Financial Inclusion:
Financial Services for the Unbanked

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This memo seeks to provide an overview of the existing literature, mainstream and critical ideas, as well as policy alternatives in financial inclusion, i.e., the provision of financial services for the “unbanked”. It is estimated that about half of the world’s adult population is unbanked -they do not have access to secure formal financial services-. Mobile banking, institutional innovations and improvements in performance have revolutionized the field making private actors, international institutions and governments focus on this industry in constant development. In the belief that microfinance can provide an effective response to this relegated group, microfinance and the financial inclusion of the unbanked have taken a central position in the agenda of many developing countries.

There are upward 12,000 microfinance institutions (MFIs) around the world serving more than 205 million people being 82% of them women. Microfinance customers are often described according to their poverty level - vulnerable non-poor, upper poor, poor, very poor. However, this can hide relevant information. MF customers are not a homogeneous group and therefore, they require diverse services.

**Formal MF** providers are sometimes defined as those that are subject to specific banking regulation and supervision (development banks, savings and postal banks, commercial banks, and non-bank financial intermediaries). **Semiformal providers** are registered entities subject to general and commercial laws but are not usually under bank regulation and supervision (financial NGOs, credit unions and cooperatives). **Informal providers** are non-registered groups such as rotating savings and credit associations (ROSCAs) and self-help groups. Another categorization can be determined by ownership: government-owned -rural credit cooperatives in China-; member-owned -credit unions in West Africa-; socially minded shareholders -many transformed NGOs in Latin America- and profit-maximizing shareholders -microfinance banks in Eastern Europe. In general, the types of services offered are limited by what is allowed by the legal structure of the provider. Thus, non-regulated institutions are not generally allowed to provide savings services or insurance.

Following the prevalent consensus, the memo understands financial services to include not only microcredit but the full range of basic financial services provided by microfinance institutions, i.e., credit, savings, insurance and money transfer services. It is necessary to highlight that the memo will focus mostly on the unbanked –a person that does not use banks or credit unions for their financial transactions- and not so much on the underbanked –people who have checking or savings accounts but

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1 A MFI is an organization that provides financial services to the poor. This very broad definition includes a wide range of providers that vary in their legal structure, mission, and methodology. However, all share the common characteristic of providing financial services to clients who are poorer and more vulnerable than traditional bank clients and who could not be eligible for credit in the traditional banking institutions.

rely on alternative financial services... In the former, the major challenge tends to be to reach them because there is almost no record of their credit history. In part due to this reason, the memo addresses primarily unbanked individuals and micro-enterprises, rather than SMEs which do have access to the banking system but strike with a different kind of obstacles to access finance and, hence, require a different set of policies and strategies to overcome them.

The first section explores the context in which modern finance was born, the rise of the first institutional actors, and the literature that has generally defined the borders of the field and set forth some of its basic notions. The second section analyses the main ideas that today represent the consensus on microfinance, especially in the eyes of the major institutional actors such as aid agencies, multilateral institutions and private actors. Then, in the third section, the memo focuses on the new trends in microfinance. It particularly analyzes the phenomenon of mobile banking, the increasing commercialization of the field (i.e., the transformation of NGOs and microfinance institutions into banks, the provision of microfinance services by traditional commercial banks, and the surge of private investment funds as a new funding source for microfinance institutions), and finally, innovations in lending technologies. The fourth section gathers some of the main critiques regarding the state and evolution of microfinance, especially in recent years. Last, the memo ends with an identification of some frontier issues and the exploration of questions for future research.

I. Origins and Evolution

Despite different forms of micro-financing for the poor and in rural areas have existed for centuries in different parts of the world, the origins of modern microfinance (MF) can be traced back to the 1970s. The context of that decade can explain the rise of microfinance institutions: a shift in the development of economic thinking and the rise of neoliberalism with its privatization process. The shift in development ideas was reflected in different ways. The state-led development model of the 1960s went through a crisis and was replaced by a market-oriented development strategy. Accompanying this approach, the World Bank adopted new policies on development based on poverty reduction and through structural adjustment programs advancing pro-market economic reforms.

Between the 1950s and 1970s, in a context of “Cold War”, the stress was placed in land and agrarian reforms. With this objective in mind governments and aid institutions provided agricultural credit to small and marginal farmers with the hope of raising productivity and incomes. These efforts entailed supply-led government interventions such as provisions of targeted credits by state-owned developed finance institutions or farmers’ cooperatives which received concessional loans lending them to customers at below-market interest rates.

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3 Alternative financial services include non-bank money orders or non-bank check-cashing services, payday loan institutions, rent-to-own agreements or pawn shops on a regular basis. Martha Perine Beard (2010), Reaching the Unbanked and Underbanked, Central Banker, Winter, Federal Reserve Bank of Saint Louis.


In the 1970s, following the evolution in economic development ideas, new approaches to MF emerged dominating the discourse in the field—a field in which international cooperation institutions have played a critical role. One of the most popular has been the financial system approach which is still one of the major basis for donor intervention. This financial system approach to MF gained popularity among some major development assistance agencies in the 1970s. This system has developed thanks to the research and insight prevalent during the 1960s and 1970s which focused on the interaction of the financial sector with other sections of the economy. Raymond Goldsmith (working at Yale), John Gurley, Edward Shaw and Ronald McKinnon (working at Stanford), pioneers of this new approach conveyed that the size of the financial sector determines economic growth. This view was in turn combined with the diagnostics that developing countries presented financial sectors that were “too small” because they were considered to be “repressed” given that they received subsidies that impeded financial growth. Some of the drawbacks of these policies were the granting of “artificially” low interest rate ceilings, lack of competition in banking associated with barriers to entry the market and fragmentation of credit markets creating lots of specialized intermediaries with limited powers, as well as high required reserves that helped fund government budgets at the expense of other potential borrowers, and directed credit programs and credit quotas obliging banks to lend to borrowers preferred by the government who would otherwise have been avoided by bankers. Financial liberalization took over: easing or abolishing rate controls, lowering restrictions on entry into banking, discontinuing government control of the allocation of credit and stimulating so as to allow market forces to create deeper financial markets.

Ross Levine, director of the WB, took these ideas and presented them in the World Bank’s Development Report 1989, thus giving great input and publicity to the system. The World Development Report’s introduction provided a succinct statement of the role of finance in development: “A financial system provides services that are essential in a modern economy. The use of a stable, widely accepted medium of exchange reduces the costs of transactions. It facilitates trade and, therefore, specialization in production. Financial assets with attractive yield, liquidity, and risk characteristics encourage saving in financial form. By evaluating alternative investments and by monitoring the activities of borrowers, financial intermediaries increase the efficiency of resource use. Access to a variety of financial instruments enables economic agents to pool, price, and exchange risk. Trade, the efficient use of resources, saving, and risk taking are the cornerstones of a growing economy.” One of the key points of the report was that positive real (inflation-adjusted) interest rates in the formal sector translated into economic growth. Therefore, higher real interest rates, given reasonable macroeconomic stability, tended to be associated with more rapid growth in GDP.

At the same time, these views from a macroeconomic perspective needed its correlation on in the micro level. Agricultural development, especially focusing on small farmers, was an important donor priority at

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7Over 18,000 copies of the report had been distributed by the mid-1990s. This was the largest press run of any World Bank publication, breaking the record held until then by Price Gittinger’sEconomic Analysis of Agricultural Projects. See, J.D. Von Pischke, “The Financial System Approach to Development Finance and Reflections on Its Implementation” (manuscript).
that time and throughout the 1980s.\textsuperscript{8} The origin of what then became known as the Ohio State School was funded by the United States Agency for International Development (USAID) and the Department of Agricultural Economics and Rural Sociology at The Ohio State University from the mid-1960s through 1993. Dale Adams's 1971 article in the \textit{American Journal of Agricultural Economics}, "Agricultural Credit in Latin America: a Critical Review of External Funding Policy" evinced this micro focus finding features of "financial repression" at work in donor-supported agricultural credit in South America. This approach was then followed by a series of studies led by Claudio Gonzalez-Vega from Ohio State University and consolidated by the literature produced by the Spring Review of Small Credit under the leadership of E. B. Rice, a USAID staff who then joined the World Bank. The more than 20 volumes of the report showed that in country after country different cases presented similar patterns of behavior. The conclusion born out by observation and analysis was that the policies that were being conducted were working counter to governmental objectives i.e., more credit to more farmers for productive purposes and that more foreign funding for farm credits wouldn’t help unless major liberalizing reforms were in place.

The studies produced under the Ohio State School and sponsored by USAID provided the basic justification for one of the central ideas in modern MF: the need of financial self-sustainability in microfinance institutions (MFIs). They considered that subsidized interest rates, rather than lending technologies, were the necessary instrument to achieve development through MF. Gonzalez-Vega’s dissertation "The Iron Law of Interest Rate Restrictions", together with other research studies produced by Ohio State University documented and explained that low rates attracted the larger farmers and politically aware and powerful, who left the small and the poor at the end of the line for rationed credit. Thus the greater the interest rate subsidy, the more concentrated the distribution of loans and the larger their average size. Moreover, these studies portrayed that artificially low rates associated with directed credit led to nonperforming loans, willful defaults, less economically productive investments, and weak financial institutions that did not have sufficient strength to intermediate efficiently.\textsuperscript{9}

Meanwhile, in practice, starting in the 1970s, experimental programs in Bangladesh, Brazil, and a few other countries started to extend tiny loans to groups of poor women to invest in micro-businesses. The introduction of the Joint Liability Group which ensured repayment among the poor despite the lack of collateral proved to be an extremely useful tool. This type of microenterprise credit was largely based on solidarity group lending in which every member of a group guaranteed the repayment of all members. The focus on these "microenterprise lending" programs was set on credit for income generating activities (in some cases accompanied by forced savings schemes) targeting very poor (often women) borrowers. Group pressure and other forms of social coercion proved to be as effective as - or even more- as the incentives generated by the fear of losing the collateral used in the traditional banking system.

