinary people will be able to support microfinance through their own investments.

A review of the data available on current equity investors in microfinance, as compared to those three years ago, gathered by the Council of Microfinance Equity Funds, provides several interesting trends that we believe will continue to evolve in the future:

- Public investors will play a role in equity for a longer time than in debt. In both, commercial sources will replace them. Recent data shows that their role in relation to the presence of private investors may be starting to decrease. For public investors this trend would be welcome since it is their stated intent, but not always their actual effect, to open the way to attract private sources of capital;
- There are more private investors, which include an increasing number of management and employee stock options;
- Private investors, both local and international, are increasing their role as equity holders. International investors invest primarily through equity funds while local investors invest directly in the microfinance institution;
- Socially responsible investors will retain a significant role as shareholders in microfinance institutions.

NGOs will continue to play an important role as key investors. Their role has been to ensure that microfinance institutions remain true to their original mission and perform on social and financial returns, the famed double bottom line. Some will continue to demonstrate a higher tolerance for risk and be strategic investors in institutions that appear too risky to other investors. Others, in particular microfinance networks, will deploy two ownership models: one that gives them a majority position in select microfinance institution which they control, and one that makes them minority investors in select institutions into which they bring other private

investors. To the extent that these NGOs are professionally managed, financially sound, and effective in playing their governance role, they will remain important equity players in microfinance sitting side-by-side with private investors.

Some will argue that the presence of NGOs, which lack discernable owners, as equity holders, will create considerable difficulties in privatizing microfinance, and may even deter private investors from entering the market. This negative outcome can occur when NGOs resist the entrance of private investors and effectively crowd them out, even if the presence of stronger private sector investors with experience, resources, and commitment to the objectives of the institution could be highly beneficial for the long-term goals of the institution. As microfinance becomes increasingly competitive, NGOs that prohibit private investors from investing will most likely damage the institution's overall reach in its market. At this time, there are still issues that are not fully resolved about the joint presence of NGOs and private investors in the same institution. The institutions that will be best equipped to address microfinance in the next decade and beyond will be those that open themselves up to include well-selected private investors as significant or majority shareholders.

We will also see the presence of large commercial banks as investors seeking majority ownership positions in microfinance institutions, and integrating them into their overall financial activities. There have already been such serious attempts by international banks, who are demonstrating special interest in Latin America, and it is likely that these will intensify. When this happens, specialized microfinance institutions, as we know them, will become part of the commercial banking sector.

The first Initial Public Offerings (IPOs) in microfinance have taken place in the last two years, the first by BRI in Indonesia, and recently by Equity Bank in Kenya. Both have democratized share ownership and are opening the way for other leading MFIs to join them. We can anticipate considerable movement towards IPOs in microfinance and predict that by the end of the coming decade publicly traded shares will become an important component of overall MFI ownership.

### *The Role of Donors*

The role of donors will continue to be essential in the next decade, and we will see an increasing number of private donors becoming very important players in microfinance. Their work must be done in the context of the increasingly important role played by the private sector, and should seek to expand the presence of private sector players as debt and equity providers of microfinance.

The role of publicly funded donors, who made possible the pioneering efforts of microfinance and also have funded its growth, will not be needed for microfinance operations or for financing of loan portfolios. Instead, they will focus on those areas essential for the further development of microfinance, that still require some level of subsidy. They include the following areas:

- information dissemination: to expand the knowledge of best practice and of the most recent innovations;
- building the capacity of microfinance institutions, regulators and supervisors;
- supporting microfinance that reaches very poor, rural and remote clients;
- innovation in product development and use of technology, some of which will also be privately financed;

- developing the standards for the industry by financing its infrastructure - such as ratings initiatives, and credit bureaus;
- overall economic development; and
- operation in vulnerable states (chronic war-torn states)

## **Microfinance & Social & Economic Development**

In the next ten years, microfinance organizations will make important contributions to poverty alleviation by addressing quality of life issues such as health, education, environment and shelter, and by providing new business opportunities to their clients.

During their formative years, most microfinance institutions set aside social and enterprise development activities to focus exclusively on financial services. This single-minded “minimalist” approach was necessary to build institutional capability and enable microfinance to graduate from donor dependency. Throughout this time, however, some segments of the microfinance community pursued a “credit-plus” approach, delivering additional messages or training alongside financial services, often through group lending meetings.

