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1

Introduction

Benoît Leleux, Dinos Constantinou and Mope Ogunsulire

Various authors have already set out the purpose of the conference, and its achievements, in the prefaces to this book. It is therefore not our purpose here to revisit this, but instead to give the reader a broad overview of the papers presented, and some of the fundamental discussions that took place during the conference. These confirmed that microfinance cannot, and should not, remain the preserve of social enterprise alone. Subsidized funding will not last forever, so the only path to sustainability is to move microfinance into the commercial domain, i.e. a specialized segment of the financial world. The best institutions have already recognized this, and grown into full financial institutions by adopting a for-profit approach. The latter is the only way to attract and mobilize, for the long term, significant private capital, and the conference confirmed the increasing appetite within private capital for microfinance investment opportunities. Investors want large, fast-growing markets, competent and professional management, reasonable pricing and ventures with strong, sustainable and competitive advantage.

Microfinance is already large; with profits as an objective, it could be huge and growing faster. Increasing inflows of private capital are encouraging more professional management. The market is still at an early stage of development, and as such offers opportunities for substantial returns to the early birds. Microfinance must commercialize to realize its full potential; only then will it be able to satisfy the needs of developing nations. A for-profit microfinance industry will offer significant opportunities for the private investor willing to venture into this field of considerable social and economic importance.

The book is organized in five parts, excluding this Introduction, that very much track the key microfinance dimensions as well as the structure of the October 2005 event. Part I introduces the market for microfinancing,

2 Introduction

looking at the demand side of the overall industry, and considering some of the drivers of this demand. In Part II, we move from the macro to the micro-level to consider the individual actors operating in the market, especially the microfinance institutions (MFIs) through which funds flow to the end borrowers. The focus is on understanding the various business systems, their genesis and *modus operandi*. Switching from demand to supply, but remaining at the micro-level, Part III gives an overview and some case studies on private capital in microfinance. In Parts IV and V, we return to the macro level to consider, first, the structural factors governing the actions of all players in this market, and finally, to examine the overall performance of the industry in a number of regions and how such performance can be assessed.

The changing reality of microfinance

In October 2006, the Norwegian Nobel Committee awarded the Peace Prize to Muhammad Yunus, and the microfinance institution he founded, Grameen Bank. The prize award further raised the global profile of microfinance, following close on the UN designation the previous year, of 2005 as the International Year of Microcredit. There seems little doubt that microfinance is now firmly entrenched on the global radar screen.

Yet, the image remains largely one of “doing good”; microfinance remains firmly within the confines of charity or philanthropy to many. There is no doubt that microfinance is rooted in a desire to help the poor and underprivileged. In a speech to the Commonwealth in 2003, Yunus said:

I became involved in the poverty issue not as a policymaker or a researcher. I became involved because poverty was all around me. I could not turn my eyes away from it.

In the mid-1970s, faced with a local bank’s unwillingness to lend to the poor – considering them not creditworthy – Yunus decided to act as guarantor for their loans. They always paid their dues. Yet he continued to face difficulties in expanding lending through existing banks. In 1983, Yunus created Grameen Bank, a bank for the poor that would give loans without collateral. About the same time that Yunus was backing loans to Bangladeshi poor, ACCION was making its first small loans to micro-enterprises in Recife, Brazil. Originally begun in 1961 as a community development effort to help the poor help themselves, ACCION moved to microlending in 1973. After a decade of working with the poorest in

Latin America, ACCION realized its projects¹ did not tackle the main cause of urban poverty: lack of economic opportunity. It started giving microloans to the many urban poor who were running tiny informal businesses, but who remained trapped in poverty, as most of their profits were lost to the prohibitively high interest rates levied by local loan sharks. Then in 1981 Interdisciplinäre Projekt Consult GmbH (IPC) was founded, and later went on to revolutionize the industry with the development of its micro-lending “technology”, which focused on individual, rather than group, lending. Early microcredit programs had been based on solidarity group lending in which every member of a group guaranteed the repayment of all the members. In spite of early opposition, others (including some ACCION affiliates) have since adopted its approach.² IPC first worked in Peru, setting up a system of municipal banks based on the German *Sparkassen* (savings bank) model. It used the word “technology” to denote its broader approach and methodology developed to bring credit to the microentrepreneur.