\textsuperscript{8} At the peak of this period agriculture projects absorbed between one-quarter and one-third of the World Bank’s annual lending and agricultural credit projects accounted for about one-third of the Bank’s agricultural lending. Von Pischke, supra note 3.

At the time, four MFIs emerged in the field and remain today as leading institutions in MF: ACCION International, SEWA Bank, Grameen Bank, and FINCA.\textsuperscript{10} ACCION International was founded in 1961, Joseph Blatchford, a Berkeley law student.\textsuperscript{11} Started as a student-run volunteer effort in the shantytowns of Caracas, Venezuela, with $90,000 raised from private companies, ACCION is today one of the major MFIs in the world, with a network of lending partners that spans Latin America, the United States and Africa and putting forward the idea that microfinance can be financially self-sustaining. Thus ACCION pushes its partners to make the transition from nonprofit, charity-dependent organizations to banks or other regulated financial institutions (among the most important ones, Banco Sol in Bolivia,\textsuperscript{12} Banco Solidario of Ecuador, Banco Compartamos of Mexico and Mibanco of Peru\textsuperscript{13}). On the other hand, ACCION has also advocated for the incorporation of commercial lenders to serve the poor resulting in an open door policy for micro-entrepreneurs. Some of the best-known cases are SOGEBANK (Haiti), Banco del Pichincha (Ecuador), Banco ABN-AMRO Real (Brazil), and Ecobank (West Africa).

The Self Employed Women's Association (SEWA) was registered in 1972 as a trade union in Gujarat (India), with the main objective of "strengthening its members' bargaining power to improve income, employment and access to social security." In 1973, to address their lack of access to financial services, the members of SEWA decided to fund "a bank of their own," and accordingly, 4,000 women contributed share capital to establish the Mahila SEWA Co-operative Bank. Since then it has been providing banking services to poor, illiterate, self-employed women and has become a viable financial venture with around 30,000 active clients.

Perhaps the most well-known case of a successful MFI is the Grameen Bank. In Bangladesh, Economics Professor Muhammad Yunus addressed the banking problem faced by the poor through a program of action-research. In 1976, with his graduate students in Chittagong University he designed an experimental credit program to serve the poor which spread rapidly to hundreds of villages. Thanks to a special relationship with rural banks, he disbursed and recovered thousands of loans. Supported by donors, the Grameen Bank was funded in 1983 and now serves more than 4 million borrowers. The initial success of Grameen Bank also stimulated the establishment of several other giant microfinance institutions like BRAC, ASA, Proshika, etc.

FINCA (Foundation for International Community Assistance) was founded in 1986 by a former USAID staff, John Hatch, focusing on women and the provision of credit without collateral. It was one of the pioneers in the development of the “Village Banking” model. By 2007 FINCA was operating in 21 countries, reaching out to 700,000 people, being backed up by partnerships with leading institutions such as USAID, AIG, GE Money and Visa (in Uganda, Mexico and Nicaragua, to develop innovative e-payment products as well as Village Banks).\textsuperscript{14}

\textsuperscript{10}Another flagship of the microfinance movement is the village banking unit system of the Bank Rakyat Indonesia (BRI), one of the largest MFIs in developing countries. This state-owned bank serves about 22 million micro-savers with autonomously managed micro-banks.

\textsuperscript{11}Joseph Blatchford will then become the US Peace Corps Director, appointed by President Richard Nixon in 1968

\textsuperscript{12}ACCION helped found BancoSol in 1992, the first commercial bank in the world dedicated solely to microfinance. Today, BancoSol offers its more than 70,000 clients an impressive range of financial services including savings accounts, credit cards and housing loans - products that just a few years ago were reserved for Bolivia's upper classes. Together with BancoSol more than 15 ACCION-affiliated organizations are now regulated financial institutions.

\textsuperscript{13}It is estimated that each of these institutions serves about 100,000 people.

\textsuperscript{14}Christina Gonsalves, Honors Capstone, and Professor Levinson (2008), Case Study: The Foundation for International Community Assistance - FINCA INTERNATIONAL. Small Loans, Big Changes
By the 1990s, the experience of these and other MFIs had shaken the traditional and universal wisdom on how to finance the poor. First, they showed that poor people, especially women, had excellent repayment rates among the programs, rates that were better than the formal financial sectors of most developing countries. Second, the poor were willing and able to pay interest rates that allowed microfinance institutions to cover their costs. Thus, during the 1990s, given the high repayment and cost-recovery interest rates and the innovations in lending technologies some MFIs were able to achieve long-term self-sustainability and reach large numbers of clients. A wave of commercialization and transformation of NGOs into formal MFIs characterized the decade: multiple financial services flourished to serve the needs of micro-entrepreneurs and poor households. Thanks to this evolution, microfinance a new word that included credit, saving and other financial services was coined.

II. The Microfinance Consensus

In 1995, MF witnessed the rise of a powerful international actor which would play a critical role in defining the mainstream ideas of the field as well as its standard practices: Consultative Group to Assist the Poor (CGAP). Nine leading development agencies and microfinance practitioners established this consortium that counts today with 33 public and private funding organizations - bilateral and multilateral development agencies, private foundations, and international financial institutions- to serve as a global resource center for financial services for the poor with the aim of providing advisory services and information to a wide range of stakeholders ranging from market intelligence to promoting and developing recommendations and offering advisory services to governments, financial service providers, donors, and investors.

In 2006, CGAP published the Good Practice Guidelines for Funders of Microfinance (“The Microfinance Consensus Guidelines”, MFCG) which reflects in a comprehensive way the major ideas that constitute the consensus on MF today. The target audience of this guidelines are development agencies, foundations, social and commercial investors, international NGOs that would conceptualize, design, implement, and monitor programs related to poor people’s access to financial services, Despite its explicit appeal to institutional diversity, the guidelines provide a set of specific policy recommendations with a certain bias and specific political choices.

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15 CGAP gathers a wide set of key and powerful actors in the MF field. The members of its Council of Governors are representatives of the following aid institutions: AusAID (Australia), CIDA (Canada), AFD (France), GTZ (Germany), JICA (Japan), NORAD (Norway), AECID (Spain), Sida (Sweden), SDC (Switzerland), DFID (UK), USAID (USA), and government officials of Luxembourg, Italy, Denmark, Finland, and the Netherlands. Multilateral organizations are also present: African Development Bank, Asian Development Bank, European Commission, European Bank for Reconstruction and Development, European Investment Bank, Inter-American Development Bank, International Finance Corporation (World Bank), International Labor Organization, UNDP, and the World Bank. Some private foundations also participate in CGAP: Citi Foundation, Ford Foundation, Dell Foundation, Gates Foundation, and the Mastercard Foundation.

16 An important antecedent to these Guidelines is the “Micro and Small Enterprise Finance: Guiding Principles for Selecting and Supporting Intermediaries” (known as the “Pink Book”), jointly developed in 1995 by the Donors’ Working Group on Financial Sector Development and the Committee of Donor Agencies for Small Enterprise Development at the World Bank.

17 According to the MFCG, “The intent is not to dictate one way to support microfinance, but rather to support diverse approaches and priorities within a framework of basic good practice principles.” The MFCG also envisions “A world in which poor people everywhere enjoy permanent access to a wide range of quality financial services, delivered by different types of institutions through a variety of convenient mechanisms.”
The key principles of the MFCG are the following:

**P1. Poor people need a variety of financial services, not just loans.** In addition to credit, they want savings, insurance, and money transfer services.

The first principle reflects the shift in microfinance from the 1980s to the present, and the intention of expanding the types of financial services that can be provided to the poor. It is clear that the poor benefit more from a wider range of options in financial services. In return, MFIs can diversify risks and develop new business lines. The advances and refinements in lending technologies in microcredit as well as in mobile banking MFIs can be applied in other financial services for the poor. In addition, given that many NGOs and some types of MFIs face restrictions on the provision of some types of financial services (savings, for example), the call for a variety of financial services facilitates the entry of traditional commercial banks.

**P2. Microfinance is a powerful tool to fight poverty.** Poor households use financial services to raise income, build their assets, and protect themselves against eventual external shocks.

The second principle reinforces the central idea that has legitimized modern microfinance from its origins, i.e., bringing poor people out of poverty. It highlights the notion that MF is designed as an instrument to serve the poor (see P3 below). However, this image has several implications. First, by placing the focus on the poor, the principle draws the attention away from other winners such as MFIs and other service providers. Second, the principle presents the relationships as basically non-antagonistic, leaving without analysis conflicts and tensions that may exist between MFIs and the poor. Although there may well be many cases in which the interests of MFIs NGOs and the served poor align they tend to diverge creating greater conflict, as the industry moves towards an increasing commercialization and the principles of financial self-sustainability (P4) in tandem with no price controls (P7) as the dominant dogma in the field. Thus, by presenting the relationship as non-antagonistic, when there is something that may prejudice MFIs (the right to set prices freely, P7), it is considered to be ultimately bad for the poor. Last, the image of MF as an instrument for the poor, and MFIs as servants of the poor, figuratively place the poor in a position of superiority, with leverage in the relationship which is of course far from true.

**P3. Microfinance means building financial systems that serve the poor.** Microfinance will reach its full potential only if it is integrated into a country’s prevalent/actual financial system.

