

**Accessing Loans and Grants  
from Bilateral and Multilateral Agencies  
for Microfinance Institutions**

By  
**Shankar Man Shrestha**  
**Chief Executive Officer**  
**Rural Microfinance Development Centre Ltd., (RMDC)**  
**Nepal**

With Assistance from:  
**Microcredit Summit Campaign Secretariat**  
**Washington D.C., USA**

## TABLE OF CONTENTS

I.	The Context .....	2
II.	Forms of Foreign Funding .....	3
III.	Need and Scope of Foreign Funding .....	4
IV.	Experiences in Asian Countries .....	6
V.	Modalities of accessing foreign funds from bi-lateral and multi-lateral agencies .....	8
VI.	Favorable Environment for Foreign Funding .....	9
VII.	Managing Risks of Foreign Funding .....	10
VIII.	Conclusion .....	11
	Bibliography .....	13

## **Accessing Loans and Grants from Bilateral and Multilateral Agencies for Microfinance Institutions**

### **I. The Context**

- 1.1 Across the globe, particularly in developing and transition economies, microfinance institutions (MFIs)<sup>1</sup> have access to loans and grants from bilateral and multilateral agencies. CGAP estimates reveal that international agencies have provided approximately US Dollar 0.5-1.0 billion annually in grants and soft loans for microfinance. Eighty-seven percent of these went to Latin America (mainly from private funds) and to eastern Europe/Central Asia (mainly from International Finance Institutions). Over 80 percent of the funds went to MFIs regulated and licensed by banking authorities. The regulated MFIs are increasingly seeking domestic deposits to fund their liabilities, leaving only a limited role for foreign debt investment.
- 1.2 Unregulated MFIs (NGOs), though more numerous than the regulated ones, are considerably smaller in terms of size of assets. As they are not structured to take equity investment, they are more likely to seek foreign debt than their regulated peer institutions, which can borrow more easily from domestic banks. These NGOs are funded primarily through grants and are generally prohibited from taking public savings. Their legal

---

<sup>1</sup> The term “microfinance institution (MFI)” is used in this paper to include NGOs, cooperatives, banks and licensed non-bank institutions that focus on delivering financial services to the poor and micro entrepreneurs.

structure does not include owners whom banks can hold accountable in case of default.

## **II. Forms of Foreign Funding**

- 2.1 Microfinance institutions have access to different forms of funding – either in equity, debt or guarantee - from different bi-lateral and multilateral agencies. The foreign agencies as investors buy stock of MFIs to become voting shareholders and thereby often control their seats in the board of directors. Foreign equity investment provides MFIs with a level playing field to manage more debt in local markets. These agencies can advance loans to the MFI. Or, the agencies can provide guarantees to the MFIs which are borrowings from local banks or capital markets. Guarantees have the potential advantage of strengthening the relationship between the MFI and the local lender, which may continue even when foreign guarantees are no longer needed or available. Their participation helps improve the MFI's credibility.
- 2.2 With licenses obtained from, and regulated by, national banking authorities, banks and non-bank financial institutions (NBFIs) can use debt, equity and guarantees. NGOs and cooperatives (including credit unions) are not legally structured to receive equity investments and hence, they can use only debt and guarantees.

2.3 For some of these MFIs, foreign technical support in product design and information systems could be more helpful than foreign loans.

### **III. Need and Scope of Foreign Funding**

3.1 Microfinance is recognized as a powerful instrument for poverty reduction and development, and hence features as a common program in many social organizations. This is also an important program of governments in developing countries.

3.2 A large number of non-government organizations, community-based organizations and rural co-operatives with savings and credit programs are emerging in recent years, but most of them, even after a long period of their operation, serve only a few households because of their limited institutional capacity and resources. Among the large number of institutions, some have the potentials to be promoted to quality microfinance institutions by providing them with intensive technical assistance and start-up funds for on-lending<sup>2</sup> to clients for the initial 2-3 years. Since they cannot afford large investment costs for technical assistance and cannot borrow commercial funds from markets, they need help in the form of grant and soft-loan funds from external or domestic agencies in the initial period. After that, they could be financially and technically able to have access to commercial funds for on-lending purposes and buy basic technical assistances from the market by using such funds.

---

<sup>2</sup> On-lending means retail lending by MFIs to their clients (the poor).

3.3 The governments of low-income countries often meet the funding needs of MFIs including the start-up of new institutions. In some of the developing countries, it is mandatory for the commercial banks to lend a small portion of their total credit portfolio to the poor. In the case of the majority of the MFIs, particularly the NGOs and unregulated ones, such provisions and mandatory requirements do not exist. Domestic funds from the central banks or governments for institutional capacity building of MFIs are generally not available in these countries. These effectively constrained the growth of the sector.