With such antecedents, it is not surprising that many continue to regard microfinance as primarily a powerful tool for poverty alleviation:

For many years now, I have been impressed by the power of a simple, small loan to those for whom fate and circumstance have resulted in disadvantage. Maintaining people’s integrity and showing them trust, whilst facilitating a way for them to rebuild their own lives is such a meaningful way of alleviating poverty.

Her Majesty Queen Rania Al-Abdullah of the Hashemite Kingdom of Jordan, Emissary for the International Year of Microcredit 2005 and
FINCA International Board Member

Indeed, microfinance is an important component for meeting the United Nations’ Millennium Development Goals for 2015, with the Millennium Declaration calling for “microfinance projects which meet local community priorities”.

But by considering only this aspect, we fail to do justice to the reality of microfinance today. In addition, keeping microfinance purely within the domain of development finance puts off private investors. As Ivan Pictet points out in his Preface to this volume, financial advisers and investment managers act as trustees of assets and operate under a fiduciary obligation. They must seek investments that combine good returns and guarantee capital preservation, liquidity and transparency. Put simply, private investors and their intermediaries cannot afford charity, and

ultimately neither can microfinance as an industry. Profitability is, after all, the best guarantee of sustainability. While some private individuals invest in microfinance, much more money is managed by third parties – in Geneva alone, 140 banks have \$1 trillion in assets under management.³ It is therefore clearly important to address any erroneous preconceived notions prevailing among the investment community.

The reluctance of financial intermediaries to commit funds to microfinance may be rooted in several fears: the perception that microfinance is a form of charity, subject to currency risks, lacks even basic controls in general, is subject to poor oversight, has low marketability and even lower liquidity and that it is not a “proper” asset class for portfolio diversification. But how much truth is there in these assertions?

Many of these fears are indeed realistic, but effective ways already exist in the market to address them. Some of the concerns are simply not true. Microfinance is not charity. First, microfinance encompasses more than microcredit. It also consists of other financial services, including deposits, payments and insurance, many of which are a source of revenue for MFIs. Secondly, microcredits are loans, not grants. They are fully repayable, and successful MFIs boast very high repayment rates that compare favorably to other commercial credits. ProCredit Holdings, a global grouping of microfinance banks, reports loan losses of less than 0.5 percent per year; a level significantly lower than many Western European banks according to the company. Its PAR > 30⁴ is 1.3 percent. In Chapter 8, Hanns-Michael Hölz compares the 1.5 percent average default rate⁵ in a sample of 124 MFIs with 4 percent for US “A” rated borrowers, and 5.3 percent for high-yield corporate debt (or “junk bonds”). Finally, many of the most successful MFIs have transformed into formal financial institutions that have continued to operate successfully for three decades or more. As Michael Steidl reports later in this book (Chapter 6), ten of the largest MFIs reporting to the Microfinance Information Exchange have a five-year average return on equity (ROE) of 19.6 percent, while four of the group generated ROEs of 30 percent and more over the same period.⁶ Nevertheless, as noted elsewhere in this book, the number of fully commercial MFIs remains limited and the majority are not commercially viable.

MFIs that have made the move into formal institutions are subject to the same regulatory oversight as all other national financial intermediaries. In addition, regulated local banks and finance companies also operate in the sector by “downscaling” to serve microenterprises. Liquidity remains an issue, but microfinance today offers structured investment opportunities that can certainly be considered as valid (albeit alternative) assets.

Examples include specialty microfinance vehicles and securitizations of microfinance portfolios – some securitizations have been sold to commercial investors such as pension funds, mutual funds and foundations. There is also a growing use of corporate bonds, often backed by a multi-lateral agency guarantee. Although MFI shares themselves are often illiquid, exit options are available to equity investors. These include buy-outs by strategic investors – such as large microfinance players like IPC, specialized funds and some mainstream banks – and selling the equity back to the community served by the MFI.

Finally, private investors today conducting due diligence on potential investments can draw on an increasing number of ratings offered by several independent agencies that rate MFIs. Standard financial measures are also emerging, that are widely accepted in the industry, and which may be used to gauge the performance and profitability of institutions (see Appendix 2).