There is a strong interest in mainstreaming MF that can only be achieved either by adjusting the mainstream financial system to better serve the specific needs of the poor or by bringing MF closer to the standards and practices of the mainstream financial system. The principle advocated by the guidelines actually refers mainly to the latter. Consolidated and commercial players who have already developed strong capabilities and competitive advantages in the traditional financial system can benefit from the integration of MF into the mainstream system.

**P4. Microfinance can pay for itself, and must do so if it is to reach very large numbers of poor people.** Unless microfinance providers charge enough to cover their costs, they will always be limited by the scarce and uncertain supply of subsidies from donors and governments.
This is one of the central tenets of the current consensus, i.e., the financial self-sustainability of MFIs. This principle expresses all its power when analyzed in the light of the principle of no price controls (P7). It is necessary for MFIs to operate to charge their clients in a way that that they are able to recover from the poor the full costs of their operations. In other words, an MFI is “self-” sustainable as long as it is sustained by the poor that it serves. The principle departs from the idea that subsidies are uncertain, unstable, and therefore, MFIs cannot rely on them. This uncertainty results in higher risks which prevent MFIs from expanding their reach to a larger group of poor people. Notwithstanding, one wonders what is in the nature of subsidies that makes them scarce, uncertain, or unstable bearing in mind that subsidies are not the only policy form that the government can use to provide financial support to certain types of institutions. Taxes, regulations, quality standards, special regimes, they all affect the costs structure of MFIs which in turn can foresee innumerable ways to funded them.

**P5. Microfinance is about building permanent local financial institutions** that can attract domestic deposits, convert them into loans, and provide other financial services.

This principle is related to two previous principles, i.e., the expansion of MF from microcredit to a full set of financial services (P1) and the integration of MF into the mainstream financial system (P3).

**P6. Microcredit is not always the answer.** Other kinds of support may work better for people who are so destitute that they have no income or means of repayment.

The “destitute” refers to the poorest of the poor, the people who are too poor to have access to formal financial services either because they do not have enough income to repay the loans, or simply because they face geographical and physical barriers that prevent them from having access to MF. Since serving this group would undermine the principle of full cost recovery resulting in not profitable results (P4), they end up being excluded from MF. For them, other types of policies are considered to be a better fit (employment, food security programs, etc.).

**P7. Interest rate ceilings hurt poor people by making it harder for them to get credit.** Granting many small loans costs more than making a few large ones. Interest rate ceilings impede microfinance institutions from covering their costs, and thereby, cut off the supply of credit for poor people.

This principle is intimately linked to the financial self-sustainability principle (P4). Given that the consensus presupposes the absence of subsidies or other forms of intervention to cover costs, price controls (interest rate ceilings), which limit the capacity of MFIs to make the poor pay for their sustainability, are considered to be negative. Therefore, the corollary behind this reasoning (P4 and P7) is financial liberalization. The basic idea is that MFIs should be free to set the price they consider convenient for their services. The image presented affirms that if MFIs are not allowed to freely set prices, they will be damaged (because subsidies and other forms of financial support are ruled out from the beginning), and as the relations are presented as essentially non-antagonistically (see P2 and P3), the poor would eventually lose.

**P8. The job of government is to enable financial services, not to provide them directly.** Governments can almost never do a good job on lending, but they can set a supporting policy environment.
According to this consensus, the government should not provide subsidies; it should not set price controls; it should not provide financial services to the poor directly and it should not compete with the (private) MFIs. This evinces what was previously stated: the guidelines are biased. As in the 90s with the Washington Consensus, the CGAP guidelines do not trust the managerial skills of the government to act efficiently. Therefore, they just relegate it to setting up the rules of the game so as to guarantee a “conductive environment”\textsuperscript{18}

P9. **Donor funds should complement private capital, not compete with it.** The institutional capacity of financial providers to develop support infrastructure and support experimental services and products can use the help of grants, loans and equity instruments provided by donors.

This principle is related to the institution behind this consensus (CGAP). If the governments should not be allowed to compete with private actors, the donors should not either. Moreover, the role of donors should be temporary in order to test new developments, to reduce risks, and pave the way for private capitals.

P10. **The key bottleneck is the shortage of strong institutions and managers.** Donors should focus their support on building institutional capacity.

While the recent trends in the field show that there is an increasing participation of powerful commercial institutions in MF, it is certainly true that many NGOs providing financial services require better institutional capabilities. It is interesting to note, however, that the major problem in the MF field is considered to be the shortage of strong MFIs and managers. However, there are other key aspects that may be undermining the development of the field such as lack of control of interest rates, poor consumer protection, low levels of financial literacy among the poor, lack of competition among financial services providers, poor lending technologies that are left aside.

P11. **Microfinance works best when it measures—and discloses—its performance.** Reporting not only helps stakeholders judge costs and benefits, but it also improves performance. MFIs need to produce accurate and comparable reporting on financial performance (e.g., loan repayment and cost recovery) as well as social performance (e.g., number and poverty level of clients being served).

This principle requires greater efficiency and technical effectiveness in the field. Greater transparency in the industry naturally leverages the power of donors and private funds providing funding for MFIs. The principle also relates to the mainstreaming of MF into the general financial system (P3) since there is an increasing tendency to measure performance of MFIs with standards established for the mainstream financial system rather than other systems linked to the poor such as social security.

The consensus as expressed by the establishment in the MF field (represented by CGAP) legitimizes and leads the way for the consolidation of the trends in MF during the 2000s. By the incorporation of traditional commercial banks as providers of financial services for the poor as well as by the transformation of former NGOs into for-profit MFIs have increased the commercialization in the field. It has also witnessed the surge of private equity funds and institutional investors as an alternative funding source for MFIs. The consensus also reinforces the financial liberalization that took off during the 1990s when the boom of MF began whose main motto was: markets (and particularly prices) should be kept deregulated.

The consensus retains the idea that MF is to serve the poor but keeps re-naming them as clients or customers. Despite a discourse directed to target the poor, the policies that are selected do not always bear in mind this particular group: no consumer protection rules or financial education or provision of non-financial services to develop productive capabilities or other measures that the poor can benefit from (contract rules, competition rules, social security policies, labor laws, etc.)\textsuperscript{19}

In spite of the fact that the CGAP’s document recognizes the importance of mobile banking and favors competition among financial services providers because it considers them necessary to increase the levels of efficiency and quality of the services, it fails to develop the challenge of e-banking. The dominant view sees mobile banking merely as a “delivery technology” intended to reduce costs and facilitate access to financial services by the poor. However, there is much more to mobile banking than this. Behind the introduction of e-banking there is an enormous conflict between two different types of actors: banks and financial institutions, on the one hand, and mobile network operators, on the other; and the possibility of fundamentally transforming the whole industry.

III. Trends and Innovations in Microfinance

\textit{Mobile banking}

Mobile banking offers one of the major challenges and opportunities in the future of MF. It can be the key instrument in the financial inclusion of the poor. In recent years, the availability of these devices among them has allowed mobile network operators and banks to access this population and offer for the first time some financial services that were previously reserved for the wealthier groups. As a result, telecommunications companies are increasingly offering different types of financial services to the poor such as money transfers and payments.

As mentioned in the previous section, mobile banking is much more than simply a “delivery technology”. Among its pros are their ease of use, the low cost, the widespread availability, and a high level of customer fidelity, enabling the unbanked to overcome many of the barriers that separate them from financial services. Until now, the MF industry has kept a clear division between the credit/savings services, on the one hand, and the money transfer services, on the other. While the former is dominated almost exclusively by the banks, there has been an increasingly rapid participation of mobile network operators in the latter. The money transfer function, however, is directly related to the possibility of making deposits. Once an institution is allowed to have deposits, the step from there to start providing savings and credit services is minimal, blurring thus the separation between credit/savings and transfers. Regulators have kept these two differentiated by imposing limits on the amounts of money

\footnote{\textsuperscript{19} Some of these issues such as consumer protection rules are covered by the MFCG document. However, they are bluntly left aside in the 11 core principles highlighted by CGAP.}
that mobile network operators are allowed to accept as deposits and transfer. However, in no time we will start seeing mobile network operators offering different types of financial services, beyond money transfers, directed to the poor given this will require small amounts of liquidity to revitalize their economies. One example is WIZZIT in South Africa. It began as a start-up company offering mobile banking services and had to establish a partnership with ABSA, the largest consumer bank in the country, in order to be allowed, by the South African Central Bank, to take deposits. With the support of the World Bank’s arm, the International Finance Corporation, WIZZIT has recently launched a pilot project to provide micro-credit in Gauteng Province.20

Mobile banking represents a possibility that will probably revolutionize the industry in the future. Notwithstanding, the risks and potential conflicts are evident. Telecommunication companies and financial institutions are a very different “type of animal”. They have different business models and pursue different goals. Moreover, in most countries the regulatory approach for both industries, telecommunications and finance, is largely based on the institutions rather than the services. Therefore, telecoms and banks face quite different regulatory environments and have to comply with a very different set of rules and standards. To what extent are these different actors going to be allowed to compete? Will partnerships be facilitated, required, or banned? What standards and requirements are going to be set? Will telecoms and banks compete in all of financial services? Will telecom companies be forced to meet the requirements of the mainstream financial system? Will the banks offer the mobile banking services themselves? Or will telecoms be allowed to force banks to accept their terms and conditions in order to reach the new clients? Or will the mobile devices producers prevail? What levels of interoperability, both in banking and mobile networks, will be allowed? In general, banks continue to have the monopoly for taking deposits. In turn, mobile network operators seem to have the recipe to access the unbanked. Which party will prevail? What types of partnerships will emerge? Will telecom companies be forced to meet the requirements of the mainstream financial system? Will the banks offer the mobile banking services themselves? Or will telecoms be allowed to force banks to accept their terms and conditions in order to reach the new clients? Or will the mobile devices producers prevail? What levels of interoperability, both in banking and mobile networks, will be allowed? In general, banks continue to have the monopoly for taking deposits. In turn, mobile network operators seem to have the recipe to access the unbanked. Which party will prevail? What types of partnerships will emerge? Will state-owned development banks be given a special role in this new scenario? Will the poor have a saying in the shaping of the future of the industry? These and others are some of the critical questions that remain unanswered and will define the future of MF.