During the next decade new connections between microfinance and the social and economic development agenda will blossom. With substantial progress on access to basic finance behind it, and having turned over much of the service provision to the commercial sector, socially-motivated MFIs, especially NGOs, can focus on ensuring that clients who are receiving microfinance services also have access to social and economic opportunities. Experiments are already starting, and there are several promising pathways to follow.

One is the development of unregulated new financial products to address social needs. Both regulated MFIs and NGOs will contribute to these innovations. In many cases, the commercially oriented deliverers see that there is a profitable opportunity in meeting such client needs. More difficult social issues will be pursued through NGOs.

- **Housing.** The know-how to make home improvement loans is spreading rapidly among microfinance institutions. In the last five years Mibanco in Peru has issued 180,000 home improvement loans, and its portfolio is growing at 3 percent per month. Mibanco staff believe that the demand for such loans has barely been tapped. By the decade's end, home improvement and even new home purchase loans will have become standard offer among microfinance institutions, resulting in improved shelter for millions.
- **Insurance.** Microinsurance is already becoming an established field, although the number of clients with adequate coverage worldwide is still very low. Health insurance is especially important and has a long way to go. The field is now doing the learning and experimentation to prepare the way for rapid scale-up during the middle and later years of the decade.
- **Education.** Microfinance clients often use their increased income to send their children to school, and some microfinance institutions, such as Uganda Microfinance Limited, have loan products to assist families with school fees. Other MFIs (see for example Equity Bank, Kenya and BRI, Indonesia) make loans to schools for improvements and operations.

In all three of these areas we already see momentum growing.

Another rich area for greater emphasis will be enterprise development for the clients of MFIs, especially in rural areas. Microfinance institutions are joining together with enterprise development organizations, or launching enterprise development activities of their own. Approaches in this category include “microfranchising” projects like Grameen Phone that create new business opportunities for selected clients while also benefiting their communities. The range of potential microfranchising projects is enormous -- from eyeglasses to renewable energy. Some NGOs will focus on value chain interventions, seeking ways to give low income producers a better position in the marketplace. Others will provide skills training and adult education. New models for bringing such activities to scale are being developed.

There are many non-microfinance NGOs around the world focused on enterprise development, renewable energy, health, and education. Yet microfinance institutions may have a unique contribution in such fields. The institutional resources represented by microfinance NGOs are impressive. Microfinance NGOs and their staffs and supporters have internalized principles of business-like operations, especially scale and financial sustainability, and can apply them to great advantage in the delivering of social services. For example, Fundación Paraguaya, a microfinance NGO in Paraguay, is developing self-sustaining agricultural schools, blending enterprise development, the principles of microfinance (self-sufficiency), and education into one model. Moreover, many NGOs, especially those that spawned transformed MFIs, have significant financial resources generated by the dividends and/or interest income from the MFIs they have created. The next decade will see the emergence of new institutional models for combining commercially-oriented microfinance with social and enterprise development activities, as has been done by Shorebank in the United States and BRAC in Bangladesh, each with an array of related for-profit and non-profit companies.

## Thoughts from the Field: The Future of NGOs

- *We believe that most of microfinance NGOs will be transformed into multi-service institutions to offer value-chain services and stay competitive in the market, or will be transformed into commercial institutions and shift from their mission. (Gagik Vardanyan, Kamurj, Armenia)*
- *In ten years, NGOs will be directed towards non-financial services. (René Azokli, Padme, Benin)*
- *In the next years, NGOs will work in the rural and remote areas where the competition is low. (Rafael Llosa, Mibanco, Peru)*
- *NGOs will have a comparative advantage in reaching less-privileged people. (Nimal Fernando, Asian Development Bank)*
- *The primary role for NGOs in the coming years will be to develop sustainable financial services for very small towns. (Stelio Gama Lyra Junior, Banco do Nordeste (CrediAmigo), Brazil)*
- *I think they will continue to explore new products and new techniques to reach poorer people. They are major providers if there are not others; where there are others, their role is to explore and experiment. (Mohammed Khaled, Microserve, former Director of Sanabel Network, Middle East)*
- *Absolutely I see a role for NGOs. There is ALWAYS going to be a market that is not covered by organizations that need to show financial sustainability quickly and in a rather strong way. (Elizabeth Littlefield, CGAP)*
- *If the NGO has the right people and ideas, it can be an important startup element in a lot of places, especially in serving very, very poor people. (Jyrki I. Koskelo, IFC)*
- *NGOs will likely remain important as providers of subsidized non-financial services to improve the business skills of microentrepreneurs as well as to provide ancillary community services not covered by governments strapped for cash. (Essma Ben-Hamida, Enda Inter-Arabe, Tunisia)*
- *Do NGOs have a role? Yes, new things, new developments, and other kinds of services. Maybe their role is to be a groundbreaker in education or health. (Carlos Labarthe, Compartamos Bank, Mexico)*
- *I think we will still have NGOs in the MENA region in the coming 10 years. There is a strong sense of community and solidarity in this region and this is way of expressing local solidarity. (Xavier Reille, CGAP, Middle East, based in Paris)*