While charitable and public money have been the catalysts for microfinance, commercial capital can, and indeed has to some extent, played a role in developing the market so that the industry has grown increasingly market-driven and developed the structures to operate profitably. But more must be done, for there is little doubt that significant amounts of commercial private money will be needed to fully realize the global potential of microfinance. The Geneva Microfinance Symposium 2005 represented an early step on the way towards stimulating more private sector investment interest in the sector.

Microfinance demand is big and growing fast

The first thing that strikes the new arrival to microfinance is the wide range in estimates of market size. Within this volume alone, estimates range from \$45 billion⁷ to \$1000 billion.⁸ Much depends on the definition of microenterprise. Estimates of demand sometimes also include financing for small, in addition to micro, enterprises. However, although the estimates may vary widely, the numbers are huge. McKinsey⁹ estimates that only 10 percent of this market is currently being served, yet microfinance is today already a \$10–30 billion industry. Growth is also impressive, with the industry estimated to be growing at 15–30 percent per annum.¹⁰ In Chapter 2, Vijay Mahajan takes a closer look at the make up of demand and what is driving the growth in demand. One important factor is the large number of microenterprises – perhaps as many as 500 million worldwide – among which the demand for formal financial services (including capital) remains unmet.

Microfinance can be a powerful tool in poverty alleviation, hence the strong demand seen among microenterprises. Although initial studies show that it can also have a positive impact on employment, methodological issues have made it difficult to obtain empirical statistical evidence. As Mahajan notes in Chapter 2, some early work does however indicate some employment effects. Microloans below \$100 rarely create new jobs. Between \$100 and \$1000, a small proportion of micro-loans create jobs and promote small trade. Nonetheless, both types of loans do improve the social situation of the borrower. Only loans above \$5000, however, contribute to economic growth by enabling investment and increasing productivity.

Poverty alleviation and job creation are among the “social returns” sought by microfinance investors, which compensate for the relatively lower financial returns. Although MFIs can be profitable, returns to investors are low by commercial standards. Mahajan reports debt returns of approximately 2 percent and equity returns of 5 percent. Microfinance has been able to leverage such “social capital”, but by only about 4 percent. CGAP estimates that in 2005 \$655 million of foreign direct investment (FDI) was available to MFIs and small business finance institutions (SBFIs), of which less than 10 percent was private commercial capital. A further \$1 billion was available in loans and grants. Hence, for every \$100 of “social capital” mobilized by microfinance, it leveraged on average just \$4 of commercial capital.¹¹

One of the factors hindering the fulfillment of demand is the lack of absorptive capacity. There are currently not enough MFIs and SBFIs that qualify to receive financial support. Greater effort is therefore needed to build capacity in the sector from the bottom up. Another factor is that market coverage is skewed, with just 10 percent of microfinance FDI going to the world’s regions in which 90 percent of the poorest live. Investment tends to be concentrated in Latin America and Eastern Europe.

Private investors interested in meeting this huge demand will have an important role to play. Socially conscious investors are needed to provide equity funding, and should be ready to take risks and accept initially lower returns. Profits will eventually rise, but in the meantime, there will certainly be the “social returns” mentioned above.

Microfinance funding: From public to private investment

In his Preface, Ivan Pictet notes several reasons why microfinance is becoming increasingly attractive to private investors. Volatility is low, risks are managed through broad diversification, investments may be

uncorrelated or counter-cyclical to the general macroeconomic environment and the financial markets, and there is a growing demand for assets, or sub-segments of asset classes, that offer absolute returns. In addition, the market is growing more structured and transparent and offering more and more structured investment vehicles. Hence, its attractiveness continues to grow such that, in recent years, we have seen microfinance beginning to access private commercial capital in addition to savings and donor funding.

In Chapter 6, Michael Steidl traces the progress of private commercial investment in microfinance through a series of structured investment vehicles. The industry initially began with public money from development agencies and non-profit organizations, which provided capital to highly motivated local entrepreneurs. At first, the focus was on social, rather than financial, returns. With time, this has evolved into an acknowledgement that sustainability demands both. Foreseeing that subsidized funds would one day dry up – and they would therefore require commercial capital – MFIs began to behave more like for-profit organizations. That quasi-commercial approach led to the evolution, often termed the “upscaling” of the most successful MFIs into full-fledged financial institutions. As we saw earlier, some of these successful MFIs are very profitable ventures, with ROEs ranging up to 30 percent. But they remain rare: Steidl estimates that for every MFI that has achieved institutional and commercial viability, 50–100 have not. Many institutions, however, continue to survive on donor funding as the sector is not yet wholly market-driven.

