

**The Future of Microfinance:
Visioning the Who, What, When,
Where, Why, and How of Microfinance
Expansion Over the Next 10 Years**

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Introduction

Microfinance has gradually developed to be a worldwide movement, no longer being a subject matter of microfinance practitioners alone. Governments, donors, development agencies, banks, foundations, corporations, business communities, civil societies, researchers, universities, consultants, philanthropists and others are taking an increasing interest in it.

The increasing level of acceptance of microfinance among the various groups of stakeholders worldwide presents the following questions:
Is microfinance (MF) becoming popular because it is a good business to make money?
Or
Is it because MF is a powerful tool to fight poverty?
Or
Is it because of both?

Since the concept was born in Bangladesh almost three decades ago, microfinance has proved its value, in many countries, as a weapon against poverty and hunger. It really can change people's lives for the better, especially the lives of those who need it most.

This statement by Kofi A. Anan, the UN Secretary General, succinctly validates the effectiveness of microfinance as a weapon to eradicate poverty. It has been evidenced worldwide that microfinance helps the poor to overcome poverty, and not through charity. It is a financial system that serves the poor with financial services in a most effective and productive way.

The experiences of many microfinance institutions so far strongly suggests that it is possible for the institutions to reach the goal of serving people in extreme poverty without having to sacrifice their profitability. This is mostly because microfinance is designed with the poor in mind, while at the same time being founded on market principles of competitiveness, pricing and sustainability. There is nothing wrong in earning money while serving the poor, as long as earning money does not become the prime or the only goal of microfinance providers. Microfinance institutions throughout the developing world are providing small loans to the poor for self-employment and proving to be sustainable enterprises in the fight against poverty.

A very important but often sidelined issue that is impressively incorporated in microfinance is the neglect of the human rights of the poor. Muhammad Yunus, the Founder of Grameen Bank, believes that credit is a human right. Every person has the right to credit to improve her/his livelihood. Once this right is established, the entitlement to other rights becomes easier. It empowers the poor to break the vicious cycle of poverty by opening the door for self-employment and generation of income. For women, self-employment makes even more sense because it allows them to work out of their homes and earn a better living.¹

It is known that poor people live at high risk and in vulnerable conditions. For this reason, the ability to take advantage of opportunities to protect themselves against risks of crises, and to cope with these, is very important for them. A big step towards eliminating poverty is therefore to make sure that financial services are offered even to the poorest person and that no one is rejected or excluded on the grounds that the person is too poor.

Given the financial need and the potential market of more than 1.2 billion people around the world who live under a dollar a day, and given the role of microfinance in reducing poverty, an attempt is made in this paper to focus on the development of microfinance so far and its potential future growth.

The paper is broadly divided into two parts:

- ◆ Microfinance outreach to date
- ◆ Microfinance expansion over the next ten years

Microfinance Outreach -Global Scenario

The microfinance sector has grown over time with more and different types of actors becoming involved, with increasing numbers of geographic regions around the world being serviced, with new types of products and services being developed, and with new ideas and technologies to support it.

The global picture regarding microfinance outreach is quite impressive. From a mere 7.6 million poorest families in 1997, the Microcredit Summit Campaign reported an outreach of more than 92 million clients by December 31, 2004. This number includes 66.6 million families who were among the poorest when they started with a program. Of these 66.6 million poorest clients, 55.7 million or 83.6 percent were served by the 52 largest individual institutions, all with 100,000 or more clients. Among these largest MFIs, 79% are in Asia, 17% are in Africa and only 4% are in Latin America.

Of the 3,164 institutions that had reported to the Microcredit Summit Campaign by December 31, 2004, 1628 were in Asia, 994 in Africa, 388 in Latin America and Caribbean, 48 in North America, 34 in the Middle East, 72 in Europe and the Newly Independent States (NIS). The increase in the number of institutions reporting, from 618 in 1997 to 3164 in 2004, is definitely an indication of an impressive growth in the field of microfinance.

Of the over 92 million people reached by the end of 2004, 81.5 million were in Asia, 7 million in Africa and 3.8 million in Latin America and the

Caribbean. Only 5.2 million of the 61.5 million poorest families in Africa and the Middle East were covered by microfinance programs by the end of 2004. Asia, which is home to some 67 percent of the world's people living on less than US\$ 1 a day can therefore rightfully boast of a vibrant microfinance sector.

In Asia, Bangladesh distinguishes itself by reaching more than 75 percent of poor families with microfinance. It is home to 31 percent of the largest programs in the world, who have individually reached more than 100,000 clients. MFIs in Bangladesh reached over 18 million poorest clients by the end of 2004. The intensity and density of microfinance is greater in Bangladesh than in any other country.

The pioneering role of Grameen Bank; the bold initiative of NGO-MFIs; the participation of banks; the implementation of Government programs like BRDB, PDBP, etc.; the operation of PKSF; and the strong commitment and competitive spirit of the major players in the field have largely contributed to such a development of microfinance in Bangladesh.

Microcredit Summit Campaign: Phase II Goals

In April 2005, the Microcredit Summit Campaign announced the extension of the Campaign up to 2015 at the Latin America/Caribbean Region Microcredit Summit in Santiago, Chile. Phase II of the Campaign, from 2006-2015, has two goals.

The first goal is to ensure that 175 million of the world's poorest families, especially the women receive credit for self-employment and other financial and business services by the end of 2015.

The second goal of the campaign is to ensure that 100 million of the world's poorest families move from below US\$ 1 a day adjusted for Purchasing Power Parity (PPP) to above US \$ 1 a day adjusted for PPP, by the end of 2015. With an average of 5 people per family, it can be

estimated that 500 million poor would rise above US\$ 1 a day, implying the near accomplishment of the Millennium Development Goal of halving absolute poverty. This is exactly the kind of progress needed to reach the Millennium Development Goals (MDGs).