## The Importance of Enabling Environments

The predictions we have made depend critically on the decisions of governments and policy makers to create positive enabling environments. A policy environment need not be perfect to allow for growth in microfinance, and the seeds of microfinance can be sown even in immediate post-conflict settings. However, fully realizing the vision we have outlined will require governments to make the right choices in their stance toward the overall financial sector and microfinance in particular.

Policy environments in countries around the world span a wide spectrum, and there are distinct regional variations. Latin America has taken a more private sector approach in the past, while East Asia has favored state-owned solutions. There is also a great deal of country-by-country variation within regions. We group countries into three tiers, each increasingly conducive to the kind of progress we envision.

The first tier (basic minimum countries) meet the minimum conditions for microfinance: political and economic stability and market-determined interest rates. Many countries in MENA and Africa fall into this group.

A surprising number of countries do not even make it to this tier. Among the countries that have no or only one MFI reporting to the MIX (see Annex 1), most are either state-controlled economies that have historically not allowed microfinance institutions to emerge (such as China, Belarus and Cuba) or countries suffering from war or unrest (such as Ivory Coast, Congo, Iraq and Sudan).<sup>17</sup> Microfinance will spring up when stability and a market-oriented economy exist, even if these conditions are fragile. We profoundly hope that

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<sup>17</sup> Many countries not on the MIX list are very small and lack a critical mass of clients (e.g., island economies).

in the next ten years more countries will enjoy these basic conditions, but this will be determined by factors far beyond microfinance.

In the second tier of countries (good ground rules countries), where microfinance is developing more actively, governments provide at least some of the ground rules that favor financial sector development and microfinance. In these countries, the consensus is that the government should be a facilitator but not a participant in the financial sector. The principle that credit decisions must be made without political interference is fundamental. Governments refrain from using the financial sectors as means of financing their own spending, thus freeing financial sector resources for private uses, including microfinance. The legal framework recognizes property rights, and court systems uphold secured transactions. The financial sector is overseen by a strong and independent bank regulatory and supervisory authority. Most of the countries that have liberalized their financial systems during the past decades have established these conditions, or are well on their way to doing so. At this level, although the government may do very little to explicitly recognize microfinance, it can survive and grow. The fact that most countries in Latin America have offered at least this kind of passive support is one reason for the development of strong MFIs in the region.

During the next ten years, the chief question at this level is whether the commitment to liberalized financial sectors will continue. The will to continue enforcing positive ground rules is threatened in some countries.

The best enabling environments (active support countries) are found among the few tier three countries that have taken a proactive approach to microfinance while applying best practices. In these countries a consensus makes broad access to financial services a goal of financial sector policy. These governments have entered a dialogue with the microfinance providers in their countries to chart pathways for development while maintaining high prudential standards. Their banking authorities have invested in learning

about how microfinance works. Examples of what can result from such dialogue include the special microfinance categories created in Bolivia and Uganda that encourage NGOs to transform into regulated deposit-taking institutions. We are confident that at least a few key countries will join the active support tier of countries during the next decade.

## **New Challenges in the Enabling Environment**

One of the important challenges of the next decade will be political risk – the interference of politics in microfinance in a way that hampers the continued development of the industry. As microfinance grows and becomes more visible, it attracts more political risk. Some populist governments are already calling for interest rate ceilings, launching new government microfinance banks and bringing bank supervision back into the orbit of political leadership. The next ten years will see at least some countries go down that path, to the detriment of their low income populations.