Nevertheless, the profitability of the top performers did not go unnoticed. By the 1990s, the first private investment into microfinance began. But in the beginning this was limited to industry insiders and usually leveraged by public funds. As things evolved to the next stage in the late-1990s, development agencies played an important role in the creation of structured investment opportunities to attract conventional, non-microfinance, investors. Most have taken the form of specialty investment funds, of which there are three types (see Table 1.1).¹² Some private players also created microfinance funds. In Chapter 8, Hanns Michael-Hölz discusses Deutsche Bank’s Microcredit Development Fund, launched in 1997, as well as the bank’s wider involvement in microfinance.

July 2004 saw the emergence of an organized corporate bond market for microfinance institutions. Some were asset-backed securitizations of MFI portfolios, some backed by partial guarantees from a multilateral agency but a few were guaranteed by the MFI’s financial strength alone. Most were sold to institutional investors, although brokers, foundations

Table 1.1 Three types of microfinance investment funds

Type of fund	Characteristics
Microfinance development funds	<ul style="list-style-type: none"> • Emphasize development rather than financial return. • Offer favorable financing and sometimes subsidized technical assistance.
Quasi-commercial microfinance investment funds <i>e.g. ProCredit, Profund</i>	<ul style="list-style-type: none"> • Clearly defined financial objectives. • Clear development mission.
Commercial microfinance investment funds <i>e.g. Dexia Micro-Credit, Micro Vest I, Triodos Fair Share fund</i>	<ul style="list-style-type: none"> • Target mainly mainstream financial investors.

Table 1.2 Examples of microfinance bond issues

- *July 2002* – IFC backed US\$10 million Mexican Peso bond issue for Compartamos. Guaranteed by MFI strength, not loan portfolio. S&P mxA + rating.
- *July 2004* – First international securitization of MFI portfolio by Blue Orchard and Developing World Markets. US\$40 million 7-year, fixed-rate notes; three subordinated and one OPIC-backed senior debt series. Investors included pension and mutual funds, foundations and individuals.
- *2005* – US\$52 million Colombian Peso bond issue for WWB Cali. Duff & Phelps Colombia AA + rating. Investors included brokers, pension funds, financial institutions and individuals.

and individuals have participated too. But such financing still accounts for only a tiny part of total funding, with less than 2 percent of global funding supplied by the 10 successful financings described in Chapter 6. Nevertheless, more efficient investment structures are coming up and existing structure are achieving both economies of scale and greater standardization and transparency. Hence, early microfinance investment vehicles are now integrating further into the mainstream capital market. (See Table 1.2 for examples of microfinance bond issues.)

Evolutionary changes and challenges as microfinance goes mainstream

Transparency within the industry is increasing as private money flows in. Further pressure comes from supervisory authorities as more MFIs

formalize and upscale into formal regulated financial institutions. Downscaling is also contributing to the increasing commercialization within the sector. As has happened in other financial market sectors, independent third parties have emerged to provide objective assessments of profitability and performance. In Chapters 10 and 11, two of the leading microfinance rating agencies provide some insight into the industry's key measurement metrics, and they review specific examples from Latin America, Africa and Asia. Finally, the industry has started to develop standardized measures for measuring the performance of MFIs.

However, important obstacles stand in the way before microfinance can be fully integrated into mainstream financial markets. Foremost among these are the attitude and size of MFIs. With a strong commitment to their institutional mission, MFIs are sometimes reluctant to act as normal businesses, distributing dividends and participating in anonymous share trading and mergers and acquisitions. Further, many MFIs remain too small to generate economies of scale or provide efficient services to investors, and they will remain outside the reach of the investor.

In addition to attitude and size, microfinance also faces several other challenges in its transition from public to private capital. Marc de Sousa Shields presents some of these in Chapter 7: access to savings, pricing and limited availability of debt and equity capital.