The task at hand is to make adequate institutional and policy preparations to ensure that the MDGs and the two new goals set by the Microcredit Summit Campaign are achieved on time. Based on the lessons learnt and successes enjoyed so far, this is the time to intensify the efforts to get to the goals as planned. It is therefore very important to project the possible who, what, when, where, why and how of microfinance expansion over the next ten years.

Development of Microfinance

In envisioning the future of microfinance, it is important to know the background of the microfinance movement, who took the initiatives, who supported the cause, and what opportunities and constraints it has faced.

Poverty-focused microfinance came into existence as a private initiative, growing almost unnoticed through a process of learning by doing. Muhammad Yunus and other pioneers took the initiative based on an inner urge and then succeeded in developing a sustainable microfinance system that brought financial services to the doorsteps of the poor, especially to the poorest women who were always considered unbankable. Microcredit is the result of empathy for human suffering, continuous thinking and innovative efforts.

Grameen Bank Experience

In order to see what is possible in terms of starting a microfinance program on an experimental basis, expanding, consolidating and ultimately institutionalizing it for the benefit of the poorest,² it is worthwhile to look at the experience of Grameen Bank which has

spearheaded the microcredit movement. It was started as a project by providing a total of US\$ 27 to 42 people in 1976, becoming a specialized bank for the poor in 1983.

Grameen Generalised System

Grameen has grown through a process of learning by doing. It has always remained innovative to refine and improve the system to the advantage of its borrowers and to itself. The Grameen journey from Grameen Classic System (GCS; Grameen Bank-1) to Grameen Generalised System (GGS; Grameen Bank - II) is a tale of invaluable experiences of microfinance development over time. There are many exciting features in GGS, the most important of which is that it provides custom-made credit to the poor borrowers. The staff are given the freedom to be creative so that they can design a loan product catered to the needs of the client.

Outreach and Loan

Grameen Bank has reached more than 6.4 million borrowers as of June 2006. 96% of its borrowers are women. Up until this point, cumulatively the bank has given out loans totaling about US\$ 5.6 billion. The repayment rate has been over 98 percent.

Grameen Bank gives income-generating loans, housing loans, student loans and micro-enterprise loans to poor families. It offers attractive savings and insurance products as well as pension funds for its members. The ratio of deposits and own resources of Grameen Bank to its outstanding loans is 137%. It is a profitable organisation.

Struggling Members

Grameen Bank started a microcredit program in late 2002 exclusively targeting the beggars in Bangladesh. The program is known as the Struggling Members Program. This is an initiative taken by Grameen Bank both to challenge a sustained campaign that microcredit cannot be used

by the people belonging to the lowest rung of poverty, as well as to reinforce the Grameen Bank's belief that credit should be accepted as a human right. By the end of June 2006, Grameen had provided financial services to 71,295 beggar members.

Impact

Grameen Bank has been widely researched and recognized for making a difference in the lives of its members. Studies show that the borrowers of Grameen Bank are steadily moving out of poverty. One study shows that it is at the rate of 5% a year. According to an internal survey based on ten indicators³ of crossing the poverty line, 58 percent of Grameen families have crossed the poverty line.

Grameen provides a forum, a network for its members where they are organized into groups and federated into centers. They become decision makers, leaders and a social force. They become group and center leaders and also members of the Board of Directors of Grameen Bank, which they own. The Grameen borrowers implement their social development programs under the "16 Decisions"⁴. They are active participants in social networking and the commercialisation process.

The village phone ladies of Grameen who provide cellular pay phone services to their neighborhoods not only earn more, but also enjoy a gracious social status. Cellular phones have created a new class of women entrepreneurs who have been able to move out of poverty. It has also improved the livelihood of farmers and others who have gained access to critical market information and lifeline communications previously unattainable in the villages of Bangladesh.

Whatever indicators are applied to measure changes in the social conditions of poor women, such as respect from neighbors and spouses, self-esteem, self-confidence, ability to protest social injustice, capacity to solve social issues, Grameen borrowers are found better off than others.

The process is continuing and the progress is visible. This has all been possible primarily due to their access to credit.

Grameen members have a better understanding of their political rights and obligations. They believe in freedom of speech and choice. Many Grameen members campaigned and were elected during the local government elections held in 1997 and 2003. According to reports, in the 2003 local government elections 7,442 Grameen members contested the reserved seats for women and 3,059 of them were elected. They constitute 24% of the total members elected in reserved seats.

Star System

The star system introduced by Grameen has created an environment of healthy competition among the staff and inspired them to try their hardest to achieve the goals of Grameen. Grameen has five stars: green, blue, violet, brown and red. Each star represents one particular achievement in terms of 100 percent repayment, profit earning, financing, education and crossing the poverty line. The Star system provides an example of how a competitive environment contributes to reducing poverty as well as earning profit.

While it is not necessary for other MFIs to follow the same track as Grameen Bank, the programs and progress of Grameen give an indication of what is possible for a single microfinance institution to achieve. Therefore, hundreds of MFIs in more than 100 countries are already following the Grameen Bank approach to providing financial services to the poor: they focus on the poorest women and many of them have achieved financial sustainability.

Over the last thirty years many MFIs/MFPs in different countries including Bangladesh, India, Indonesia, Nepal, Kenya, Nigeria, Ethiopia, Morocco, Peru, and Bolivia have matured in their operations and reached a critical mass for large-scale expansion. The operation and support programs of Grameen Bank, Grameen Trust, ACCION, FINCA, Women World Banking,

Grameen Foundation, Oikocredit, ASA, BRAC, etc. contributed a lot to the expansion of microfinance.