The M-Pesa case. One of the most notable success cases of mobile banking has been M-Pesa in Kenya. In 2007, the Kenya’s mobile network operator Safaricom,21 a subsidiary of Vodafone, launched a mobile phone-based payment and money transfer service for the unbanked named M-Pesa.22 The success of M-Pesa was such that about 38% of the adult population in Kenya gained access to M-Pesa in just over 2 years.

21 In Kenya cellphones have eclipsed landlines as the primary means of telecommunication. Estimations show that about 83% of the population over 15 years old has access to mobile phone technology.
22 The way in which M-Pesa works is the following. An M-Pesa customer can use his or her mobile phone to move money quickly, securely, and across great distances, directly to another mobile phone user. The customer does not need to have a bank account, but registers with Safaricom for an M-Pesa account on their mobile. Customers turn cash into e-money at Safaricom dealers, and then follow simple instructions on their phones to make payments through their M-Pesa accounts; the system provides money transfers as banks do in the developed world. M-Pesa charges a transaction fee to the sender of funds and these charges vary by the type of transaction and the amount of funds being moved. The service itself is free and all deposits made into the M-Pesa account are free of cost without affecting the customers’ airtime credit. For more information on the M-Pesa case and other success stories of mobile banking, see Annex II.
In the case of M-Pesa, it is noteworthy the fact that the company behind this success story, the firm capturing most of the rents, is a giant telecom multinational (Vodafone) headquartered in Kenya’s former imperial ruler, the UK. It is also important to highlight that the early stages of the project counted with funding from DFID, the UK aid agency. Added to this, Safaricom is the largest mobile network operator in Kenya with a control of about 80% of the market. Finally, the collaborative role of the Kenyan Central Bank, and the government which is a minority shareholder of Safaricom have facilitated the success and growth of M-Pesa.

The case of M-Pesa illustrates many regulatory challenges that arise around mobile banking. Despite not having a full banking license, Safaricom has been providing financial services that include some forms of deposits, money transfers and cash withdrawals. The fear of Safaricom is that if M-Pesa is considered to be operating as a bank, then the company would have to follow Central Bank regulations. However, the transactions covered by M-Pesa are several times smaller than regular bank transactions, payments and ATMs operations, and do not compete with traditional banking services. Still, M-Pesa has found and filled a niche in the market in which it provides significantly enhanced financial services. For this reason, despite operating outside the traditional banking regulatory system, Safaricom is audited by the Central Bank and has received its approval for operation. On the other hand, banks in Kenya have been aggressively lobbying the Central Bank to either require M-Pesa to adhere to full banking regulations or to halt the service completely. In turn, Safaricom has expressed that is keen to see the Central Bank implement regulatory measures that will open up the market for deposit-taking, clearing systems, and know-your-customer rules to incorporate the activities of mobile operators.

New Cards

As in the case of mobile devices, cards designed to carry out financial operations such as payments, transfers, debits, can function to engage poor people with the banking system at initial stages. Once the customer gets used to the financial system and increases its financial education, financial institutions can start offering other financial services such as credit, savings, and insurance more easily. In recent years there have been a series of innovations in card uses which may facilitate the access to the banking system by the poor. They can serve as an introductory financial product for unbanked consumers who do not manage a checking account, but can anyhow detract the benefits of direct deposit and a nationally branded debit card. In particular, three developments are worth mentioning:

- **Stored Value Cards**: A variety of stored value cards exist, including prepaid phone cards, mass transit cards, and prepaid debit cards. Stored value cards operate in either “closed loop” or “open loop” systems. In the former, an issuer provides a card that can be used only for its products or at certain shops. Mass transit fare cards and college-issued cards that can be used at cafeterias, bookstores, and other campus venues typically have closed-loop systems. In an “open loop” system, cards are accepted beyond the issuer’s locations through a more universal network for PIN-based (e.g., STAR) or signature-based (e.g., Visa, MasterCard) transactions.

23 The government of Kenya is another winner. It owns 35% of Safaricom.
24 Also, if the situation had been different, characterized by several players, the success of the project would have required regulatory measures to ensure interoperability among different MNOs.
By using stored value cards low-cost remittances individuals working in the United States are now able to send money to families in their home countries targeting Mexicans, Filipinos and Indians. The programs provide ATM access in these countries to funds that have been transferred to the card here in the United States. A good example in this field has been provided by the successful program initiated in 2010 by Visa with Banco Industrial, a MoneyGram agent in Guatemala. It was later expanded to Mexico, the top remittance market in Latin America with an estimated US$ 22.6 billion (2010), and the third in the world after China and India.

- **Payroll Cards**: The payroll card is a particular type of stored value card. By using an open loop system it provides the client direct payment process for purchases or cash withdrawals. Payroll cards, a less costly alternative to paper payroll checks, allow employees to access their pay through various means, depending on the particular product. Wages are deposited to the payroll card account via direct deposit, and the employee uses the card to withdraw cash at an ATM or purchase goods and services. One of the distinguishing characteristics about bank-issued payroll cards is that they generally are not marketed directly to consumers but to the employers. Naturally, this presupposes we are dealing in a formal employment scenario, more common in advanced economies.

- **Smart Cards**: In recent years, governments and international institutions have started to use government to person cash transfer programs, relying on smart cards to implement poverty alleviation, income support, or humanitarian emergency programs. These cards contain a magnetic strip to enable identification, authentication, data storage and application processing. They can hold data like fingerprints, photographs and other details of the beneficiaries in an encrypted form. Their potential is based on their high effectiveness to reduce fraud and achieve a wider coverage, reaching a larger number of beneficiaries.

India has been one of the pioneers in this field. After the implementation of a pilot project, the Andhra Pradesh government has established a successful program using smart cards. It has help nearly 12.7 million poor people across the state get timely and full payment of their social security pensions and wages under the Mahatma Gandhi National Rural Employment Guarantee Scheme (MGNREGS), which promises 100 days of work a year to at least one member of every poor rural household. Another successful case has been the use of smart cards in the Benazir Income Support Program through the United Bank Limited in Bangladesh.

**Agent Banking**

One of the primary challenges to providing financial services to the poor through branches and other bank-based delivery channels is the high costs of these traditional banking methods. Commercial banks to serve a poor customer with a small balance and conducting small transactions costs way too much to make them viable. But on the other hand, when banks do not have branches that are close to the customer, the customer will be more reluctant to use and transact with their service. In some countries,

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26 Comptroller of the Currency Administrator of National Banks (2005), Payroll Cards: An Innovative Product for Reaching the Unbanked and Underbanked, Insights, Community Development, Community Affairs Department, June 2005.
like in Brazil, banks have successfully expanded their outreach by hiring local “agents” or “correspondents” to offer their services. By using retail points as cash merchants (agent banking), banks, telecom companies, and other providers can offer saving services in a commercially viable way and at the same time, reduce fixed costs and encourage customers to use the service more often, thus providing access to additional revenue sources.

In the beginning the models focused on traditional payments products such as the payment of bills or taxes, but agents in many countries are now being authorized to offer a broader range of financial services, such as withdrawals, deposits, pre-approved credit lines, simplified current accounts, and international remittances. The allocation of full responsibility on the banks for their agents and the non-exclusionary nature of the agents are the secrets behind this successful model.

Brazil seems to have been one of the most successful cases in agent banking. In less than ten years, Brazil’s agent network has reached 13 million extra unbanked people. Since 1999, more than 100,000 retail outlets, distributed in all Brazilian municipalities, were transformed into agent banks. In the Brazil case, payments, transfers and deposits are made using real-time Point-of-Sale devices and bank cards. However, savings services have been less successful.29

**Commercialization**

The 2000s have experienced an increasing commercialization of MF. Traditional MFIs and NGOs have been transformed into commercial banks30 and on the other hand, traditional banks have begun to offer financial services to the poor.

Furthermore, new actors have entered the scene. Given the high levels of return registered by MFIs, investment funds are increasingly incorporating in their portfolio MFIs to channel their funds. The incorporation of these major players to the industry promises to transform it. Two cases, not exempt of controversy, have drawn the attention in the field: SKS Microfinance in India and Banco Compartamos in Mexico.31

Compartamos, a MFI supported by ACCION International, was funded in 1990 as an NGO and became one of the major MFIs in Mexico during the 1990s. In 2000 Compartamos adopted the form of a limited liability financial institution and in 2002 it became the first MFI in the world to issue debt on the stock market with its own collateral. In 2006 Compartamos was transformed into a commercial bank and in

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29 Under 5% of customers claim to make deposits and less than a third of outlets offer cash-in, cash-out services – most operate as brokers for banks’ credit and insurance products. Alfred Hanning (2009), Innovative Policies for Financial Inclusion, Alliance for Financial Inclusion, Asian Development Bank Institute’s Microfinance Training of the Trainers, Videoconference Session, October 29, 2009.