Savings are a critical means of accessing cheaper capital, thus reducing borrowing costs, but collecting enough to fuel growth is difficult for even large and successful MFIs. Few, if any, have reached the ideal deposit-to-loan funding ratio for small financial institutions of 90–95 percent. MFIs face several problems in attracting savings: lack of appropriate regulation, lack of management capacity, cost of start up and greater competition from commercial banks.

Pricing drives MFI appetite for debt. Although commercial bank debt is available to well-performing MFIs, most prefer to use capital from retained earnings, national development banks or international specialty funds because of pricing. Few MFIs have good liability management strategies, and development agency capital is just sufficient to keep MFIs from creating their own private capital networks.

Although it is true that commercial debt is available to well performing MFIs, such capital as is available is uneven among regions – concentrated, as noted earlier, in Latin America and Eastern Europe – and highly limited in most countries. Commercial lenders do not understand microfinance and are often constrained by reserve requirements that make lending to MFIs too expensive. Hence, they usually require strong guarantees. Microfinance institutions have found ways to meet collateral requirements, ranging from

international loans to development agency guarantees. As we saw earlier, some MFIs have successfully raised debt through bond issues or securitizations. But restrictive national regulations, transaction costs that are too high relative to available funding and issue amounts too small to attract private interest, can be a bar to these methods. Debt capital is also increasingly available from specialty funds, but drawn from private sources only to a limited degree. This is because much private funding comes subsidized by the investor or government; few institutional investors can subsidize investment. Overall, what debt funding is available goes to a few large MFIs.

Turning to equity capital, we find that 80 percent of it, like debt capital, is subsidized or provided by development agencies.¹³ There is no doubt that development agencies, like specialty funds, are important catalysts for leveraging commercial capital for microfinance and enabling the transition to private capital. But MFIs continue to use development capital even after they are able to access private capital. Thus, even profitable, regulated enterprises still draw on such capital with the result that most of the sector's high-risk capital is concentrated in a few large MFIs to the detriment of the smaller emerging institutions who need it most. In addition, as with debt, this influx of subsidized capital has negative consequences, such as preventing MFIs from developing private capital ties and a general crowding out of private capital from the market. The concentration of capital pushes the sector in pursuit of the wrong goal, i.e. creating large financial institutions rather than catalyzing new, fast-growing MFIs, which can then be sold to the larger institutions. Further, the continuing involvement of NGOs and development agencies can sometimes hinder the selling to larger institutions. The effect is to deny the sector some of the profit maximization and exit motivation that drives venture capital. So, there is clearly a role here for private investors to play in helping shift the focus of donors to capacity building. Finally, vis-à-vis local equity funding, little is available and so the sector is mostly owned by NGOs with some minority participation by specialty funds. Private ownership is however increasing, notably in Mexico and the Philippines. In general, much of the sector's equity comes from public funds, with several factors inhibiting private interest in microfinance equity: Illiquid shares, a "social" image and limited or no dividend payments.

Better understanding of MFIs critical to sound investment

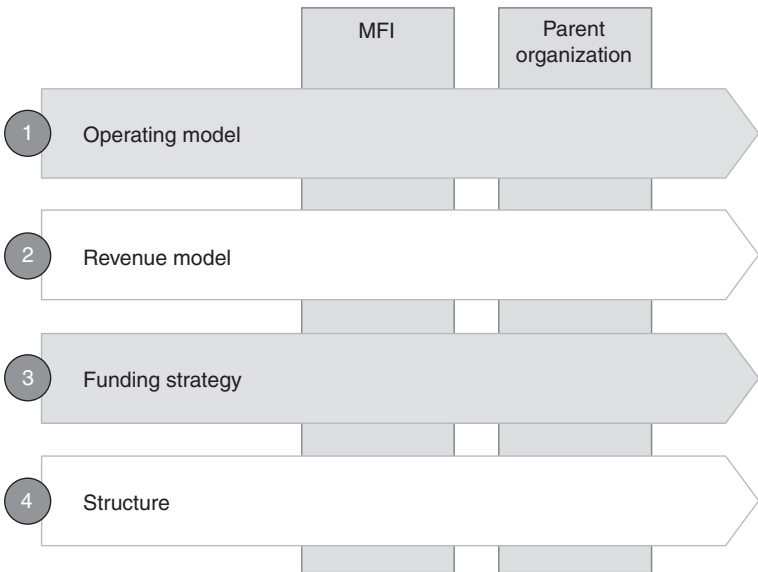
Despite the above difficulties, there is an increasing appetite within the private and public sector for investment opportunities in microfinance, corresponding to the great unmet demand. And ever more sound investment vehicles for channeling that money into the sector. But as noted

earlier, there are not enough institutions able to absorb the funds. Damian von Stauffenberg, in Chapter 10, sets out the resulting problem:

the market is being squeezed for good investment opportunities. A market that is already not very large. With too much money chasing too few opportunities, mistakes will be made as caution is thrown to the wind.