3.4 There is a large scope for bilateral and multilateral agencies to do a number of things for the promotion of microfinance sector in these countries. They can provide MFIs with grant funds for their institutional capacity building and soft-loans for expanding their on-lending activities to their clients. The international agencies could disseminate experiences on best practices and information to MFIs through study visits, workshops and interaction programs. They can also undertake action research programs to develop appropriate products and practices for MFIs. Moreover, they can extend support to MFIs, or implement programs for the creation and development of micro-enterprises and for upgrading occupational skills of the poor. Furthermore, the international agencies can provide equity or capital funds to start-up programs in some countries. They can consider providing support to regions where the poor need them. Even in countries with large MFIs, such as India, there are pockets that are under-served, such as Eastern and Northern States particularly Assam, Bihar, and Uttar Pradesh. Donor funding can

support poverty alleviation efforts through microfinance in these regions.

#### **IV. Experiences in Asian Countries**

- 4.1 In general, experiences in Asian countries show that specialized apex<sup>3</sup> MFIs have played a vital role in the promotion and development of the microfinance industry in their respective countries. Before the establishment of the national wholesale organizations<sup>4</sup>, microfinance's reach was much more limited: microfinance programs were not integrated with the national financial system, and most of them were suffering from inefficiency and high delinquency. Microfinance programs were considered as welfare programs. They were dependent on substantial subsidies and the continuity of the programs was expected only in the event of donor supports.
- 4.2 There are many examples. For instance, after the establishment of Palli Karma-Sahayak Foundation (PKSF) in Bangladesh, RMDC in Nepal, Pakistan Poverty Alleviation Fund (PPAF) in Pakistan, and the Small Industries Development Bank of India (SIDBI), microfinance outreach in those countries has increased substantially. As of March 2006, PKSF has disbursed US\$ 472.18 million (Tk 26,732.31 million) through its 207 partner organizations (POs). At present, over 8.8 million clients are getting microfinance service from its active 185 POs. As of April 2006, PPAF has disbursed US\$ 228.8 million (Rs. 13.767 billion)

---

<sup>3</sup> Apex organization means here a wholesaling organization.

<sup>4</sup> National wholesale organization means an organization which has got larger supports from the central bank and the government and it has larger outreach than other wholesale organizations in the country.

for microcredit and community development programs in Pakistan. Over 12 million people have benefited from its development programs. Through 65 POs, it has been providing microcredit to over 850,000 clients. The cumulative assistance of SIDBI's microfinance initiatives as at the end of March 31, 2005 aggregated US\$ 91.2 million (Indian Rs. 4,218.1 million) through 209 MFIs, benefiting over 1.5 million poor. In Nepal, RMDC has disbursed US\$ 12.7 million (Nepalese Rs. 931.5 million) to over 300,000 clients through its 41 POs.

4.3 In most of the countries, microfinance programs undertaken by non-government organizations are outside the regulatory framework. The central banks have mandated that commercial banks disburse a part of their total portfolio to the poor. There were concrete efforts from both the central banks and the governments to introduce professional microfinance programs in these countries.

4.4 Over the years, national apex organizations were created in most of the Asian countries to promote and develop the microfinance industry in the respective countries. The apex organizations have been playing different roles for promotion and development of sustainable microfinance institutions, such as innovations in microfinance products and systems, institutional capacity building of MFIs, strengthening the capacity of clients, developing and maintaining standards, etc. These organizations have assisted the central banks and the governments in the formulation of appropriate rules and regulations for the industry. With constant supervision and

monitoring from these apex organizations, their partner retail organizations were able to implement their programs in a professional manner. The partner MFIs have been able to implement viable and sustainable programs over a reasonable period of time. The apex organizations have set minimum standards for monitoring performance of programs in the microfinance industry.

## **V. Modalities of accessing foreign funds from bi-lateral and multi-lateral agencies**

- 5.1 Foreign funds from bilateral and multilateral agencies to an organization are channeled to the country through its Government. No organizations can have access to loan funds directly from the bilateral and multilateral agencies. Even for grant funds, the international agencies and the concerned receiving organizations have to apply for formal permission from their respective Governments and concerned authorities.
  
- 5.2 For providing loan funds to an organization for certain projects, international agencies go through a number of technical assessments and meetings with the Government to discuss a variety of aspects, including the roles of the proposed executing and implementing organizations and the potential ultimate beneficiaries. Once the projects are discovered feasible, the international agencies enter into agreements with the respective Governments, and then the government agencies make subsidiary agreements with the concerned executing and/or implementing agencies of the projects. The funds are released in

a number of installments based on the compliances with the specified covenants and conditions agreed upon by the parties. The project activities are monitored and supervised through a number of project missions and studies conducted by the international agencies and the government agencies. For smooth implementation of the projects, international and domestic consultancy services are procured, which generally incur a huge amount of funds. The donor agencies normally ensure that the concerned government agencies are committed to the systematic implementation of the projects in the specified period. However, there have been a number of projects managed by a professional team, which have been implemented successfully without any external consultancy service. For instance, the Rural Microfinance Project (RMP), which has been awarded four times by the Asian Development Bank for exemplary performance, has not used the budgeted consultants from the very beginning. RMP has been implemented by the Rural Microfinance Development Centre Ltd. (RMDC), an apex microfinance organization in Nepal.