30 The pioneer case in this field is BancoSol in Bolivia. In 1992, PRODEM, an NGO founded in 1986 by ACCION and Bolivian business leaders to provide MF services, joined with ACCION, Calmeadow Foundation, Bolivian banks and other investors to establish BancoSol, the first private commercial bank in the world dedicated exclusively to microenterprise. In 1997, BancoSol became the first microfinance institution in history to issue dividends to shareholders. The bank declared cash dividends of $162,857 or $0.45 per share on 1996 earnings of $1.1 million.

31 Other three major MFIs have publicly listed shares: Bank Rykat of Indonesia, BRAC Bank of Bangladesh, and Equity Bank of Kenya.
2007 it was the first Latin American MFI to offer equity through an Initial Public Offering (IPO)\textsuperscript{32} that reached the value of US$ 470 million. Today Compartamos is the largest MFI in Latin America.

SKS Microfinance was founded in 1998 in India. In 2003 it was incorporated as a limited liability company and in 2005 it was registered with RBI to carry on the business as a non-banking financial institution without accepting deposits. In 2010, SKS raised US$ 350 million through an IPO, catching the attention of several prominent investors such as Vinod Khosla, George Soros and Sequoia Venture. SKS is today the largest MFI in India and probably the largest in the world.

Given the objective of investment funds on returns and profitability, MFIs depending on them will be required to ensure them as expected. As highlighted by Yunnus, founder of the Grameen Bank,\textsuperscript{33} this transformation of some MFIs poses important challenges for the industry and evinces the tensions that may arise between the competing goals of serving the financial needs of the poor and generating profits to attract private investment funds. Critical views regarding this shift in the field are further developed in the next section.

\textit{Lending technologies innovations}

One of the key factors behind the success of MF has been its innovations particularly in lending technologies. The success of MF critically depends on its ability to expand its reach to include the poor, and accordingly, it is a field in which innovations are a constant feature that defines its evolution.

The first section of this memo reviewed the key role played by the JLG model. Annex I reviews some further examples of recent innovations in financial services for the poor.

\section{Critical Voices}

\textit{MF as the privatization of safety nets}

One major critique to MF is that as a whole it is a partial and ineffective private response to the dismantling of the social safety nets which were once built under the developmental and welfare state, by neoliberal economic reforms. “Turning peasant women into mini-capitalists is just furthering the reach of finance capital and shifting the burden of risk to a class who already bear the brunt of poverty without safety nets.”\textsuperscript{34}

\textit{Poor borrowers are staying poor}

Despite the fact that microcredit has certainly become a powerful tool for the financial inclusion of the poor, some studies question the impact of MF to bring poor people out of poverty. Many poor

\footnote{On April 20, 2007, Compartamos went public through an IPO that listed it on the Mexican Stock Exchange and also offered shares to international institutional investors under US SEC Rule 144A. The peculiarity lies in the fact that the Bank received none of the proceeds from the sale. The principal shareholders and founders of Compartamos offered $470 million which allowed them to keep running the MFI and permitted them to earn substantial profits. Shareholders in Compartamos, including ACCION International, the International Finance Corporation (IFC), Compartamos NGO, and private Mexican investors sold 29.9 percent of Compartamos’ stock.}

\footnote{Grameen Bank is mainly funded through deposits made by the poor and donations.}

\footnote{Gina Neff (1996), \textit{Microcredits, Microresults}, Left Business Observer, 74, October 1996.}
borrowers use much of their loan, not for business or productive endeavors, but for simple consumption needs such as food, or even non-essential goods. As stated by a study, "Grameen borrowers are staying poor."35

Women are not being empowered

It is widely recognized that one of the key innovations in early MF was the discovery that women present higher levels of loan repayment. According to supporters of micro-lending, despite its flaws, MF benefits and even "empowers" women. Some studies have found, however, that while women are getting the loans from Grameen Bank and similar organizations, a significant portion of those loans are directly invested by male relatives (although women bear the liability for repayment), and in only 37% of the cases had women retained full or significant control over the businesses that were in their names.36

Poorest of the poor are not being served

It is well documented that MF actually does not address the poorest of the poor (see Annex III). In fact many of the poorest do not even qualify for a loan, because they are a risky audience which does not generate the necessary income for repayment. As recognized by the CGAP guidelines, this group requires types of interventions different from MF.

Excessive focus on financial services

The increasing commercialization of MFIs has tended to relegate the provision of non-financial services which could be the recipe for success for helping the poor get out of poverty. Many NGOs at the beginnings of modern MF, and even today, have been conscious about the importance of serving poor people from a bilateral approach providing at the same time financial and non-financial services such as counseling to develop a micro-enterprise. Today, as the commercialization of the field advances, MFIs are exclusively focusing on financial services.

Over-borrowing by the poor

Another consequence of the commercialization of MF has been the increasing pressure on MFIs agents to increase the number and value of loan placements which has translated into a lowering of lending standards. Added to this, the increasing availability of funds for MF and the low levels of financial literacy among the poor have led to critical cases of over-borrowing.

Questionable debt collection methods

The commercialization of MF has also led to increased pressure on MFIs’ debt collector agents to improve their performance. Thus, in many cases, debt collector agents have resorted to methods which take little into account the critical situation and financial needs of the poor. A recent report has linked India’s SKS Microfinance loan collection policies to more than 200 suicides in the state of Andhra

35 Neff (1996), supra note 18.
Pradesh in late 2010. The state government blamed MFIs for fueling a driving poor people into over-
indebtedness and then intensively pressuring borrowers leading them to commit suicide.37

*Usury interest rates*

The absence of price controls have led to high interest rates being charged by MFIs. It is estimated that
on average MFIs charge 25-30% interest rates. Even though they are lower than what pawnbrokers can
charge for the credit it still doubles the rates charged by commercial banks in traditional credits to non-
poor people. One of the key reasons behind the successful IPO of Compartamos in Mexico in 2007 was
the fact that Compartamos had been generating very high profits (returns on equity above 50% a year),
sustained by very high interest charges to borrowers (about 86% a year).38 The lack of supervision and
control has also led to some sounded cases of abuse such as the one involving the Russia Post office
where interest rates reached 730% per year.39

Another well-known case related to outrageous interest rates and over-borrowing has been the *No Pago
Movement* in Nicaragua.40 Nicaragua is one of the poorest countries in the Western Hemisphere and has
the largest number of MFIs in Central America. In 2008, a movement began in the country called
“Movimiento No Pago” (a movement for non-payment of loans). It was supported mostly by farmers of
the north of Nicaragua which organized protests (some of them quite violent) and forced MFIs in some
cases to close branches. They even received the support of the Sandinist Presidential candidate, Daniel
Ortega. Eventually, in 2010, despite the pressure of MFIs and international institutions such as the IMF,
the Congress passed a Moratorium Law with a vast majority.41

*Poor consumer protection rules, weak governmental supervision, and low financial literacy among the
poor*

Many of the failure cases reviewed above could have been avoided, or at least their negative
consequences reduced, had there been in place stronger consumer protection rules, had the state had
greater supervision capabilities in a sector that is in permanent change, and had the poor people
affected by these cases received proper training and financial education.

*Ideological indoctrination*

The way in which MF has expanded around the world and the standard practices applied by MFIs have
important political consequences: they empower certain groups over others, they transfer resources
from some to others, and so on. Some critics have questioned the type of empowerment of women

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37 Erika Kinetz (2012), Associated Press IMPACT: Indian lender SKS’ own probe links it to borrower suicides, despite
company denials, February 24, 2012.
38 CGAP (2007), BancoCompartamos: Interest Rates, Profits, and an Initial Public Offering.
40 In addition to the case of SKS/Andhra Pradesh in India and the No Pago movement in Nicaragua, another
notorious case has been documented in Bolivia where over-lending sparked hunger strikes and protests against
banks and MFIs during 1999 and 2000.
41 Sergio Guzmán (2009), *Nicaraguan Microfinance in Crisis*, From the Field, Microfinance, Policy, November 5;
Sergio Guzman (2010), *Ley Moratoria (Moratorium Law) Passes in Nicaragua*, From the Field, Microfinance, Policy,
We Learn?*, January 24, 2011.
promoted by MFIs, the financialization of the poor, the charge of interests in Muslim communities, and
the promotion of individual entrepreneurship and self-employment over collective approaches and
wage employment. As part of its lending and repayment strategy, the Grameen Bank introduces in
villages practices that have generated some controversy such as the chanting of slogans known as the
*Grameen’s 16 Decisions*. Some of these slogans include public health recommendations such as the
construction of pit-latrines. Other slogans, however, have a social impact that brings about some
controversy such as the call to keep families small, or the prohibition of dowries in weddings.42

*Commercialization of the MF field*

We have already shown some of the negative consequences stemming from the increasing
commercialization of the field. In addition to specific problems related to over-borrowing, changing debt
collection practices, and so on, critics also highlight that the commercialization of MF is forgetting about
the original objectives of MF, i.e., taking poor people out of poverty. The focus of MFIs has shifted to
maintain high profits and letting private investors and MFIs owners collect the gains.

*Frontier Issues and Future Research*

This final section identifies some key frontier issues, many of which have been addressed in this memo,
and proposes some areas for future research.

1. Despite the exponential growth of MF and the significant advances in lending technologies,
   remote and poor rural areas as well as agriculture financial services continue to be
   underdeveloped and deserve much attention.

2. Another challenge continues to be the financial inclusion of the poorest. What kind of financial
   and non-financial services need the poorest? What are the best ways to reach them?

3. Perhaps as a result of their marginal position in the dominant consensus there is little
   knowledge in critical areas such as financial education for the poor and financial consumer
   protection.