Damian von Stauffenberg, MicroRate, USA

An understanding of the current universe of institutions is therefore important for sound investment decisions. In Part II of this volume, we briefly consider the existing universe of MFIs. Leleux and Constantinou first consider the microfinance institution builders – examining their evolution and operation and suggesting a typology of microfinance business models (see Figure 1.1). They conclude that MFIs on the ground seem to be converging to similar operating, revenue, funding and organizational strategies. Further, they conclude that three main models have emerged so far: the tight network, the public–private banking group and the private equity/venture capital model. Freytag and Chakraborty go



Note: MFI = Microfinance institution

Figure 1.1 Typology of microfinance business models

on to focus on specific examples of MFIs using several case studies. In particular, the downscaling model pioneered by the Inter-American Development Bank (IDB) about 20 years ago, and several models that evolved in ICICI Bank in India.

Building inclusive policy frameworks

As more private capital flows into microfinance, the nature of the industry will undoubtedly change. We have seen some of those changes in the sections above. But the core purpose of microfinance – the provision of financial services to the poor – will not change. In other words, microfinance is a key factor in building the inclusive financial sectors necessary so that all can participate in and contribute to national economic growth.

People, poor and rich, need reliable financing so that their ideas can be brought together with assets to generate long-run sustainable growth. The two key ingredients to a well-functioning market economy are competition and access, competition so that performance keeps improving and access so that everyone has a chance to participate and nobody's talents are wasted. In the coming Year of Microcredit, we will focus on access to finance, for after all, people, poor and rich, need reliable financing so that their ideas can be brought together with assets to generate long-run sustainable growth.

Raghuram G. Rajan
Economic Counselor & Director,
Research Department, International Monetary Fund
Adviser for the International Year of Microcredit 2005

The private sector certainly plays an important role in market development. But it is for governments to provide the policy environment needed to build an efficient, and inclusive, financial sector that, particularly through microfinance, provides access to financial services for the poorest in society. And microfinance has done best in settings where governments did not follow directed credit policies, allowed the market to determine interest rates, kept credit allocation separate from politics and did not get involved with direct lending.¹⁴

In Chapter 9, Kathryn Imboden highlights the importance of financial inclusion, sets out a vision of an inclusive financial sector and the key considerations for designing a sound policy environment. She suggests a common vision, independent of national differences: to have multiple financial institutions collectively offering appropriate services to all parts

Table 1.3 Microfinance policy issues and strategic options

-
- Degree, and quality, of government intervention in the financial sector.
 - Achievement of affordable and sustainable interest rates.
 - Consumer protection.
 - Government promotion of diverse institutions, within its supervisory capacity.
 - Explicit inclusion of increasing access within regulatory and supervisory goals.
 - The creation of access-friendly financial infrastructure.
 - Above all, building access into overall financial sector policy.
-

of society, characterized by access for all to a full range of services, sound institutions and financial and institutional stability. To achieve this, certain conditions are key: the right to fair treatment, an acceptance of different models (for example, private, non-profit, public, public/private) transparency of financial policy interventions, good public sector governance and a well-functioning legal system. In addition, there must be macroeconomic stability, pro-poor growth policies and an openness to progress and change. As governments seek to establish a policy framework, certain issues and strategic options must be considered (see Table 1.3). In the end, effective financial inclusion is achieved by all stakeholders working well together to ensure that appropriate strategies are designed, and these are in turn developed into effective policy.

Conclusion

The lack of absorptive MFI capacity notwithstanding, microfinance has all the ingredients necessary to become an attractive market for private investments as various papers in this volume show:

- Huge demand.
- Fast growth.
- Profitable institutions with returns enhanced by social components.
- Returns potentially uncorrelated to mainstream markets and other asset classes.
- A growing array of standard investment instruments, some offering interesting liquidity and marketability characteristics.
- Increasing transparency, enforced by rating agencies.