Microfinance Expansion over the Next Ten Years

Microfinance expansion over the next decade can be expected to be an extension of what has been achieved so far while overcoming the hurdles that have been posing difficulty in effective microfinance operation and its expansion.

Who will take the lead and where, are the two questions that need to be addressed first without any bias. Given their experience and expertise, it is expected that the current providers of financial services to the poor will take the lead in the expansion of microfinance. There may be several participants in this process and their participation may be seen in the following forms.

1. Existing microfinance institutions can expand their operations to areas where there are no microfinance programs.
2. Cooperatives/Credit Unions may be more active in providing financial services to the poor.
3. More NGOs can incorporate microfinance as one of their programs.
4. In places where there are no microfinance institutions, the government channels at the grassroots level may be used to serve the poor with microfinance.
5. Postal savings banks may participate more not only in mobilizing deposits but also in providing loans to the poor and onlending funds to the MFIs.
6. More commercial banks may participate both in microfinance wholesale and retailing. They many have separate staff and windows to serve the poor without collateral.
7. International NGOs and agencies may develop or may help develop microfinance programs in areas or countries where microfinancing is not a very familiar concept in reducing poverty.

8. Community based organizations may get involved in microfinance services.

It is expected that one or more of the above mentioned operators will get involved in one or more places where there is the need for microfinance services. They may opt for group lending, village banking, individual or any other form of lending, as they see fit. But their participation will depend on their capacity and commitment, leadership, enabling environment, and access to financial capital.

In the case of NGOs, which have more focus on poverty lending, funding is a very critical issue for both start-up and scaling-up projects. Unless the funding problem is taken care of, it will be difficult for microfinance programs to start and expand their operation and increase their outreach. The situation may be different for regulated MFIs who can mobilize savings and use it for onlending purposes and who have access to commercial sources.

All the possible financial services can be tapped and all the actors committed to poverty alleviation whether in urban or rural areas can get involved in increasing the microfinance outreach. In addition to the focus on bottom poor, attention may also be given to the "missing middle". Development of Small-Scale Enterprises through microfinance will not only increase the outreach but will also help the generation of more employment and income for the poor. It is expected that in the following years there will be considerable deepening of microfinance in this direction along with simultaneous drives to reach and serve the poorest of the poor.

The role of the government, the donors, the networks and the media will remain as important as before in creating an enabling environment, in providing/channeling funds and creating awareness for the rapid expansion of microfinance. The role of the Microcredit Summit Campaign as a driving force will be vital for achieving these goals.

Growth Potential for Microfinance - Focusing on the Where of Microfinance

Although there has been remarkable progress worldwide, in terms of growth in the number of MFIs and their outreach, there is still a lot to do. As MFI outreach to the poorest families is only 38% in Asia, 8.5% in Africa and the Middle East, 11.6% in Latin America and the Caribbean and 1.7% in Europe and the CIS, there are millions of poor people in different regions who can be and should be reached with microfinance to help them overcome poverty.

Asia and the Pacific

Asia is the home of the largest number of MFIs and MFI outreach. But even in Asian countries there is still high scope for expanding and deepening MFI outreach. Consider the case of the four most populous countries in Asia (China, India, Indonesia and Pakistan) that have many microfinance programs but at the same time have millions of poor people without any access to formal or semiformal financial services.

There is an enormous demand for microfinance in China, which according to a report of the China Association for Microfinance (CAM) has a poor population of about 110 million people. As reported by CAM, the total number of poor clients so far reached by NGO-MFIs, RCCs, the government—mainly through Agricultural Development Bank—and the City Commercial Bank for urban entrepreneurs is only slightly over 7 million.

About 26 percent of 1.1 billion people in India are still under the poverty line. Only an estimated 10 to 12 percent of the poor in India are reached by microfinance including the outreach of SHGs, NGO MFIs, NBFCs, Commercial Banks and Cooperatives.

Indonesia, the fourth most populous nation (over 245 million people) in the world has over 40 million people who are living below the poverty line.

Although there are several formal, semiformal and informal microfinance providers working in the country and serving a few million, the need and potential for increasing microfinance outreach to millions of both rural and urban poor who are still excluded is very great.

In Pakistan 32 percent of its 164 million people are under the poverty line. Although a number of microfinance providers including NGOs and banks are working in the country, their outreach is still less than one million. As a believer in the poverty fighting capacity of microfinance and as a pioneer in the development of legal and regulatory framework, the country needs a great breakthrough to increase the microfinance outreach at a faster rate.

Microfinance development in most of the Asian countries except Bangladesh has remained skewed and slow. In India for instance, almost three-fourths of the total microfinance clients are concentrated in four southern states, namely Andhra Pradesh, Tamil Nadu, Karnataka and Kerala. Large parts of Northern and North Eastern states have remained underserved by the sector.

Although the countries in the Pacific region have relatively small populations, a large percentage of them live under the poverty line. For instance, 37% of the 6 million people in Papua New Guinea, the most populous country in the region, are living under the poverty line. Other countries in the region with much smaller populations have significant numbers of poor. They have microfinance programs with little capacity, outreach and exposure to best practices. How the outreach can be increased in the region is an issue that should be addressed taking into consideration the constraints the MFIs are facing on the ground.

Africa

The global concern for the level of poverty in Africa is well known to all. Africa is hardest hit by the crippling problems of chronic hunger and

malnutrition. The great concentration of poverty in Sub-Saharan Africa is also a matter of concern for all.

Despite such disappointing facts, microfinance in Africa is growing. A broad range of diverse institutions offers financial services to low-income clients in Africa. These include non-government organizations, non-bank financial institutions, cooperatives, credit unions, rural banks, Rotating Savings and Credit Associations (ROSCA), postal financial institutions, and an increasing number of commercial banks.