## **VI. Favorable Environment for Foreign Funding**

- 6.1 Domestic governments need to create and maintain a favorable legal and institutional environment for the foreign agencies to extend their financial and technical support to the sector.
- 6.2 Since government-led microfinance programs have not become sustainable and successful in most cases, private or civil-society owned microfinance programs are emerging. They should be

encouraged and facilitated by the domestic governments and international agencies to expand their outreach substantially for meeting the credit needs of the large masses of poor people. The role the government has is mainly to create and establish a favorable policy and regulatory environment so that maximum inflow of foreign funds takes place in the country, and they are cost-effectively and professionally utilized for the purpose. If necessary, international agencies can help the respective governments to develop necessary policy and legal environments in their countries.

## **VII. Managing Risks of Foreign Funding**

- 7.1 Foreign investors sometimes displace local funds. In order to avoid this, a carefully planned and managed approach is required. Local funding has at least two advantages. First, it usually does not create foreign exchange risk for the MFIs and governments. Second and more important, local deposit, debt and equity funding are more likely to come from commercially motivated sources that avail funds in larger amounts and on a permanent basis. In any case, funding from domestic sources- especially deposits and loans from commercial banks- is more likely to be commercial, and therefore more assured over the long-term, than most foreign investment that MFIs receive. Besides, it does not disturb the interest rates of the local market.
- 7.2 As far as possible, local resources should be utilized by MFIs for lending to their clients. Only if the local resources are not adequate for scaling up microcredit programs as planned, need

foreign funding be used to meet the deficit. To avoid foreign exchange risk, MFIs should be allowed to borrow and repay in local currency. Donors should be encouraged to provide technical assistance and grants as seed funds to start-up programs and for the expansion of the programs only.

## **VIII. Conclusion**

- 8.1 Loans and grants from international development agencies have vital roles in the promotion and development of the microfinance industry in developing countries, particularly in those countries where MFIs have not developed a microfinance culture, and where it is not yet prevalent among commercial banks. They could play important roles in capacity building of MFIs and in providing seed fund to start-up programs. They could also play significant roles in disseminating best practices and innovation of appropriate products in these countries. The respective governments can create favorable legal and policy environments for the international agencies.
- 8.2 Foreign funding could be used for scaling-up programs, until local resources are adequately available. In such a situation, the transaction between the foreign agencies, the MFIs and the governments should be in local currency to avoid foreign exchange risk for the borrowing institutions. As far as possible, local resources should be utilized for lending to clients.
- 8.3 Since the vast number of grass-root institutions are located far away from the capital city and are scattered all over the country,

it is less likely to be cost-effective for the international agencies to approach the local institutions directly. The donor agencies are also likely to face the shortage of skills and experienced human resources to assess the institutions and manage the disbursement of funds. Hence, the existence of a professional and experienced institution which enjoys the confidence and trust of the international agencies and which can efficiently and effectively manage the funds for the promotion of a large number of quality microfinance institutions would be helpful. Experiences reveal that national apex organizations, such as PKSF in Bangladesh, RMDC in Nepal, PCFC in Philippines and PPAF in Pakistan, which have proven experience and good track records with wholesale financing and capacity building, are the best institutions to meet both ends. Over the years these institutions have made significant contributions to promote and to develop microfinance industry in the respective countries and thereby have helped in reducing poverty.

- 8.4 It hardly needs any overemphasis that ultimate end of such institutions is to ensure the mobilization of local resources for financing such institutions, thereby helping them to attain self-sufficiency at the national level – a goal cherished by developing countries of the world.

## **Bibliography**

### **Written Sources**

Ahmed, Salehuddin. "Creating Autonomous and Sub-Regional Microcredit Funds". A paper presented at the African Regional Microcredit Summit held in Harare, Zimbabwe, 8-12 December 2000.

Yunus, Muhammad. "Expanding Microcredit Outreach to Reach the Millenium Development Goal – Some Issues for Attention". A paper presented at the International Seminar on 'Attacking Poverty with Microcredit' organized by PKSf in Dhaka on January 8-9, 2003.

Yunus, Muhammad. "How Donor Funds Could Better Reach and Support Grassroots Microcredit Programs Working Towards the Microcredit Summit Goal and Core Themes". A paper presented at the Microcredit Summit Meeting of Councils in Abidjan, Cote d'Ivoire, 24-26 June 1999.

"The Market for Foreign Investment in Microfinance: Opportunities and Challenges". CGAP Focus Note 30.

### **Web Sources**

[www.sidbi.com](http://www.sidbi.com) (last accessed: June 28, 2006)

[www.pksf-bd.org](http://www.pksf-bd.org) (last accessed: June 28, 2006)

[www.ppaf.org.pk](http://www.ppaf.org.pk) (last accessed: June 28, 2006)