4. The commercialization of MFIs, the provision of MF services by traditional commercial banks,
   the incorporation of private investment funds as a powerful alternative source of funding, and

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42Grameen’s 16 Decisions: 1. We shall follow and advance the four principles of Grameen Bank --- Discipline, Unity,
Courage and Hard work – in all walks of our lives. 2. Prosperity we shall bring to our families. 3. We shall not live in
dilapidated houses. We shall repair our houses and work towards constructing new houses at the earliest. 4. We
shall grow vegetables all the year round. We shall eat plenty of them and sell the surplus. 5. During the plantation
seasons, we shall plant as many seedlings as possible. 6. We shall plan to keep our families small. We shall
minimize our expenditures. We shall look after our health. 7. We shall educate our children and ensure that they
can earn to pay for their education. 8. We shall always keep our children and the environment clean. 9. We shall
build and use pit-latrines. 10. We shall drink water from tubewells. If it is not available, we shall boil water or use
alum. 11. We shall not take any dowry at our sons’ weddings, neither shall we give any dowry at our daughters
wedding. We shall keep our centre free from the curse of dowry. We shall not practice child marriage. 12. We shall
not inflict any injustice on anyone, neither shall we allow anyone to do so. 13. We shall collectively undertake
bigger investments for higher incomes. 14. We shall always be ready to help each other. If anyone is in difficulty,
we shall all help him or her. 15. If we come to know of any breach of discipline in any centre, we shall all go there
and help restore discipline. 16. We shall take part in all social activities collectively.
the entry of MNOs in the MF market poses a complex regulatory challenge. The banking industry is going through a profound revolution, the results of which are to a large extent in the hands of regulators. Rules, or the absence of them, will play a decisive role in structuring the new market, defining rights and obligations of the different actors, setting standards and requirements, establishing rules of competition. They will all have a significant impact on cost structures, viable business strategies, and distributions of rents. Given that most the aforementioned changes and innovations are very recent, this is an area that is virtually unexplored in the literature and calls for an ambitious research effort.

5. In addition, technical and regulatory challenges remain to be analyzed. Questions of interoperability among different banking and telecom institutions, effective mechanisms for commercial banks to reach the lower end of the MF market, special supervisory rules for commercialized MFIs, effects of private investment funds on MFIs performance, expansion of agent banking and role of e-identities among the poor among others

6. A key topic in the field continues to be the determination of interest rates. How are interest rates constructed in different markets, countries, and settings? How could abuses be prevented? Which mechanisms could be used by the state in order to maintain interest rates at reasonable levels and at the same time not undermining the sustainability of MFIs? What could be the role of state-owned development banks?

7. Despite the increasing formalization of MFIs and MF providers, MF consumers live in informal environments, they operate under informal and sometimes illegal arrangements, and their productive activities take place mostly in the informal economy. Sometimes the point of contact between the formal and the informal generates tensions that are hard to overcome. What are the best policy strategies from both, the formal and the informal perspectives, to address these issues and potential conflicts?

8. Many of the criticisms reviewed in the previous section take the perspective of the consumer, and departs from the assumption that MF is an effective tool to help people get out of poverty. While this is an approach that must certainly be part of the analysis, little is known about the correlation between MF and the development process as well as the longer-term effects of MF. In other words, what is the developmental impact of the systemic biases in MF? What are the intended and unintended consequences of providing finance for consumption rather than productive investments? What is the impact of empowering women rather than men? What are the effects of favoring the relatively wealthier unbanked? If commercialized MFIs are increasingly capturing the rents generated in the industry, how are they being used? How could they be reshaped? These and other questions constitute a promising, and largely unexplored, area for future research.
Annex I. Recent Innovations in Financial Services for the Poor

1. **CCACN (Central de Cooperativas de Ahorro y Crédito Financieras de Nicaragua)** is marketing its “Agriculture Salary” savings product to farmers. The goal of the product is to smooth the flow of income from the proceeds of an annual or semi-annual harvest. With this idea in mind, each credit union works with its farmers to identify their individual expenses and determine a monthly "salary" (portion of harvest proceeds on deposit combined with an above-market interest rate) to be withdrawn from the credit union.\(^{43}\)

2. **Caja los Andes** in Bolivia offers four loan repayment options that fit the cash flow of various agricultural activities, including an end-of-term payment for both principal and interest that fits single crop activities, and unequal payments at irregular intervals for farmers that have planted several crops with different harvesting periods. Flexibility is also provided in loan disbursements, and farmers can receive the stipulated loan amount in as many as three installments.

3. **Banco Sol** in Bolivia has introduced a combination of biometric fingerprint and Smart Cards to deliver financial services to its clients. By using biometric technology -it measures an individual's unique physical or behavioral characteristics, such as fingerprints, facial characteristics, voice pattern, and gait, to recognize and confirm identity- Banco Sol can reduce fraud, error and repudiation of transactions. The time saved by not having to deal with forgotten PIN numbers or unauthorized use of cards and accounts allows employees to have more time to provide personal service and advice to clients.

4. **International Remittance Network (IRnet):** In late 1999, WOCCU, in partnership with Vigo, a money transfer firm, launched IRnet. As of June 2003, 173 credit unions in Central America offer IRnet, allowing workers to send their remittances through 800 US credit union points of service. The Central American credit unions distribute remittances primarily to rural clients. The distributing credit unions help to integrate remittance recipients into the formal financial sector through trained staff who cross-sell services. When a non-member enters a credit union to pick up a remittance, a staff person encourages this person to become a credit union member and save a portion of the remittance in savings account that will generate interests.\(^{44}\)

5. **Unibanka (Latvia):** Prior to introducing credit scoring, Unibanka, a commercial bank, viewed microfinance loans as too costly to deliver. With the assistance of Bannock Consulting, Unibanka instituted a credit-scoring system based on qualitative client data since sufficient quantitative data was not available to develop a statistical model. Branch staff now uses scorecards to evaluate microfinance loan applications quickly, which has reduced the cost of review and made microfinance lending profitable for Unibanka.\(^{45}\)

6. **Managed ASCAs:** A number of local organizations in the Nyeri District of Kenya provide management services to group-based loan funds. The groups operate as Accumulating Savings

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\(^{44}\)WOCCU (2003), supra note 31.

\(^{45}\)CGAP (2004), ITInnovation Series: Credit Scoring.
and Credit Associations (ASCAs) and receive management services provided by ASCA Management Agencies (AMAs). The AMA model serves a broader client base than the mainstream donor funded MFIs who tend to focus their attention on micro and small entrepreneurs. The clientele of AMAs are also drawn from other socio-economic groups, including salaried workers such as nurses, teachers and civil servants as well as subsistence and semi-commercial farmers. Hence their reach into the rural areas is much greater than the MFIs.\footnote{Nthenya Mule, Susan Johnson, Robert Hickson. WambuiMwangi. The Managed ASCA Model: Innovation in Kenya’s Microfinance Industry. Micro-Save Africa. 2001.}

7. **ICICI Bank (India):** Two state banks in India (Corporation and Canara) partnered with an NGO to provide salaried low-income workers with access to savings. The project takes hold of the already established automatic teller machines (ATMs) in the factories to offer a recurring savings product, along with education on personal finance.

8. **Microenterprise Access to Banking Services (MABS) in the Philippines** takes advantage of the expanded use of the credit bureau by rural banks, which was started in 2001 to minimize client over indebtedness and defaults. By using an e-mail encryption program that allows rural banks to share information electronically at a low cost, MABS has helped to integrate the rural banks' microenterprise loan clients into an existing national credit bureau.\footnote{Anita Campion and John Owens, MABS: A Sustainable Approach to Rural Microfinance, Microbanking Bulletin, July 2003.}

9. **BASIX in India** reduced transportation and transaction costs for its clients and decreased staff expenses by establishing tellers in phone booths operating in India. The company operating the phone booths receives a service fee and phone booth operators receive training in basic collection operations and accounting. BASIX is currently redesigning the project after the pilot and preparing it for re-launching it.

10. **Credit, life, and funeral insurance:** A WOCCU study on savings and credit cooperatives (SACCOs) in Kenya indicates that HIV/AIDS poses high levels of risk to rural finance institution viability. To overcome this, the Cooperative Insurance Company (CIC), a professional insurance provider, insures over half of Kenya’s more than one million credit union members who subscribe to policies through their credit unions.\footnote{WOCCU (2003), supra note 31.}

11. **The National Microfinance Bank (NMB) in Tanzania** was created to retain the extensive rural branch network of the National Bank of Commerce (NBC) when it was privatized in 1997. In order to make it commercially viable, rigorous controls of costs have been set through drastic simplification of the business model and tight managerial control. Key initiatives have been correcting the pricing of products, particularly payments and remittance services, which had traditionally been cross-subsidized by other product lines, and the development of microfinance products, mainly small (average US $400) individual loans.\footnote{Rural financial services: Implementing the bank’s strategy to reach the rural poor. Rural Private Sector, Markets, Finance and Infrastructure Thematic Group. Rural Sector Board, The World Bank. Washington, D.C. March 2003.}
12. ADOPEM (Dominican Republic) thoroughly evaluated its PDA (Personal Digital Assistants) program and recorded dramatic improvements. Client retention improved significantly, and the number of days between application and disbursement dropped from five days to two. Expenses for paperwork dropped by 60% and data entry expenses dropped by 50%. Loan officer caseloads and other productivity measures increased by about 35%.50

13. The international NGO Technoserve has developed an inventory credit scheme in Ghana that enables farmers' groups to obtain higher value for their crops by providing post-harvest credit through linkage with a rural financial institution. Instead of selling their entire crop at harvest - when prices are lowest - in order to meet cash needs, small-scale farmers in the scheme store their crop in a cooperatively-managed warehouse and receive a loan of about 75-80% of the value of the stored crop serving as collateral. This loan permits them to pay their accumulated debts and satisfy immediate cash requirements. Then, when the season has finished, prices rise and the farmers can either sell the stored crop or use it for home consumption.51