Countries with a high number of MFIs in Africa include Kenya, Uganda, Ethiopia and Senegal. Kenya with K-Rep contributed to the growth of microfinance especially in East Africa. There is a growing number of MFIs in Rwanda, Zambia and Tanzania. As a country, Uganda has the largest outreach in the microfinance sector. But in countries such as Nigeria, Ghana, Liberia, Sierra Leone, Libya, Tunisia, Cameroon, Zambia, Angola and Mozambique, there is low density of MFIs. Although East Africa is the leading region in the microfinance sector in Africa, even there a large number of potential members are yet to be reached.

In countries like Mozambique where rural areas are characterized by low population density, poor infrastructure, limited participation of the rural poor in the cash economy and restricted diversification of income sources, it is very challenging to develop a sustainable microfinance program. Political instability, the AIDS epidemic, lack of familiarity with best credit and savings practices also hinder in the development of microfinance in Africa.

Arab World

Microfinance in the Arab world, which is spread over both Africa and Asia, is also growing. The experience of microfinancing in this region in terms of scale and outreach is encouraging. From less than 10,000 in 1997, the outreach has gone to over one million by 2006. Yet it still has more than 20 million potential clients to reach. Although Morocco has the largest

outreach in the Arab World, even in this country there are lots of poor without any access to microfinance.

In the Arab world, the microfinance programs are predominantly urban. The majority of MFIs in the region are NGOs. They are mostly dependent on donor funding. There is the presence of some large government sponsored programs in Tunisia, Jordan, Egypt and Syria. They reportedly do not follow good practices. There is, therefore, a lot of room for developing viable programs to serve the millions of unserved people who could benefit from microfinance in the Arab World.

Latin America and the Caribbean

Unlike Asia and Africa, the majority of the poor live in urban areas in Latin America. While 38% of the population in urban areas is below the poverty line, 62% of the population in rural areas is also poor. As there is a high concentration of microfinance programs in urban areas in many of the Latin American countries, the need for making more microfinance services available to the rural poor is great.

The current microfinance providers in Latin America include NGOs, microfinance institutions and commercial banks. They are mostly working in urban areas. When they can expand their operations to new areas, the new programs can also be started and supported to serve the areas which are without any microfinance program. In many of the countries in Latin America and the Caribbean including Bolivia, Brazil, Columbia, Dominican Republic, Guatemala, Haiti, Honduras, Mexico, Nicaragua, Peru, where millions of poor are under the poverty line and not reached by microfinance there is a lot of scope for its expansion to both urban and rural areas. As Argentina has the lowest microfinance coverage in Latin America it provides a challenge to those who want the rapid expansion of poverty focused microfinance programs in countries which are lagging behind.

Europe and North America

There is a need and opportunity to step up efforts to promote self-employment and growth through microfinance in the member states of the European Union where 12 percent of all households live below the threshold of poverty. There are MFPs in many European countries including Albania, Bosnia, France, Germany, Italy, Netherlands, Norway, Spain and Kosovo. Their outreach may be increased to give every poor person the right to economic initiative and the opportunity to generate self-employment.

Over 35 million people, or nearly 12% of the population in the United States, the third most populous country in the world, live below the poverty line. Although microfinance is used as a tool to fight poverty in the USA, its outreach is limited. According to estimates, there are over 750 organizations in the USA providing microfinance and/or related business training. Many of them are reportedly run as social welfare programs. None of them recover all their costs. The best reported cost recovery is 70 percent. There is, therefore, the challenge to increase outreach and develop sustainable microfinance programs in the USA. Such is also the case in Canada, which has 16% of its population living below the poverty line.

Sources of Financing - Towards Solving the How of Microfinance

One of the main challenges in successfully getting through the start up phase to the integration phase and expanding operation is to solve the problem of continuous financing. The biggest problem in many cases for expanding outreach is not the lack of capacity of MFPs but the lack of funding to get through initial years of operation. There is a huge gap between the demand for and supply of new funds to serve more and more poor despite the proficient capacity and track record of loan providers. It is encouraging to see that new opportunities are being explored and utilized

for financing MFIs. Funding from sources of savings, equity, quasi-equity, social and private investors, corporations, foundations, banks, and wholesale funds is considered to have a lot of potential to support the expansion of microfinance programs.

Loans, Guarantees and Equity Participation

Many commercial banks in different countries are providing loans to the MFIs either without any outside guarantee or on the basis of guarantee provided by someone else. Their support can be increased and the requirements can be relaxed to accommodate more MFIs for funding and capacity building. They can develop separate microcredit funds out of their own profit and also can contribute to the development of national and international microcredit funding. They can participate in guarantee funding through a variety of transaction structures such as direct loans, securitization and bond issues. Their participation in the form of partnership like ICICI Partnership in India and equity share holding like NIRDHAN in Nepal is also encouraging. More such initiatives are needed to support the MFIs further in all phases of their development in different countries. Bank-MFI credit linkage is of benefit to all the participating parties – banks, MFIs, and the borrowers. It benefits a bank, which has idle funds, in terms of profitability and business expansion; an MFI in terms of sustainability and outreach; and the borrowers in terms of their increased earning.

Continuation of funding in increasing amounts to MFIs is important for the expansion of their program. But how far commercial banks will go with their support depends on the minimization of risk factors and ensuring earning for their shareholders. It is ultimately the performance of MFIs in terms of portfolio quality, transparency and progress towards sustainability and profitability that will matter.