Risks also arise when the microfinance sector has weaknesses that need correction. Two incidents from 2006 illustrate the problem. In Rwanda the central bank stepped in to close a number of weak MFIs. This move may have been appropriate on the part of the central bank, and it may strengthen the sector in the long run. However, in the near term it is likely to have negative effects on the image of microfinance in the country. In India, the local government of a district in the state of Andhra Pradesh closed the offices of two MFIs, citing interest rates that were too high and improper collections practices. Although the local government action was quickly overturned by the Reserve Bank of India, it sent panic through the Indian microfinance industry with some players reactively calling for voluntary interest rate caps.

Such events will only become more frequent during the next several years, and they call for vigorous action and forethought. The microfinance industry must engage in some soul searching to ensure that MFIs adhere to high standards of consumer protection, and to educate the public about the principles of fairly-delivered microfinance. In both instances cited, a positive dialogue with regulatory authorities was essential. If the microfinance field does not anticipate these kinds of issues and create strong standards for itself and a solid public understanding of best practices, it is likely that in ten years the sector will go through more painful episodes and end up with much heavier regulation.

### **Thoughts from the Field: Political Risk**

- o *The politics of microfinance will become more intense during the next ten years. I don't think that people have realized the gravity of this problem. There has to be a coordinated concerted effort to address this issue.* (Nimal Fernando, Asian Development Bank)

Looking to the future, one of the main challenges facing regulatory authorities involves the introduction of innovations such as the new technologies described in the technology section above. These technologies are often outside existing regulatory frameworks, simply because they are so new. An example of regulators opening new channels is Brazil's program of correspondent banks, through which banks can appoint retailers as agents to carry out transactions, thereby extending the reach of the financial system to remote areas. Issues of security underlie the current debate in India over whether to adopt something like the Brazilian banking correspondents framework. Cell phone banking is one of the most obvious question marks because both potential and risks are enormous. Banking authorities will have to decide whether cell phone banking and other innovations meet minimum standards of safety and security, and they will need to work closely with providers to encourage them to bring their systems up to acceptable levels.

## **Toward the Vision**

We are on the path for microfinance to realize its grand vision of creating access to finance for all. The developments of the last decade allow us to fast forward ten years and see enormous and astounding advances, many made possible because of what has been achieved to date.

This next decade of microfinance will bring new players to the table and will create alliances among what before were considered unlikely partners, who together will continue to reinvent microfinance. The new players – commercial banks, non-financial retailers, technology companies – will assume an increasingly important role. Institutions that gave birth to this industry, NGOs, will have to reinvent and modernize themselves, as many have done when transforming into regulated institutions, in order to continue making a contribution in this next stage. They will have to go where more commercial players will not go, to deepen coverage, and increase social impact. All involved in microfinance will have to expand their minds and visions to develop the exciting possibilities before us.

Microfinance also should be set in the context of the Millennium Development Goals, in which all nations, under the coordination of the United Nations, have developed a comprehensive road map to address the major problems facing humanity today, in particular, peace and security, human rights, democracy and governance, the environment, and poverty. Among the many important tasks that constitute the agenda for poverty eradication, the UN Millennium Declaration calls for “microfinance projects which meet local community priorities.” From this perspective, microfinance is brought back to its roots, addressing poverty, and becomes an important component to meeting the Millennium Development Goals for 2015. This assertion places greater pressure on microfinance to address the challenges and to seize the opportunities of the next decade so that in 2016 it will have realized the vision – assuring access to financial services to the world’s majority.

