

Building Domestic Financial Systems That Work for the Majority

By Women's World Banking

EXECUTIVE SUMMARY

Over the past ten years, microfinance has come of age. Poor women and men have shown that they are strong entrepreneurs, borrowers, and change agents. Outreach has expanded rapidly. Leading microfinance institutions, banks, and cooperatives have demonstrated how to provide efficient, responsive, and profitable microfinance services. Common performance indicators and standards have been established and are being used by networks, wholesalers, and raters. Microcredit has become microfinance, with a growing number of institutions responding to poor people's needs for a range of lending, savings, and insurance services. Key elements of the required policies, regulations, and institutional infrastructure have been agreed on and these elements have been adopted in several countries. New private actors have entered microfinance, with equity and loans made available by commercial and public sources.

Yet the microfinance industry is still in the early stages of development in most countries. While micro-lending outreach has expanded rapidly in the last ten years, from 9 to 90 million households, development has been uneven, and in most countries less than 10% of low-income entrepreneurs and households have access to basic lending and savings services. Our objective is for the number of households served to quadruple over the next ten years and, in all countries, for at least 50% of poor households to have access to financial services geared to helping them build income, assets, and livelihoods. In most countries this will require a three-pronged strategy.

MORE PATHWAYS OUT OF POVERTY

High potential specialized microfinance institutions will require financial and capacity building support that fits their stage of development. The entry of commercial banks into wholesale and retail microfinance must be promoted. And strong cooperatives and savings institutions must be encouraged to improve their organizations and product offerings.

In all cases, emphasis needs to be on developing the products that help low-income entrepreneurs and households build income and assets. Savings, business loans, insurance, and remittances for microfinance are all valued. MFIs will need to reinforce their knowledge of and connection with low-income clients to provide excellent service to this client segment. MFIs will need to become regulated or to build alliances to be able to offer savings products. Banks need to resist the temptation to fall into consumer and transaction finance. And most cooperatives and savings institutions will need to build more solid management and create stronger lending products. Technology applications, combined with solid risk assessment methods, will be key in reducing transaction costs and expanding outreach to underserved rural and urban clients.

Country microfinance strategies will constitute the core of a successful build-up of financial systems and services that work for the poor. Each country is different, but experience indicates the key elements that country stakeholders need to put in place, over time, to build a robust financial system that works for the majority. While some countries have implemented some of the essential measures, most countries have far to go. This chapter provides a general roadmap for country-level stakeholders—policymakers, microfinance institutions, banks, and supporters. Five levels of action will be key:

1. Policies, regulations, and legal structures that work for microfinance.

The following dimensions need to be addressed in building policy regimes that work for microfinance: liberalized interest rates, responsive government and financial sector policies, performance indicators and standards, regulations and supervision capabilities for microfinance, a range of suitable legal structures, legal and judicial systems, government roles, and external support.

2. Institutional infrastructure, including technical service suppliers, wholesale finance, microfinance networks and industry associations, rating agencies and credit bureaus, IT platforms, payment systems, and

business services, all playing effective roles in building standards, capacity, innovation, transparency, outreach, and performance in microfinance.

3. Key financing instruments and arrangements, including domestic savings mobilization, domestic wholesale financing, grants and soft loans for younger MFIs, bonds and securitization for the strongest MFIs, domestic equity financing, and guarantees—all supported by increased transparency and overall development of domestic capital markets. The chapter identifies key elements of microfinance that regulators, wholesalers, and raters need to understand if they are to play effective roles in microfinance. Also provided is a tool to enable funders to assess the likely success of smaller microfinance institutions. Both tools are geared to help build domestic capital markets, moving from the dependence on hard-currency loans and equity funds that create serious risks for microfinance.

4. Retail capacity in microfinance. In most countries, microfinance institutions, banks, cooperatives, and savings institutions all have important roles to play. Each will require a thorough understanding of supply and demand, including supply by different sets of institutions of key products, for different income segments in rural and urban geographies. Each set of institutions will need to strengthen the commitment and competence of their boards and management to drive growth in microfinance. This chapter provides an analysis of competitive advantages, common pitfalls, and key measures of success in increasingly competitive markets for each of these sets of retail actors.

5. Products and processes that reflect the needs and wants of low-income clients and their households need to be developed. Regulated MFIs have been slow to build broad-based savings services, housing finance, and insurance. Commercial banks need to offer a range of products for lower-income entrepreneurs and households, with appraisal-based business loans forming the core.

Key areas for action to realize this massive expansion in outreach, product offerings, and impact over the next ten years include the following:

- Build retail capacity by microfinance institutions, banks, cooperatives, and new channels.
- Build the depth and diversity of products necessary to help low-income clients accrue income and assets.
- Build domestic and financial markets and industry infrastructure.
- Utilize best-practices methods and technology to cut costs and expand outreach.
- Develop permanent state policies and country strategies for microfinance.
- Mobilize new actors, and help them to play effective roles.

This chapter outlines the key building blocks in establishing country strategies for microfinance at six levels: policies, institutional infrastructure, domestic financing, retail capacity, product offerings, and impact on poor households

This material is excerpted from the book *More Pathways Out of Poverty* (Bloomfield, CT: Kumarian Press, 2006). To order go to: www.kpbooks.com.