Commercial banks with their extensive networks, technology infrastructure, and access to capital and financial markets can play a greater role in promoting microfinance services to unserved and

underserved areas in different parts of the world. They can provide both financial (retail and wholesale loans, equity, etc.) and non-financial products (technical assistance, grant/sponsoring, etc.) to MFIs. Citigroup, Deutsche Bank, ING, ABN Amro, Standard Chartered Bank, etc. are already supporting microfinance institutions in some form or other like direct financing for loan portfolio growth, catalytic financing through a guarantee mechanism etc. The recently introduced 'Growth Guarantee Program' of Grameen Foundation is an example of such support.

If a closer look is taken at the financing problem of different categories of MFIs and the responses from different sources, it is seen that until and unless the MFIs are mature and financially self-sufficient they can hardly mobilize funding on market conditions. The newborn MFIs that start from scratch, cannot grow without sponsors/donors to provide them with seed capital for on-lending and operational purposes. If they can overcome obstacles by getting funds for scaling-up and become operationally self-sufficient by expanding their client base and loan-portfolio, they will not need capital grants or soft loans anymore because they will be strong enough to borrow funds and to include the costs of funds and the cost of a prudent loan loss provision in their cost estimates.

Savings

Although many financially self-sufficient MFIs can secure funding from various market sources, they still cannot mobilize savings from the general public. That is why their cost of funding is more than if they could become a bank or get permission to accept deposits. Until such a stage is reached the MFI's funding problem stands as a stumbling block in the way of its growth and restricts its capacity of increasing outreach.

Savings can play a significant role in providing funds for MFIs. Its importance as a means of servicing clientele and as a source of mobilizing funds for on-lending capital is gradually increasing. Saving provides security, convenience, liquidity and returns to the poor savers if this is not locked in. But how far it will solve the problem of capital shortage of MFIs

will depend on how much saving can be generated by MFIs and at what price. It can be argued that the acceptance of savings from the borrowers in order to mitigate the problem of shortage of funding can be risky as loan recovery is not guaranteed. The financial management capacity of the MFIs to utilize savings as a tool to mitigate the funding problem needs to be strengthened so that both the loan providers and the savers are benefited.

It is argued that saving should have a legal cover. If the MFI that is mobilizing savings is not doing well, losing money or is closed, then what will happen to the hard-earned savings of the depositors, especially of those who are not borrowers? Hence the question of a regulatory environment becomes dominant while considering whether NGO MFIs, should be allowed to accept deposits and whether savings can play a major role in financing MFIs.

Money is all around. If it can be mobilized / tapped in the form of savings and deposits it can help a lot. How savings can be a continuous source of adequate financing can be seen from the experience of Grameen Bank which has more money in deposits than in outstanding loans.

African MFIs reach many more savers than borrowers. They mobilize deposits as their main sources of liabilities (72%). In Asia, BRI among others in Indonesia also generated more savings than loans outstanding.

The question is how to solve the funding problems of MFIs who are not allowed to take savings and deposits, who are not backed by local banks and who have to solicit donations and tap other sources. Ideally any MFI which has a good track record and has potential to make profits should be able to get funding from the market whether in the form of loans, bonds and/or equity. But in practice MFIs with a performing portfolio of thousands of unsecured loans are not welcome by banks for borrowing unless the banks are under obligation by the priority sector lending and other requirements by the government or if there is a guarantee fund for their loans.

Securitization

Securitization as a source of funding deserves attention. It is a good idea that microfinance could be securitized in much the same way that credit card debt, home mortgages, and an increasing variety of other assets are sold. But its attractiveness to investors will depend on the nature and size of loans and legal and other issues related to securitization of loans. It is observed that only when many MFIs are making substantially similar loans and using similar legal frameworks, a true market in securitized micro loans can be contemplated. The experiences of securitization of micro loans receivable in Bangladesh, India (ICICI, SHARE) and Latin America can be taken into consideration in this connection. Only the successful MFIs with a proven track record in collections, management, profitability and good governance who can offer a potentially risk-return profile, can be expected to expand their microfinance outreach through securitisation. But the number of such MFIs is limited. BRAC, Bangladesh has recently entered into securitisation market. It will be important to see how it works and how much it is able to solve the problem of getting funds for microfinance activities.

Bonds

As bonds may be easily traded in the market, they may appear more attractive for MFI financing than loans. But the reasons that make local banks reluctant to give loans to MFIs are the same reasons that prevent regular investors from buying MFI bonds. For foreign investors, investment in MFI bonds is more complicated because of foreign exchange risks. An enabling environment and conditions for the MFIs to utilize bonds as one of the important sources of financing needs to be in place as soon as possible.

Equity and other Investments

Equity is of course the most preferred way of financing MFIs. The problem is, however, in the absence of a clear exit strategy in which share could easily be sold to a willing buyer for cash, the prospect of equity participation does not appear to be bright at this moment. Either because of low profit margin or non-profit status of many MFIs, they are not found to be attractive to the investors who could be interested in equity financing.

In fact, financing MFIs is not considered as run of the mill business for regular banks and regular investors. It requires a different approach and a different mind set. For unregulated MFIs and for MFIs without sustainable large-scale operation, none of these instruments do help much.

As reported more than 70% of all foreign investments in microfinance land with regulated MFIs that have been recognized by the regulatory authorities as stable financial institutions and that have got the license to operate as banks. In reality, the situation is even sharper. More than 60% of that amount is received by ten MFIs only, the front runners like Bancosol in Bolivia, Compartamos in Mexico, Banco de Solidario in Ecuador, Confinaza in Peru, Cajalos Andes in Bolivia and Pro Credit Bank in a number of countries managed by IMI in Germany, whose profits make them qualify for investors. Most of them serve the upper layer of the pyramid, some serve a mix of stronger and weaker clients but none of them focus specially on the poorer clients below the poverty line. It may be because, according to many, it is almost mutually exclusive to serve the very poor and to be profitable enough for investors. But in reality it is not found to be generally true.

