# 9
# The Road Ahead: A Platform for Microfinance

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## 9.1 Introduction

Microfinance has changed dramatically over the last few decades. These changes have affected beneficiaries, products and practitioners. The shift from microcredit, intended for the 'poorest of the poor', to microfinance, allocated to all victims of financial exclusion, has created a different microfinance pattern. New customers have introduced new needs, and new needs have brought about new financial products offered not only by NGOs, or non-profit institutions, but also by banks and other financial intermediaries. This new scenario highlights different issues which come together within modern microfinance. These concern the setting for microfinance, policy and strategies for microfinance programmes and institutions, microfinance management objectives and tools, and, finally, microfinance financial structures. These four aspects represent the key variables for modelling a microfinance platform in which markets, authorities, institutions, intermediaries, practitioners and customers could work together to better achieve the final goal.

## 9.2 The features of modern microfinance

In the light of the changing trend, modern microfinance will be characterized by different features.

### Modern microfinance must be transverse (crosswise oriented)

Microfinance is not only microcredit but consists of different financial and technical services offered to respond to the needs of beneficiaries, and to manage the financial and operational risks involved in each transaction. Working towards transverse microfinance means, first of all, working towards a legal, fiscal and regulatory framework that makes it possible. The recourse to new financial products must be easy, cheap and transparent. Furthermore, operational boundaries of MFIs must be regulated ensuring flexibility, efficiency and stability of each intermediary and of the market as a whole. Financial innovation, both at a product and at a process level, must be feasible and sustainable at the same time. *Modern microfinance needs a new regulatory environment, both in developing countries and in industrialized ones*.

### Modern microfinance must be programmatic

This means that every single programme sponsored by international donors, public or private, as well as the composition criteria behind each single MFI portfolio, must be inspired by a planned strategy implemented at an international, national and local level. As such, the role of governmental local bodies is particularly relevant, as they know the territory and the social customs. Thus, they are best able to establish the effective opportunity cost of each single initiative. *Modern microfinance needs to be programmatic in nature in order to maximize the efficacy of projects carried out in specific areas*.

### Modern microfinance must be ethical

In Chapter 1, we outlined the main features for an ethically compliant microfinance. As explained, ethicality is not an exclusive goal of the non-profit sectors. Ethical behaviour, the depth of ethicality and the level of intermediation costs require a strong collaboration between the non-profit and profit sectors. To increase the depth of ethicality in terms of extension, transversality and consolidation, the non-profit and profit sectors must work together to implement a transparent operational process, consistent across shareholdings and strategies. To reduce the intermediation cost, the non-profit and profit sectors, together with local governmental bodies, must implement risk management models to ensure a higher degree of efficiency and more accurate pricing policies in order to achieve positive performances that respect the goal of ethicality.

### Modern microfinance must be sustainable

Sustainability has been the main goal of modern microfinance over the last decade. Nevertheless, there is still a long way to go. In Chapter 4, we have seen that sustainability in microfinance is a complicated task for at least two reasons. First, the definition of sustainability in microfinance differs from the traditional one. Moreover, microfinance programmes and institutions may adopt different levels of sustainability. Secondly, sustainability must be reached without compromising outreach. The shift from operational sustainability to financial self-sustainability has been determined mainly by the growing percentage of private investors financing microfinance and by the need for public donors to be more selective in the initiatives they support: financial self-sustainability means good performance; operational sustainability means more attention to outreach. Modern microfinance needs to strike a balance between these two goals. This calls for a big effort from both the non-profit sector and private investors. The non-profit sector must operate primarily to reduce operational costs, in order to achieve greater efficiency. Private investors must collaborate to measure and manage microfinance risks more accurately and to reduce financial costs, while being aware that a higher level of outreach calls for a rate of return lower than the market rate. Higher levels of efficiency, sophisticated risk management and positive rates of return lower than the market rate, facilitate self-sustainable outreach. A combination of efficiency and ethicality is the recipe for a balance between sustainability and outreach. Obviously, this recipe needs a great number of chefs to prepare and serve. Semi-formal and formal MFIs, banks and other financial intermediaries, local and national governmental bodies, together with public donors, are all invited to take up this challenge.