## Annex 1. Current Microfinance Outreach by Country

Current Microfinance Outreach by Country –Mix Data, 2004 (excludes institutions with fewer than 5,000 borrowers)										
Country	Number MFIs	Type MFI				Total Portfolio (Millions)	Total Borrowers (Thousands)	Avg. Loan Size (US\$)	Population (Millions)	Market Penetration (Borrower / Population)
		Bank	NGO	NBFI	Rural Bank / Credit Union / Other					
	Total									
<b>Africa</b>										
Benin	7	0	5	1	1	149.90	159	955	7.86	2.02%
Burkina Faso	1	0	0	1	0	51.50	55	936	13.9	0.40%
Cameroon	4	0	0	0	4	17.10	33	605	17.34	0.19%
Chad	1	0	0	0	1	2.05	10	205	9.94	0.10%
Ethiopia	14	0	3	14	0	110.33	969	98	74.77	1.30%
Ghana	3	0	2	1	0	5.12	65	79	22.4	0.29%
Guinea	1	0	0	1	0	5.55	128	43	9.69	1.32%
Ivory Coast	1	0	0	0	1	27.11	14	1937	17.65	0.08%
Kenya	5	2	1	2	0	79.50	154	407	34.7	0.44%
Madagascar	1	0	0	0	1	5.93	19	312	18.59	0.10%
Malawi	5	1	2	1	2	21.91	272	173	13.01	2.09%
Mali	5	0	2	0	3	36.82	146	275	11.71	1.25%
Mozambique	5	2	2	1	0	15.09	39	377	19.68	0.20%
Niger	1	0	0	0	1	1.29	7	185	12.52	0.06%
Nigeria	3	0	2	1	0	4.38	186	41	131.85	0.14%
Rwanda	1	0	0	1	0	0.78	18	44	8.64	0.21%
Senegal	4	0	0	0	4	95.75	107	887	11.98	0.89%

Current Microfinance Outreach by Country –Mix Data, 2004 (excludes institutions with fewer than 5,000 borrowers)										
Country	Number MFIs	Type MFI				Total Portfolio (Millions)	Total Borrowers (Thousands)	Avg. Loan Size (US\$)	Population (Millions)	Market Penetration (Borrower / Population)
		Bank	NGO	NBFI	Rural Bank / Credit Union / Other					
Total	Bank	NGO	NBFI	Rural Bank / Credit Union / Other						
<b>Africa</b>										
Sierra Leone	1	0	1	0	0	0.52	9	59	6	0.15%
South Africa	5	1	2	2	0	191.12	213	520	44.18	0.48%
Tanzania	4	1	3	0	0	27.89	122	330	37.44	0.33%
Togo	3	0	1	0	2	27.63	61	372	5.54	1.10%
Uganda	9	1	2	6	0	86.24	228	342	28.19	0.81%
Zambia	1	0	1	0	0	0.85	13	66	11.5	0.11%
<b>AFRICA SUBTOTALS &amp; AVERAGES</b>	<b>85</b>	<b>8</b>	<b>29</b>	<b>32</b>	<b>20</b>	<b>964</b>	<b>3,027</b>			
<b>East Asia</b>										
Cambodia	9	1	0	8	0	144.72	479	268	13.88	3.45%
Indonesia	6	1	4	0	1	1,816.43	3,158	1245	245.45	1.29%
Mongolia	2	2	0	0	0	134.92	228	595	2.83	8.06%
Philippines	24	2	9	0	13	111.18	791	235	89.46	0.88%
Thailand	1	0	0	0	1	0.67	7	96	64.63	0.01%
Vietnam	2	0	1	1	0	9.89	70	145	84.4	0.08%
<b>E. ASIA SUBTOTALS &amp; AVERAGES</b>	<b>44</b>	<b>6</b>	<b>14</b>	<b>9</b>	<b>15</b>	<b>2,217.81</b>	<b>4,733</b>			
<b>Eastern Europe and Central Asia</b>										
Afghanistan	3	1	2	0	0	11.33	72	343	31	0.23%
Albania	2	1	1	0	0	126.91	27	4318	3.58	0.75%

Current Microfinance Outreach by Country –Mix Data, 2004 (excludes institutions with fewer than 5,000 borrowers)										
Country	Number MFIs	Type MFI				Total Portfolio (Millions)	Total Borrowers (Thousands)	Avg. Loan Size (US\$)	Population (Millions)	Market Penetration (Borrower / Population)
		Bank	NGO	NBFI	Rural Bank / Credit Union / Other					
	Total	Bank	NGO	NBFI						
<b>Eastern Europe and Central Asia</b>										
Armedenia	4	1	3	0	0	45.27	60	587	2.97	2.02%
Azerbaijan	1	0	0	1	0	3.04	15	203	7.96	0.19%
Bosnia	11	3	4	4	0	372.21	183	1714	4.49	4.08%
Bulgaria	1	0	0	1	0	188.11	28	6718	7.38	0.38%
Georgia	3	1	2	0	0	83.48	48	1687	4.66	1.03%
Kazakhstan	1	0	0	1	0	6.11	11	560	15.23	0.07%
Kosovo	2	1	0	1	0	157.40	35	3420	n/a	n/a
Kyrgystan	2	0	1	1	0	53.10	58	814	5.21	1.11%
Macedonia	2	1	0	0	1	40.48	12	3342	2.05	0.59%
Moldova	1	0	0	1	0	12.61	6	2102	4.46	0.13%
Russia	2	1	1	0	0	273.44	54	3874	142.89	0.04%
Serbia	3	2	1		0	203.17	54	3135	9.39	0.58%
Tajikistan	1	0	1	0	0	3.78	10	378	7.32	0.14%
Ukraine	1	1	0	0	0	101.49	22	4613	46.71	0.05%
<b>EE/CA SUBTOTALS &amp; AVERAGES</b>	<b>40</b>	<b>13</b>	<b>16</b>	<b>10</b>	<b>1</b>	<b>1,681.93</b>	<b>695</b>			
<b>Latin America and the Caribbean</b>										
Bolivia	9	2	4	3	0	436.65	391	1,051	8.98	4.35%
Brazil	2	0	0	2	0	42.95	173	235	188.07	0.09%
Colombia	10	0	9	1	0	181.76	367	457	43.59	0.84%