Under the circumstances as stated above, it is clear that funding for MFIs under the start-up, expansion, or consolidation phase should come from the government as grants or subsidised loans: from the donors as grants, from specialized agencies and social investors (private and public) as soft /concessionary loans to enable them to work for the poorest in unserved and underserved areas. Although social investors give the social effects of their investment the same or higher priority than the financial returns, the

experiences so far, are not encouraging for MFIs who are unregulated. According to a CGAP study (2004) out of total private social investment of US\$435m, only US\$44m has gone into unregulated MFIs. Such is the case with social public investments as well: where the public social investments have reached a level of US\$575m, the unregulated MFIs received only US\$6 million. There is, therefore, a considerable gap between the phase that MFIs should be funded by donors and the phase that they should have funding from the market.

How to narrow or fill this gap? Social investors, both private and public, can play a significant role in bridging this gap. The awards for innovations and other achievements introduced by CGAP, AGFUND, GF, etc. are steps in the right direction. But the question is that in order to come to the stage of competing and qualifying for any award, one needs start up support, which is very critical. Without this critical support, it is almost impossible for MFIs to grow. If this critical support comes from donors or from the government in the form of technical assistance, grants and soft loans, it will definitely expedite the process of increasing the outreach to the areas which are yet to be served by microfinance or which are underserved.

Mere technical support without funding for operational and on-lending purposes at the beginning does not really help much. Many of the NGO MFIs which are getting only technical support from donors and not any support for on-lending purposes are not able to expand their programs. Some NGO MFIs in China, for instance, are facing this problem at the moment.

Donor support can come directly to the NGOs or it can come, among others, through national wholesale funds like PKSF in Bangladesh or international whole sale fund like Grameen Trust. Experience shows that it works better if the fund is channeled through wholesale funds. Wholesale funds are better equipped to process project proposals and provide funding support to seed and scaling-up projects. They have special skills in developing sustainable microfinance programs through proper training

and technical assistance, monitoring, evaluation, and dissemination of information.

Wholesale Fund/Apex Institutions

The effectiveness of wholesale funds/apex institutions in supporting microfinance programs with financial and technical assistance at different stages of their development is well established. As an apex institution for microfinance in Bangladesh, PKSf has come to be recognized globally as a model of apex funding institutions for MFI development.

One of the reasons for the high percentage of microfinance outreach (over 75% of poor families) in Bangladesh is the establishment and operation of PKSf. It has benefited from an existing critical mass of retail capacity and has successfully managed to expand the outreach of microfinance with a strong focus on financial sustainability. It has provided financial support to 213 partner organisations including large NGOs like BRAC, ASA and Proshika. It has disbursed about US\$410 million as loans to its partners who in turn made a total loan disbursement of US\$3117 million to their borrowers.

Given its success so far, PKSf is gradually moving into second and third generation issues in microfinance including reaching the poorest of the poor, up-scaling micro enterprises, attaining full financial sustainability, establishing synergies with other social development interventions, and mainstreaming microfinance into the financial market.

The existence and operation, of wholesale funds/apex institutions in many countries including RMDC in Nepal, NABARD, SIDBI and others in India, PPAF in Pakistan, PCFC in the Philippines, NDTF in Sri Lanka and their experiences highlight one thing for the success of apex institutions: they should be allowed to remain independent of political interference or pressure in making their funding decisions.

It may be mentioned, however, that a cross country CGAP study raised doubts about the effectiveness of apex institutions in many countries on the grounds that there was not enough retail capacity to absorb the funds. While this is true, this should not be treated as a constraint, but rather should be taken as a challenge. The same way that MF programs developed their client base among the poorest who were unwilling to join the programs, the apex institutions can create the retail capacity in countries where there are poor people and where there is the need for poverty focused microfinance programs. This is a hard task but this can be done if there is a will and a high level of commitment.

Grameen Trust

How microfinance programs can be supported at their start-up and scaling-up stages and how they can be implemented in difficult situations can be seen from the experiences of Grameen Trust (GT), which is an international wholesale fund.

GT Support

Grameen Trust supports and promotes the Grameen Bank Replication Program worldwide through financial and technical assistance and also through equity participation (NUBL, Nepal) and legal subordination of loan (CFTS, India). It has so far supported 138 organizations in 37 countries including seven projects under its Build, Operate and Transfer (BOT) Program.

How a limited start-up support sows the seed for growing large is evident from the experiences of Grameen partners who started small and became big in terms of outreach in the course of time. The start-up and scaling-up funding from GT and its training and technical assistance not only provided them finance and confidence but also reinforced their determination to build a poverty free world with microfinance as the instrument. Many GT partners in different countries—including FPC and CFPA in China, CEP Fund in Vietnam, MKEJ and YDBP in Indonesia, CARD,

PD, KAZAMA and TSPI in the Philippines, ASA, GBUP, Grameen Koota and SHARE in India, CSD and NIRDHAN in Nepal, KASHF and ASASAH in Pakistan, KAT in Kyrgyzstan, LAPO in Nigeria, PTF in Tanzania, MCDT in Uganda, Pro Mujer in Bolivia, Padakhep, DSK, MSS and IDF in Bangladesh—have not only distinguished themselves by their increasing and deepening outreach, diversifying products, and financing sources, but also by their performance standards and sustainability status. Many of the pioneers in the field of microfinance/microcredit in different countries, including China, started their work with the support from Grameen Trust.