### Modern microfinance must be integrated (networked)

The feature of transversality and the need for programmatic, sustainable and ethical initiatives are the variables that characterize modern microfinance and which call for new actors to come into the microfinance market. The offering of new products and services, the need for conscious strategies, the growing attention to sustainability and the difficult task of combining sustainability with ethical goals and outreach requires the effort of different players, each with his own role to play. Microfinance networks must be established considering the non-profit sector (donors, informal and semi-formal MFIs), the traditional financial sector (formal MFIs and other financial intermediaries) and governmental bodies (at an international, national and local level). Each one of these parties can contribute to the achievement of the key features of modern microfinance.

## 9.3 The microfinance platform: actors and functions

The microfinance network must be implemented considering the different attitudes of the different players, each one of which can play a role in shaping the different features of modern microfinance (Figure 9.1).

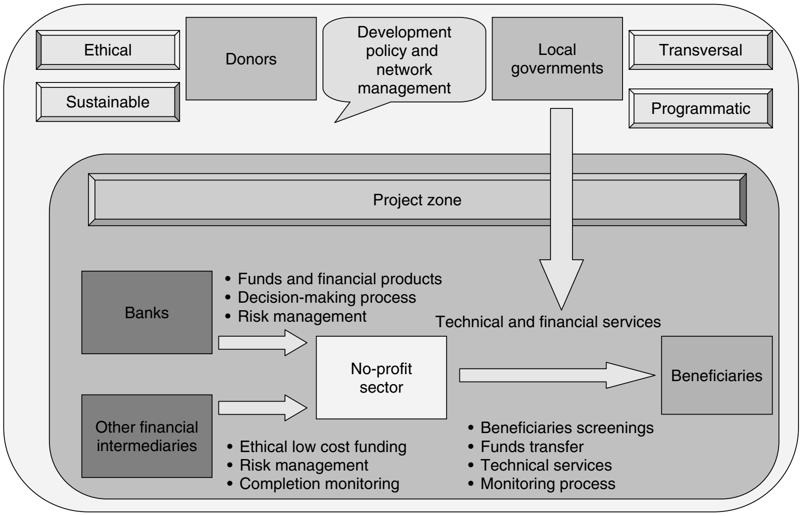


*Figure 9.1* Microfinance platform

## The role of national/international donors and local governments

Within the microfinance platform, national/international donors, and municipalities and local governmental bodies, have a fundamental role that can be broken down into three main functions. First, as already explained, they can work towards achieving programmatic microfinance by planning microfinance initiatives that meet world-wide and local needs and by selecting those feasible initiatives that present the lowest opportunity costs for the community. Secondly, they can offer technical services, within the programmes sponsored, directly or in collaboration with informal and semiformal institutions.

Donors also offer funds and financial services. In the case of municipalities, this function should be restricted to the coverage of operative expenses or to non-monetary financial services, such as guarantee funds. Through the offer of technical and financial products, donors and local bodies contribute to lowering the intermediation cost of the programme, while avoiding direct involvement in the credit process by financing microcredit funds. This function furthers both the ethicality and sustainability of the initiatives. Finally, donors and municipalities can play the role of network-manager, creating, organizing, managing and monitoring the microfinance network for each single initiative.

As such, donors and local governmental bodies are in the position, once a microfinance project has been selected, to involve different actors of the non-profit and profit sectors in order to implement the most effective operational and financial structure.

## The role of banks

Banks and other financial intermediaries are gaining more space in modern microfinance programmes. We saw in Chapter 1 that a greater involvement of profit-oriented institutions in the microfinance market may have positive effects, in terms of efficiency and sustainability, and negative effects, in terms of ethicality and outreach. Thus, the role of banks and financial intermediaries in modern microfinance must tie in with the aim of maximizing the positive effects, while minimizing the negative ones. The network must operate to increase sustainability and outreach at the same time.

In this scenario banks can play different roles in a microfinance network. First, they can ensure private funds to microfinance programmes, sponsoring single projects, investing in share capital of MFIs or creating microfinance special purpose vehicles within the banking group. Secondly, they can carry out the credit decision-making process, and in particular the evaluation of the beneficiaries' creditworthiness. Their expertise in this field would help to achieve a higher economy of scale, especially for those programmes that aim to benefit a large number of customers. Thirdly, banks can contribute to implement risk management models specifically tailored to microfinance projects, increasing the efficiency of the initiatives. Finally, the presence of a bank in microfinance projects facilitates the provisioning of other financial services, in addition to microcredit, such as microleasing, deposits, payments services, thus improving the efficacy and the outreach of the initiatives. Through banks, financial innovation can be made available to microfinance. Microcredit portfolio securitization can be taken as an example of financial innovation enhancing the degree of liquidity stored in the balance sheet of MFIs and facilitating the credit risk management of microcredit portfolios.