Current Microfinance Outreach by Country –Mix Data, 2004 (excludes institutions with fewer than 5,000 borrowers)										
Country	Number MFIs	Type MFI				Total Portfolio (Millions)	Total Borrowers (Thousands)	Avg. Loan Size (US\$)	Population (Millions)	Market Penetration (Borrower / Population)
		Bank	NGO	NBFI	Rural Bank / Credit Union / Other					
	Total	Bank	NGO	NBFI						
<b>Latin America and the Caribbean</b>										
Dominican Republic	2	1	1	0	0	81.82	66	1509	9.18	0.72%
Ecuador	11	3	4	0	4	342.85	270	1121	13.54	1.99%
El Salvador	4	0	1	2	1	42.15	39	1267	6.82	0.57%
Guatemala	1	0	1	0	0	25.79	42	614	12.29	0.34%
Haiti	4	1	2	1	0	11.69	49	315	8.3	0.59%
Honduras	6	0	6	0	0	17.97	71	271	7.32	0.97%
Mexico	6	0	3	3	0	137.39	465	298	107.44	0.43%
Nicaragua	10	0	9	1	0	112.00	192	602	5.57	3.45%
Paraguay	4	0	0	3	1	61.55	113	527	6.5	1.74%
Peru	23	3	7	11	2	969.76	884	803	28.3	3.12%
Uruguay	1	0	0	0	1	230.87	102	2263	3.43	2.97%
Venezuela	1	1	0	0	0	12.61	14	901	25.73	0.05%
<b>LAC SUBTOTALS &amp; AVERAGES</b>	<b>94</b>	<b>11</b>	<b>47</b>	<b>27</b>	<b>9</b>	<b>2,707.81</b>	<b>3,238</b>			
<b>Middle East and North Africa</b>										
Egypt	5	0	4	0	1	31.17	166	204	78.88	0.21%
Jordan	3	0	0	3	0	47.79	39	1394	5.9	0.66%
Lebanon	1	0	1	0	0	7.70	7	1100	3.87	0.18%
Morocco	9	0	9	0	0	135.67	589	223	33.24	1.77%
Palestine	1	0	0	0	1	7.93	14	567	4	0.35%

Current Microfinance Outreach by Country –Mix Data, 2004 (excludes institutions with fewer than 5,000 borrowers)										
	Number MFIs	Type MFI				Total Portfolio (Millions)	Total Borrowers (Thousands)	Avg. Loan Size (US\$)	Population (Millions)	Market Penetration (Borrower / Population)
		Bank	NGO	NBFI	Rural Bank / Credit Union / Other					
	Total	Bank	NGO	NBFI						
<b>Middle East and North Africa</b>										
Tunisia	1	0	1	0	0	6.17	25	247	10.17	0.25%
<b>MENA SUBTOTALS &amp; AVERAGES</b>	<b>20</b>	<b>0</b>	<b>15</b>	<b>3</b>	<b>2</b>	<b>236.43</b>	<b>840</b>			
<b>South Asia</b>										
Bangladesh	44	1	43	0	0	995.48	13,600	67	147.36	9.23%
India	26	1	17	5	3	159.61	1,620	82	1095.35	0.15%
Nepal	8	2	2	0	4	20.30	183	103	22.28	0.82%
Pakistan	12	2	9	1	0	80.90	532	176	165.8	0.32%
Sri Lanka	5	2	2	1	0	77.61	367	180	20.22	1.82%
<b>S.ASIA SUBTOTALS &amp; AVERAGES</b>	<b>95</b>	<b>8</b>	<b>73</b>	<b>7</b>	<b>7</b>	<b>1,333.90</b>	<b>16,302</b>			
<b>GRAND TOTALS</b>	<b>378</b>	<b>46</b>	<b>194</b>	<b>88</b>	<b>54</b>	<b>9,142.25</b>	<b>28,835</b>			