Build, Operate and Transfer Program

In the experiences of Grameen Trust, its BOT approach is very rewarding. Given the fund, GT undertakes BOT projects in countries or regions where there is little or no microfinance experience and where there is a need for immediate implementation of microfinance programs to reach a large number of poor people quickly. BOT programs significantly lower implementation time and training costs as well as ensure a fast track to sustainability. It follows the Grameen Bank Approach, takes key personnel from Grameen, recruits local staff and trains them to become professional staff. Under the BOT approach, Grameen Trust prepares the project document, develops the business plan, and remains responsible for developing a viable microfinance program.

All the BOT projects of Grameen Trust operating in Myanmar, Kosovo, Turkey, Zambia, Costa Rica, Guatemala and Indonesia are doing well in terms of increasing outreach and sustainable operation. The Myanmar project is now run by the local staff.

Given the success of BOT projects of Grameen Trust in Asia, Africa, Europe and Latin America and the commitment of donors to help the poor in post conflict and other special situations, it is encouraging to note that different foundations and other organisations are coming forward with more offers to implement such projects in many different countries.

Project Dignity

Grameen Trust is committed to reach the bottom layer of the poorest (beggars) with microfinance services. Under its Project Dignity, GT is supporting its replication partners in Bangladesh to serve the beggars with microfinance following the "Struggling Members" Program of Grameen Bank. GT has a plan to replicate this program in other countries where there are beggars to help them overcome poverty and lead a more stable and dignified life.

Capacity Building

For healthy growth of MFIs and for meeting the challenges of microfinance expansion, it is necessary that the training facilities be extended and training materials be updated and upgraded. Fortunately more training materials and more cost-effective management tools are being developed and disseminated continually by different institutions now a days.

Given the introduction of technology in the microfinance sector and the requirement of becoming more efficient, more cost-effective and transparent, the need for continuous training is high. Training for trouble shooting and meeting industry standard will remain vital not only for survival but also for remaining at the forefront in terms of increasing outreach and achieving and maintaining financial self-sufficiency. Sharing of more information on the experiences and strategies of fast growing as well as large MFIs through the Internet and other means will be helpful for those MFIs who want to grow fast and serve more. It is expected that pioneering service providers like CGAP, SEEP, Grameen Trust, CASHPOR, Women's World Banking, ACCION, FINCA, UNDP, apex institutions, different networks and others will continue their support in the form of developing and disseminating training program materials and organizing training programs for capacity building.

In the experiences of Grameen Trust, the development of user friendly training materials and conducting effective training programs are some of

the toughest jobs in the industry. It requires the special skill of preparing and presenting materials in a language, style and format that can be followed by trainees with different educational and cultural backgrounds. GT finds field level experience and exposure very useful in this respect. GT has always followed the participatory method of learning and encourages the process of learning by doing.

Legal and Regulatory Environment

An enabling legal and regulatory environment is important for the development of the microfinance industry and its integration with the mainstream financial sector. This is an area where the government has a vital role to play. In fact, the issues of financing microfinance and the legal and regulatory framework for integrating microfinance with the mainstream financial system are inextricably connected with each other. The framework is necessary to facilitate the expansion of microfinance and accelerate its growth rate. It should create an environment in which MFIs can flourish.

Mobilization of saving deposits and commercial and other funding become easier when the MFIs have appropriate legal status. Donor confidence is also increased with some form of regulation that ensures transparency, good governance, and accountability. Expanding outreach to achieve the Microcredit Summit Campaign and the Millennium Development Goals will require increasing funding resources from different sources. If the issue of appropriate legal and regulatory framework is rightly resolved, then the funding issue becomes easier to address. These two issues are becoming more and more pressing for many countries today for the development of their microfinance programs.

It is not easier to considerably increase microfinance outreach when the prime source of money is donor money. The irony of the situation is that there is plenty of local money all around where MFIs are operating but they are not allowed to tap that money. The fact is that they are not only

not permitted to take public deposits, but in many countries they are not even allowed to accept savings from their own borrowers.

Mobility of Funds and Personnel

For developing sustainable microfinance programs in different countries it is necessary that there should be easy and rapid mobility of financial and human resources across the regions and the countries. There are a lot of restrictions in the mobility of loan funds, risks in foreign currency investments and complications in obtaining visa and work permits for technical personnel. For strengthening the microfinance movement and significantly expanding its outreach throughout the world, it will be necessary to relax the rules for international movement of microfinance fund and personnel. There should be no complications or delay in their movement. The governments who have committed themselves to fight poverty with microfinance may kindly consider this as an urgent issue.

Interest rate

Interest is the main source of income for MFIs. Their sustainability and profitability depend on their interest income. There is a lot of debate on the appropriate rate of interest that should be charged on loans. In most countries MFIs charge at a flat rate ranging from 12-27 percent per annum. In some countries, some MFIs even charge higher rates which go up to 36% or even more on the grounds of covering costs and attaining viability faster.

The question is what should be the ideal or optimum rate of interest? This has been bothering many people in many countries. Some argue that it should be enough to cover the cost of operation and allow some profit for capitalisation but it should not be so high that it appears exploitative.

The rate of interest of MFIs should not, however, be compared with the rate of money lenders, but it may be compared with the commercial rate to show how cost-effectively MFIs operate. MFIs provide small loans to

hundreds of borrowers at a rate of interest, which in many cases is not much higher than the commercial rate. According to Muhammad Yunus it should not ever be more than 10 percent higher than the market rate.

There is also an ongoing campaign for capping the rate of interest to protect the poor from the exploitation of greedy MFIs, who on some ground or other charge higher rates either to enjoy their luxury or to bear the costs of their inefficient high operational costs. But, for the sake of competitiveness and provision of quality services, it is better not to have capping but to form a consensus on a range of interest rates that will ensure a win-win situation for both the lenders and the borrowers. This may be possible with the government/central bank/regulatory body playing a leading role.

What is the solution under this kind of situation?