Banks' financial and technical services have a cost. Such costs must be covered by revenues, in order to implement a sustainable project, but they should also match the degree of ethicality and the outreach of each single initiative. As a result, banks have two options: financing only those initiatives that ensure a market rate of return or forgoing market return when considering their involvement in microfinance. The first option will restrict the number of microfinance projects to support, in particular those programmes which penalize outreach over sustainability. The second option will impact negatively on the bank balance sheet because of a lower profit. Nevertheless, bank managers must consider at least two factors: first, that there are ways to reduce the negative impact on profit; secondly, that the value of a bank is also influenced by qualitative aspects, such as ethical behaviour and transparency, which markets and customers are beginning to take into consideration.

With regard to the first point, banks may encourage new ethical practices in order to distribute the opportunity cost implicit in microfinance projects. Some banks, for example, have lowered the intermediation cost asking their employers to devote a certain amount of working hours for free to the microfinance initiatives promoted. Others have devoted stock options revenues to microfinance programmes. Still other banks set aside a certain percentage of customer credit card payments (ethical credit cards) for microfinance initiatives.

With regard to the second point outlined, it is worth remembering that corporate social responsibility is becoming a key variable in banking strategies and microfinance can represent a valid alternative to improve banks' reputations and, through this, banking value.

## The role of other financial intermediaries

The goal of lowering the intermediation costs and the need to manage the risks associated with microfinance programmes can be best achieved through the entry of non-bank financial intermediaries in the microfinance market. Therefore, Ethical Investment Funds, Pension Funds and Insurance Companies can play a major role. EIFs and EPFs represent an important source of low-cost funding for microfinance, which remains, as yet, unexploited. Savings collected from ethical investors could find market investment alternatives in microfinance that meet the ethical features required. Moreover, ethical savings do not incorporate a risk–return paradigm similar to traditional savings and, therefore, can be devoted to investments that ensure rate of returns lower than the market. Microfinance networks, then, should operate in order to enforce the role of EIFs and EPFs in microfinance projects.

The role of insurance companies is more related to the managing of financial and non-financial risks and to monitoring. Microfinance needs insurance products specifically tailored for microfinance programmes. This is true not only for financial risk, such as credit risk and market risks, but also for business and process risks. As seen in Chapter 5, the transfer of non-financial risk to third counter-parties is often the only alternative to managing them. Chapter 6 outlined the need for monitoring procedures, in particular for business and process risks. Nevertheless, insurance products and services raise the cost of microfinance projects. For this reason, the role of local governmental bodies and other public institutions offering guarantee funds, particularly structured with regard to business and process risks, can help in lowering these kinds of costs.

### The role of the non-profit sector

The non-profit sector will still play a fundamental role in microfinance. Informal and semi-formal institutions have the important task of preserving the original features of microfinance, notably the ethicality of the business, the flexibility of the organizations/process, and the proximity to the beneficiaries. They must interact with donors and local governments in order to propose projects that tie in with national and local development policies. They are in the position of selecting those beneficiaries who may be more appropriate for the programme. They have the human resources to offer technical assistance to the selected beneficiaries from the first step of the project right up to the exit strategy. They must collaborate with financial intermediaries to implement an efficient credit process that minimizes agency costs, arising from different incentives and asymmetric information, and risk management models that do not jeopardize the flexibility of the procedures. During the project they are in the best position to channel the funds and to act as delegate monitors for public and private investors in order to reach the exit strategy goal.

## 9.4 Conclusion

Modern microfinance needs a market policy to be successful. This policy can take the form of a microfinance platform which establishes goals, actors and functions and which lays the fundamentals for local, national and international microfinance networks, interacting with each other. The platform must reflect the features of modern microfinance, which aims to be *transversal*, *programmatic*, *ethical* and *sustainable*. These features can be achieved only with the collaboration of different actors, each playing his own role within the network: the non-profit and profit sectors must work together. Local, national and international governmental institutions can act as network managers, devising the platform, promoting the network and monitoring that it is working efficiently, transparently and in compliance with antitrust laws.