## Annex 2. Interview Respondents

RESPONDENT	ORGANIZATION	COUNTRY or REGION
Abboushi, Reem	Palestinian Businesswomen's Association	Palestine
de Akerman, Clara	Women's World Banking Cali	Colombia
Akula, Vikram	SKS India	India
Annibale, Robert	Citibank	Global
Azokli, René	Padme	Benin
Bazoberry, Eduardo	Prodem	Bolivia
Ben Hamida, Essma	ENDA Inter-Arabe	Tunisia
Chuluun, Ganhuyag	XACBank	Mongolia
Copisarow, Rosalind	Accion International	Global
Davis, Geoff	Unitus	Global
El-Ashmawi, Ahmed	Sanabel	MENA
El Tabaa, Motaz	Alexandria Business Association	Egypt
Fernando, Nimal	Asia Development Bank	Indonesia
Ferreira, Hennie	Microfinance South Africa	South Africa
Harper, Malcolm	independent	Global/South Asia
Hashemi , Syd. Mohammed	CGAP	MENA
Jaczewski, Krzysztof	Fundusz Mikro	Poland
Kabeer, Khalid	Kashf Foundation	Pakistan
Khaled, Mohammed	Microserve	MENA
Koskelo, Jyrki	International Finance Corporation	Global
Kremenovic, Aleksander	Mikrofin	Bosnia & Herzegovina
Labarthe, Carlos	Compartamos	Mexico
Ledgerwood, Joanna	independent	East Africa
Littlefield, Elizabeth	CGAP	Global
Llosa, Rafael	Mibanco	Peru
Gama Lyra, Junior	Banco do Nordeste/CrediAMIGO	Brazil
Merryman, Adrian	Opportunity International	Global
Morduch, Jonathan	New York University	Global
Mutua, Kimanathi	K-Rep Bank	Kenya
Mwangi, James	Equity Bank	Kenya
Nawawi, Yusuf	Bank Rakyat Indonesia	Indonesia
Obama, James	PRIDE Tanzania	Tanzania
Owens, John	Chemonics	Philippines
Pattillo, Bob	Gray Ghost Microfinance Fund	Global
Reille, Xavier	CGAP	Global
Richardson, David	World Council of Credit Unions	Global
de Schreval, Jean-Philippe	Blue Orchard Finance	Switzerland
Uy, Marilou	The World Bank	Global
Vardanyan, Gagik	Kamurj	Armenia
Villar, Eduardo	Fundacion Social	Colombia
Voorrhips, Gera	ING Bank	Netherlands

### Annex 3. The ACCION Network

# ACCION | NETWORK

#### Outreach as of June 2006

Active clients	2.04 million
Active portfolio	1.43 billion
Average loan size (in USD)	\$699
Portfolio at risk (>30 days)	3.20%

Member Institutions	Country
ACCION International	USA
ACCION USA	USA
ADMIC	Mexico
Banco ADEMI	Dominican Republic
Banco do Nordeste/CrediAMIGO	Brazil
BancoSol	Bolivia
Banco Solidario	Ecuador
BanGente	Venezuela
Compartamos Bank	Mexico
Financiera El Comercio	Paraguay
Cooperativa Emprender	Colombia
FAMA	Nicaragua
FINAMERICA	Colombia
FINSOL	Honduras
Fundación Ecuatoriana de Desarrollo (FED)	Ecuador
Fundación Mario Santo Domingo	Colombia
Fundación Paraguaya	Paraguay
Génesis Empresarial	Guatemala
Apoyo Integral	El Salvador
Mibanco	Peru
REAL Microcredito	Brazil
Sogesol (SOGEBANK)	Haiti
Uganda Microfinance Limited	Uganda