Obviously it is the creation of an enabling environment by developing appropriate legal and regulatory frameworks for MFIs to mobilize resources lawfully that are around and also that may be mobilized from foreign sources.

Taxation

There is a controversy whether microfinance institutions should pay taxes and what should be the taxation policy for microfinance.

MFIs may be classified into different categories on the basis of their ownership structure, scale of operation, legal status, size of capital, earnings, and purpose, such as for-profit and not-for-profit. The owners may be private, individuals or a group of individuals, or public. The MFI may even be owned by the borrowers themselves, as is the case with Grameen Bank.

The question is whether all MFIs should be treated equally for taxation purpose or whether there should be a differential treatment. Should the

microfinance sector as a whole enjoy a tax holiday and remain outside the tax net? These are the issues that should be taken care of by the regulatory authorities in order to create a tension free environment for microfinance development.

While considering the taxation issues for MFIs, a microfinance regulatory authority may take into consideration that a tax holiday for MFIs can help establish a microfinance sector, provide time to increase an MFI's capitalization, and enable its growth and greater outreach among the poor in countries where microfinance activities are still limited. On the other hand, a fully defined tax code for different categories of MFIs can foster greater transparency in operations and reporting, eliminate the grey areas and creating a path for MFIs to become comparable to mainstream financial institutions.

Conclusion

Microfinance has come a long way despite doubts expressed and criticism launched about its viability, impact, and poverty fighting capacity. The pioneers in the field and the practioners at large with their commitment, determination, and innovations have not only demonstrated its power and success, but also accelerated its growth. The Microcredit Summit Campaign deserves credit for making it a worldwide movement. Everyone who has supported or participated in this movement deserves high appreciation.

There should, however, be no room for complacency. The task of building a poverty-free world is yet to be finished. There are still over 1.2 billion people living in extreme poverty on this planet. They are not living in one country or region but spread all over the world.

Considerable work and continuous efforts are needed to diversify the source of funding for microfinance, to attract more foreign investments for well established MFIs, to use all the possible channels to serve more rural

and urban poor, to develop its staff as more productive and professional, and to make it more poverty-focused and profitable. As the number of microfinance programs is growing, it is expected that they will remain competitive and innovative in serving the underserved and unserved throughout the world.

Although the last decade has witnessed an impressive growth of microfinance, lack of funding is still considered a major obstacle in the way of its growth. However, it is encouraging that the situation is changing. Given the experiences of large and fast growing MFIs, there are lessons for others who want to increase their outreach and operate on a sustainable basis.

Fortunately, there is an increasing awareness about the power of microfinance, and the need to support its growth. Many players have committed themselves to its promotion. Governments are taking an increasing interest in it. More banks, both national and international are coming forward with different support packages. NGO-MFI partnerships are on the increase. New instruments are being used to solve the problem of funding. It is expected that in the coming years more ideas, innovations, cost saving devices, and players will continue to reinforce the microfinance movement and increase its expansion.

How fast microfinance outreach will increase and what role different players will play in it, will largely depend on the creation of an enabling environment by the governments. Macroeconomic stability, liberalised interest rates, viable alternatives to subsidised credit schemes, savings mobilisation, opportunities for institutionalisation, and participation of domestic and foreign investments are some of the issues that deserve government attention. Fortunately some governments have already developed legal and regulatory frameworks for the microfinance sector and some more are in line.⁵ The sooner the enabling environment is created through appropriate legal and regulatory frameworks in more and more countries, the better the chance for achieving the goals of the Microcredit Summit Campaign is.

Given the goals set by the UN through its Millenium Development Goals and the Microcredit Summit Campaign's new goals for 2015, this commitment to end poverty is an historic opportunity for all to make a breakthrough in poverty alleviation. If an effective roadmap is put together to incorporate poverty reduction strategies through microfinance, and if all the actors in the society join hands—practitioners, governments, donors, banks, corporations, NGOs, foundations, wholesale funds, networks, civil society and others—then there is no reason why the goals should not be achieved.

End Notes

1. Social and cultural norms in many societies prevent women from leaving their houses and actively participating in income-earning activities. In Bangladesh, for instance, it has not been long since women started being considered as income-earning members of their families.
2. The **start-up phase** is basically an experimental phase. In this phase the microfinance growth witnesses product development (credit & saving), and capacity and confidence building. In the **expansion phase** microfinance programs scale up their operations with more staff, clientele, area coverage, product development and disbursement to meet the increasing and diversified demand of the increasing number of clientele. In the **consolidation phase** the focus is on institutional strengthening and formalization. The issues of productivity, sustainability, transparency, diversity, flexibility, and meeting industry standards become important at this stage. The **integration phase** is the last phase, characterized by transformation of MFIs into regulated financial institutions, the disappearance of subsidies, mobilization of resources by attracting private capital, and accepting deposits from the public.
3. In Grameen Bank a poor household is considered to have moved out of poverty if it can avail good housing, pure drinking water, education for children, satisfactory loan installment, hygienic latrine, clothing, additional income sources, considerable savings, three square meals a day, and health care.

Please visit [http:// asp.grameen.com/dialouge/dialouge36/action.html](http://asp.grameen.com/dialouge/dialouge36/action.html) for details.

4. 16 decisions include bringing prosperity to the family, educating children, maintaining cleanliness, using hygienic latrines, giving up the practice of dowry, etc.

Please visit <http://www.grameen-info.org/bank/the16.html> for the details of 16 decisions of Grameen Bank.

5. It is reported that Bangladesh, Bolivia, Chile, Ghana, Nepal, Pakistan, Peru, Philippines, South Africa, Uganda, Vietnam and Zambia already have regulatory frameworks for microfinance. China, India, Kenya, Tanzania, Turkey and some other countries are reportedly working on it.

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