14. Savings-based, Agriculture-oriented Rural Credit Unions - SICREDI in Brazil specializes in agricultural lending, primarily for the production of rice, wheat, beef, fodder, fish, vegetables and for agricultural equipment. Loan approvals are based upon the members' savings history and credit record, with the size limited to 50 percent of production costs and dependent upon the potential return of crop sale at harvest as well as household income and debt obligations. The borrower makes monthly interest payments and then a payment of the principal at harvest time. In addition, SICREDI participates in the PROAGRO national crop insurance, for which a premium is added on the loan rate. PROAGRO pays 100% of the loan loss if the crop fails.52

15. Producer Associations as Clients of a Financial Institution: GAPI and CLUSA in Mozambique: GAPI offers investment and working capital loans to fora (federations of associations) of small farmers and small and micro-enterprises. GAPI collaborates with CLUSA to set-up and register these fora. Loans are secured through a solidarity group-like guarantee between the participating fora. Each forum lends to its member associations, who collect the produce from their individual members and other area farmers and deliver it to the forum in return for the loan. About 80% of the profits from the sale of produce are handed back to the associations - the remaining 20% of the profits are kept by the forum as interest payments.53

16. In South Africa, a network of 8,000 armored trucks equipped with thumbprint recognition and smart-card technology deliver pension payments of about $60 each month to 4.5 million South Africans. The niche to offer other financial services is evident.54

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51World Bank (2003), supra note 37.
52WOCCU (2003), surpa note 31.
53Pearce, Douglas. "Buyer and Supplier Credit to Farmers: Do Donors Have a Role to Play?" prepared for Paving the Way Forward for Rural Finance: An International Conference on Best Practices, held June 2-4, 2003.
17. **Banco Postal in Brazil**, a joint venture between the Post Office and the largest private bank (Bradesco) has offered banking (and payment) services through its network of postal branches in remote and poor areas of the country since March 2002.

18. **Tanzania Posts Corporation** mini-buses offer passenger service along domestic regional routes. Postal outlets have become one-stop service centers that provide photocopying, telephone and money transfer services. They have developed into agents for others by accepting newspaper advertisements, selling lottery tickets, revenue stamps for radio stations, and tickets for boats between Dar es Salaam and Zanzibar.\(^{55}\)

19. **Equity Building Society (EBS) in Kenya** has emerged as one of Kenya's leading microfinance institutions, with over 155,000 savings clients and 41,000 borrowers. Once insolvent, EBS transformed itself into a profitable financial-service provider by rigorously focusing on the needs of its clients - in particular, by developing a wide range of market-based financial products and services, including a mobile banking service.\(^{56}\)

20. **Kiva**. In 2005 Kiva started as an online lending platform that allowed individuals in the developed world to loan to small business people in the developing world. Kiva works with a growing network of microfinance institutions (MFIs) in more than thirty countries. MFI partners post the profiles of their loan applicants on the website which permits internet users in the United States, Canada, Europe, and beyond to make small loans via PayPal to these businesses. The businesses pay the lenders back over a period of about a year. Since starting, Kiva lenders have funded $60 million in loans this way.\(^{57}\)

\(^{55}\)International Trade Forum, Issue 4/2002


\(^{57}\)Matt Flannery (2009), Kiva and the Birth of Person-to-Person Microfinance, Innovations: Technology, Governance, Globalization, M.I.T.
Annex II. Mobile Banking: The case of M-Pesa in Kenya

In the first decade of the 21st century, the number of cell phones in Africa has increased 30%, from 16 million to 500 million accounts. Countries with low income and almost no internet access often prioritize the use of mobile phones to communicate. In the rural areas of developing countries, cell phone ownership is high and rapidly growing everyday. This, added to the little bank infrastructure, was the perfect scenario for mobile banking.

By managing high volumes of low value transactions mobile banking has offered mainstream banks’ the possibility to reach the low income market. In order to do this, banks have designed alliance with mobile network operators (MNO) to significantly extend the reach of financial institutions into the rural areas.

One of the biggest examples of this was presented in 2007 when Safaricom, Kenya’s largest MNO, launched an innovative financial service for the unbanked called M-Pesa.

Before developing this case any further, it is important to note the spread of mobile phone technology in the sub-Saharan Kenya where, in the last years, cell phones have won over landlines as the primary means of telecommunication. The number of landlines had fallen from about 300,000 in 1999 to around 250,000 by 2008. On the other hand, during this same period, mobile phone subscriptions increased from virtually zero to approximately 17 million units which, assuming an individual owns one cellphone, 83% of the population over 15 years old has access to mobile phone technology.

As the biggest mobile network provider, Safaricom controls nearly 80% of the market. Following a donor-funded pilot project, Safaricom launched the mobile phone-based payment and money transfer service, known as M-Pesa, so as to attend the needs of the unbanked.

Its simplicity is the reason of its attraction: an M-Pesa customer can use his or her mobile phone to move money quickly, securely, and across great distances, directly to another mobile phone user. The customer does not need to have a bank account; he/she simply registers with Safaricom for an M-Pesa account on their mobile. Customers turn cash into e-money at Safaricom dealers, and then follow simple instructions on their phones to make payments through their M-Pesa accounts. By charging a transaction fee to the sender of funds that varies taking into account the type of transaction and the amount of funds, the system provides money transfers as banks do in the developed world. The service itself is free and all deposits made into the M-Pesa account are free of cost without affecting the customers’ airtime credit.

M-Pesa retail agents are responsible for registering new customers and facilitating cash deposits and withdrawals. Retail agents often play a key support role for customers as well, since they are able to quickly and easily contact M-Pesa Customer Care.

Retail agents are required to follow strict practices during new customer registration and to validate a customer’s identity during each transaction using the national ID card presented by the customer. Transaction limits are set at 35,000 Kshs (approx. USD 450) per day for cash deposits, transfers and withdrawals and at 10,000 Kshs (approx. USD 130) for airtime purchases.
Retail agents are also required to record transactions in a paper logbook. For each transaction, the agent enters: the M-Pesa balance, the date, agent ID, transaction ID, transaction type (customer deposit or withdrawal, agent cash rebalancing), value, customer phone number, customer name, and the customer’s national ID number. Most of this information can be extracted from the confirmation SMS that the agent receives. Customers are then asked to sign the log for each transaction in order to avoid fraud. Safaricom brands the logbook and all retail agents use the same format.

Within the first month of providing the service, Safaricom had registered over 20,000 M-Pesa customers, much more than what was expected in the business plan. This rapid development evinced that mobile banking service for the unbanked fill a gap in the Kenyan market and around the world. M-Pesa had spread so quickly that it has become the most successful mobile phone-based financial service in the developing world.

In August of its debut year the average number of new registrations per day exceeded 5,000 and reached nearly 10,000 by December. By August 2009, a stock of about 7.7 million M-Pesa accounts had been registered. Ignoring multiple accounts and those held by foreigners, this suggests that about 38% of the adult population had gained access to M-Pesa in just over 2 years.

Among the benefits the users see are: increased security – not having to carry cash, ability to safely and quickly send money back to family – especially for urban migrant workers, and the ability to buy airtime credit at any moment aside from the fact that receiving a text message from the bank made customers feel secure about the system.

Since Safaricom currently has over 12,000 retail agents nationwide, it pursues a strict set of guidelines to ensure that the growth of retail agent outlets continues to meet customer subscriber levels and its correspondent e-float needs. The following is an explanation of the agent organization system of M-Pesa:

Safaricom’s M-Pesa network is organized by agents that are divided into groups. Originally, these agents required to be operated in at least three different physical locations, so as to minimize the probability of imbalances arising. There are currently three agent group models in operation. In the first, one member of the agent group (the “head-office”) deals directly with M-Pesa, while subsidiary agents, who are owned by the head office, manage cash and electronic funds (e-float) balances through transactions with the head-office. Both the head office and the agents can transact directly with M-Pesa users.

When it comes to money withdrawal given that the agent group model works with other agents positioned all around Kenya, some have shown problems with liquidity due to the distance from the bank to their village. Nevertheless, M-Pesa remains strong as a fast service with quick access.

The second model is called the aggregator model, which is based on hierarchy. At the top of the hierarchy are master agents who are mostly Safaricom’s own dedicated airtime resellers, but can also include large organizations such as Group 4 Securicor, branches of Equity Bank, and some larger supermarket chains. The next level in the hierarchy is made up of retail agents that receive directions from 300 master agents. A single agency agreement is signed with a master agent who in turn recruits multiple outlets to act as M-Pesa smaller retail agents. By this strategy, Safaricom has very quickly increased the number of M-Pesa retail agents by signing agreements with a limited number of master agents.
Thirdly, a final and more recent model allows a bank branch, referred to as a “super-agent,” to perform the functions of the aggregator of the second model exemplifying the integration of M-Pesa services into the banking system. It works by having the bank branch manage cash and e-float balances of a group of M-Pesa agents. It distinguishes from regular and aggregator models because the bank does not trade e-float directly with M-Pesa users.

The cash collected by M-Pesa in exchange for e-float is deposited in bank accounts held by Safaricom. Initially, all funds were held in just one account at the Commercial Bank of Africa, but recently in order to diversify its risk Safaricom has opened accounts at an additional bank. These accounts are regular current accounts subject to the regulatory policy of the Central Bank and insured by the Deposit Protection Fund but with no restrictions on Safaricom’s access to funds. However, this deposit insurance only covers up to a maximum of Kshs 100,000 (USD 1,300) thus, almost the same as being uninsured.