The market's attractiveness can only grow as the further influx of private capital forces further evolution. Furthermore, microfinance benefits from the availability of donor (and development agency) support to help it

develop and enhance capacity at no direct cost to the private investor. But there are other major challenges to developing the full potential of this \$1000 billion market. There is insufficient start-up capital (both debt and equity) available. This in turn further limits the emergence of professionally managed start-ups, contributing to the existing shortage of absorptive capacity. Finally, there are significant regulatory challenges.

Much remains to be done in the area of capacity building, where publicly funded donors can play an important role in: building capacity in MFIs, regulators and supervisors, disseminating information on best practices and innovation, supporting microfinance to the poorest in rural and remote areas, innovation in product development, developing industry standards and financing infrastructure, economic development and operating in vulnerable (for example, war-torn) states. Both public and private donors can play a role in helping expand private sector involvement as debt and equity providers of funding to microfinance. This must be matched by a greater appetite for risk-taking among private commercial investors.¹⁵

Microfinance thrives in a supportive enabling regulatory environment. In general, there has been a shift from state-control towards more liberalized financial markets, which has been good for microfinance. But a recent paper by ACCION warns that this trend is under threat in some places. Weaknesses in the microfinance sector can invite political interference, such as happened in Rwanda and India in 2006. In Rwanda, the central bank closed down several weak MFIs, while in India a local government in the state of Andhra Pradesh closed two MFIs citing exorbitant interest rates and improper collection practices. The Indian action was later (and quickly) overturned by the central bank.¹⁶ The industry must ensure that institutions maintain high standards of consumer protection, and educate the public about the principles of fair microfinance. Failure to do so, and anticipating similar issues that might arise, may result in heavier regulation.

Notes

- 1 In its first decade, ACCION's volunteers worked closely with local residents to identify the most pressing community needs such as electricity and water. The "ACCIONistas" then worked with residents to install electricity and sewer lines, start training and nutrition programs and build schools and community centers. Source: ACCION website: <http://www.accion.org/> (accessed 24 November 2006).
- 2 See Chapter 3 by Benoît Leleux and Dinos Constantinou.
- 3 See the Preface 1 by Ivan Pictet.

- 4 Portfolio-at-risk (PAR) is the outstanding principle amount of all loans that have one or more installments of principal past due by a certain number of days, in this case by 30 days.
- 5 Using $PAR > 90$ as a benchmark.
- 6 For period FY2000–04: range of ROEs $51.2 \text{ percent} \leq x \leq 8.1 \text{ percent}$, a group of 10 MFIs. These were ASA, Bancosol, Banco Solidario, BRAC, CERUDEB, CMAC Arequipa, Compartamos, Los Andes, Mi Banco and PRODEM.
- 7 See Chapter 8 by Michael Hölz.
- 8 See Chapter 3 by Benoît Leleux and Dinos Constantinou.
- 9 See Chapter 8 by Michael Hölz.
- 10 See Chapter 3 by Benoît Leleux and Dinos Constantinou.
- 11 See Chapter 2 by Vijay Mahajan.
- 12 P. Goodman, “Raising MFI Equity through Microfinance Investment Funds”, paper presented at the KfW Symposium in Frankfurt am Main (2005).
- 13 See Chapter 7 by Marc de Sousa Shields.
- 14 M. Otero and E. Rhyne. “Microfinance through the Next Decade: Visioning the Who, What, Where, When and How”, paper commissioned by the Global Microcredit Summit 2006 (Boston: ACCION, 2006).
- 15 Op. cit.
- 16 Op. cit.

Transcript of former UN Secretary-General Kofi Annan's remarks at the Geneva Private Capital Symposium: Investing Private Capital in Micro & Small Business Finance, 10 October 2005

Microfinance is gaining general acceptance. A small loan, a savings account, an affordable way to send a paycheck home, can make all the difference to a low-income family, or to a small-scale enterprise. With access to microfinance, people can earn more and better protect themselves against unexpected losses and setbacks. And with the ability to collateralize their assets, they can move beyond day-to-day survival, towards planning their future. That means they can invest in better nutrition, housing, health, and education for their children. They can create productive businesses, and recover quickly in the aftermath of natural disasters. In short, they can take real strides towards breaking the vicious cycle of poverty and vulnerability.

Of course, much more than microfinance is needed to eradicate poverty and hunger. Sound macroeconomic policy. Good governance. Strategies to develop rural areas and the industrial sector. And of course, good regulatory systems that create the proper incentives for businesses. Investments in classrooms, clinics and human capital. These are among the essential elements in any national strategy for defeating poverty.

International support is crucial: more and better aid; more debt relief; and a trade regime that is open, fair, and truly gives the poor a chance. Only with such a sustained global partnership will poor people have a proper chance to lift themselves out of poverty.

Microfinance has much to contribute to that effort. And let us also be clear: microfinance is not charity. In some cases, it might have started out as philanthropy. But today it is real business.

Microfinance is a way to extend the same rights and similar services to low-income households that are available to everyone else. It protects people against shocks, and allows the majority of the population to become part of a country's economic activity. It can help to build markets, and show that profits and principles can reinforce each other.

However, microfinance is not as widespread as it could or should be. The vast majority of people in the world do not have access to financial services. In many countries, the financial sector reaches only a small fraction of the population, with very few people having even something as basic as a bank account. There are great disparities in the availability of banks, ATMs and other services. Some countries have less than one bank branch per 100 000 people, while others enjoy as many as 50 or more.

Thankfully, this situation is changing. A new mindset is taking hold. Where once the poor were commonly seen as passive victims, microfinance recognizes that the poor people are remarkable reservoirs of energy and knowledge. And while the lack of financial services is a sign of poverty, today it is also understood as an untapped opportunity to create markets, bring people in from the margins and give them the tools with which to help themselves.

Governments, public and private financial institutions, private businesses and others are recognizing the value of microfinance for poor individuals and for small- and medium-sized enterprises. The World Bank and the International Monetary Fund have embraced it as part of their strategy for alleviating poverty.

The United Nations, for its part, is making this a key issue in implementing the Monterrey Consensus on Financing for Development. Last month's The 2005 World Summit at the United Nations headquarters re-affirmed the need for access to financial services for the poor. And, as you all know, the General Assembly has proclaimed 2005 to be the International Year of Microcredit.

Our collective challenge is to sustain this momentum, and to meet the growing global demand for increased access to financial services. The International Year has served as an effective stimulus for action. More than 90 governments have undertaken initiatives to observe the Year. A number of microfinance leaders, development banks, credit unions, postal and savings banks and commercial banks are lending their support, for which we are most grateful. More than 300 events have been held around the world at which financial experts have been raising awareness and sharing their knowledge.

I believe microfinance offers another platform for private-public collaboration and for interventions by private solidarity institutions such as non-profit organizations and cooperatives. Through such arrangements, poor people can gain new choices, and a chance to increase their wealth. Small- and medium-sized enterprises can build up their infrastructure and capacities. Societies benefit in their efforts to defeat hunger and achieve other development goals such as better nutrition,

gender equity and education for children. And private businesses profit from access to new markets and, not least, the boon to their reputations that comes with offering services that have a positive social impact.

I hope such engagement will intensify. The potential is significant. It is estimated that many millions of people around the world have unmet needs for financial services. The challenge is to scale up without losing sight of the poorest and the most vulnerable members of our society. Microfinance has been a small and, at times, partially subsidized venture. Now, the possibilities for commercial involvement have increased. We need to transform it into a viable and truly developmental effort on a mass scale that reaches the people, businesses and microfinance institutions that need to be supported. I hope financial institutions will continue to show that they are true entrepreneurs, and invest robustly in this line of business.

Last month's The 2005 World Summit in New York served as a real catalyst for development advances that we have been seeking for many years in key areas such as aid, debt relief and quick-impact projects. As we continue our efforts to achieve the Millennium Development Goals, microfinance can and must be part of that picture. Where people have a stake, a start, a piece of ownership, they are more likely to prosper. And where businesses are given a chance to develop, countries are more likely to flourish. I look forward to working with you to expand the reach of microfinance, and most importantly, to intensify our global struggle against poverty.

KOFI ANNAN
Former UN Secretary-General

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