Since the launch of this innovative service in March 2007 and given its rapid success all around Kenya, it has been tremendously difficult for Safaricom to express that M-Pesa is not a bank susceptible of being regulated by the Central Bank of Kenya. Even though M-Pesa’s steady growth through its years in the market have led to hopes that its accounts could substitute banks accounts for the unbanked population, the volume of its financial transactions is still low in comparison to the transactions taking place between banks under the Real Time Gross Settlement method which is nearly 700 times the daily value transacted through M-Pesa.

On the other hand, the average mobile transaction is about a hundred times smaller than the average check transaction, and even just half the size of the average Automatic Teller Machine (ATM) transactions. Thus, M-Pesa is not designed to replace all payment mechanisms, but has found and filled a niche in the market in which it provides significantly enhanced financial services.

M-Pesa is not regulated under a full banking license, so it is essentially operating outside of the traditional banking regulatory environment, but it has been audited by the Central Bank and has received their approval for operation in accordance with the European Mobile Payment Directive, which establishes the role of payment service providers in the financial system.

Banks in Kenya have been aggressively lobbying the Central Bank to either require M-Pesa to adhere to full banking regulations or to stop providing the service completely. Safaricom is keen to see the Central Bank implement official regulatory policy that will open up the market for deposit-taking, clearing systems, and know-your-customer rules to incorporate the activities of mobile operators.

As M-Pesa continues to expand, and these balances grow, the authorities may decide to revisit this arrangement. However, Safaricom and Vodafone have maintained a strong relationship with the Central Bank of Kenya and it is possible that the fact that the Kenyan government owns 35% of Safaricom, has made it easier for the regulation to be approved.

Moreover, in recognition of the potential grasped in mobile banking, regulatory innovations are beginning to take place in order to ensure the strong financial health and reputation of the electronic money issuer, to monitor transactions, to limit transaction size and the range of services offered, and to adjust KYC norms for low-value accounts. In addition to this, the Mobile Financial Services Working Group was created to deliver a space for policy maker discussion concerning regulatory issues over
mobile financial services whilst promoting the broad use of m-financial services as a key solution for
greater financial inclusion in developing countries.

Other success cases of mobile banking

In India, there are around 428 million deposit accounts in the country but only 30% of them are in rural
areas. With a rural population of 741.6 million, the rural penetration of banks is only 18%. Even when
access to banking is available, the transaction costs of savings in formal institutions in India are as high
as 10% for the rural poor.

The State Bank of India (SBI), which is the biggest public sector bank of India, appointed Eko as its
Business Correspondent (BC) and is currently offering its No-Frills Savings Account (NFSA) through Eko’s
mobile banking platform and a network of retailers referred to as Customer Service Point (CSP). The
reasons behind choosing Eko over other business correspondents, is that it is easy to use and useful at
the same time.

Despite having access to the formal banking sector, most clients still choose to use their mobile banking
account over the traditional account. A single transaction of deposit or withdrawal at a traditional bank
branch entails huge opportunity costs for the clients in terms of the business/wages lost during the time
spent at the branch, and money spent on travelling to bank branches. Thus, it makes sense to visit the
branch only when the transaction size is expected to be large enough to warrant these costs. In contrast
to this, the transaction size of m-banking clients is as low as Rs. 50 (USD 1). This can be attributed to the
markedly less time required to travel to the branch and transact at an m-banking agent. Hence, the
clients frequently save more in their m-banking account than they used to save in their traditional bank
account.

Other examples of joint mobile network operator (MNO) – bank ventures include M-Paisa in
Afghanistan where Vodafone and their local partner, Roshan, quickly recognized the importance of
leveraging local MFI partners in order to provide increased access banking services, especially the access
to credit via a mobile wallet. To accomplish this, they partnered with a large MFI, First Microfinance
Bank, to offer loans and repayments via the M-Paisa platform. Bu these means, it allows MFI to use the
technology platform of the MNO, while the MNO was able to build on the existing network and large
base of microfinance clients thus leveraging the strong grassroots connections of an established MFI.

Another case is seen in the Philippines with the GCASH service that works with Globe Telecom as their
MNO for their mobile banking service via SMS. GCASH has partnered with MFIs such as the Rural
Bankers Association of the Philippines (RBAP) to further expand existing m-banking services of rural
areas. Users find it quick and easy to access their accounts when using the GCASH payment platform
with the Association’s (RBAP) program on Micro-enterprise Access to Banking Services (MABS).

Many rural banks are integrating GCASH into their operations benefiting the bank by being able to reach
more clients and provide an additional channel for accessing the various financial services offered. In
their latest m-banking quest, GCASH is developing a pilot money transfer program targeted for the
Filipino communities around the world (Hawaii, UAE, Hong Kong and others).

In the Dominican Republic, one can also appreciate the mobile banking wave with their tPago system
that works similar to the M-Pesa but directed only to the Banco Popular users. It is relatively new in the
market and it is just beginning to catch on to the Dominicans, nevertheless it promises to be useful with transactions with third parties and effective managing of bank accounts.

All this shows that cellphones are now the 24-hour tellers, ATM’s and banks for their easy access and practicality. We can agree with Governor Ndung’u from the Central Bank of Kenya when he explained that, while “mobile money was made with the poor in mind, it is rapidly becoming a platform used by all segments of society.”

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Annex III. Critical Voices in Microfinance: An Annotated Bibliography

Milford Bateman (2010), Why Doesn’t Microfinance Work? (Zed Books)

Over the last thirty years, microfinance has developed into the most mentioned policies to target poverty and under-development in developing and transition countries. The devotion has reached rock stars, royalty, movie stars, high-profile politicians and ‘trouble-shooting’ economists. In 2006 Muhammad Yunus, its most famous pioneer, was awarded the Nobel Peace Prize. Bateman claims that microfinance doesn't actually work; he conveys that its foundation lies in the will of advancing a free market ideology and the prevalent greed and self-interest of the people working in microfinance. Using a multitude of case studies from across the globe - from India to Cambodia, Bolivia to Uganda, Serbia to Mexico - he demystifies the flags carried by its defenders and demonstrates that microfinance actually constitutes a major barrier to sustainable economic and social development, and thus also to sustainable poverty reduction. Bateman urges to reconsider the role of microfinance in development policy.

Thomas Dichter (2007), A Second Look at Microfinance: The Sequence of Growth and Credit in Economic History

The aim of the microfinance movement is to grant funds for investment in microbusinesses, to take people out of poverty and promote economic growth. Recent experience and the economic history of rich countries, however, suggest that those expectations are not likely to be achieved. Most people are not entrepreneurs, so there is no reason to think that mass credit would in general lead to viable business start-ups. Today as in the past, starting a business in the advanced countries depends predominantly on savings and informal sources of credit; past forms of microcredit never played a role in small business development, and the greater portion of microcredits are actually used for consumption rather than investment. The same happens nowadays.

Milford Bateman and Ha-Joon Chang (2009), The Microfinance Illusion, Mimeo, University of Juraj Dobrila and University of Cambridge

The appeal of microfinance is based on the widespread assumption that giving loans to the poor will automatically create sustainable economic and social development built up by the poor themselves. The authors argue that this is not true in the long run. They also suggest that the current drive to establish the central role of microfinance in development policy cannot be divorced from it being of service to the neoliberal/globalization agenda. The authors even consider that microfinance can constitute a “new and very powerful form of ‘poverty trap’”. Optimistic narrative constructed around microfinance is flawed; no proof of achieving sustainable poverty reduction and economic development; it basically helps advance neoliberalism and the globalization project. What are the reasons? 1. Assessing the sustainable impact of microfinance: (a) Microfinance ignores the crucial role of scale economies; (b) Microfinance ignores the problem of ‘fallacy of composition’; (c) Microfinance acts to ‘crowd out’ industrial microenterprises with prospects of technological upgrading; (d) Microfinance ignores the need to promote vertical and horizontal relationships; (e) Microfinance encourages an unsustainable import-dependent and trade-based local economic structure; (f) Microfinance ignores the crucial importance of
solidarity and local community ownership and control. 2. Microfinance as a vehicle for neoliberalism: (a) Microfinance provides a model for poverty alleviation that is politically acceptable to neoliberals; (b) Microfinance highlights the concept of financially self-sustaining economic units and discredits the notion of public support (e.g., subsidies) for organizations; (c) Microfinance can be used to undermine the concept of basic state service provision and to support privatization and private sector provision; (d) Microfinance supports the drive towards financial sector liberalization and commercialization; (e) Microfinance acts as an important ‘safety valve’ within the globalization project.

Muhammad, A. (2009), Grameen and Microcredit: A Tale of Corporate Success

This paper examines whether the Grameen Bank (GB) model has actually worked in reducing poverty and empowering women. GB’s microcredit program has been recognized internationally as a successful model. Findings from publications, studies and international experiments of the GB model reveal that: (a) GB model has been successful in earning high profits and high repayments but indicators show that no significant change was made in education or poverty reduction; (b) Although a large majority of borrowers are women, only ten percent have control over their loans; (c) Dowry pressure on borrowers has increased after enrolment; (d) Borrowers have had to take loans from money lenders or sell valuable assets to repay their GB loans; (e) Very few borrowers have actually used microcredit for economic improvement. The paper concludes that although the GB model created a good opportunity for expanding the market for finance capital, it has failed as a tool for poverty alleviation and empowerment of women.


Advocating a larger role for the state in helping the poor escape poverty, this paper critically examines the Bottom of the Pyramid (BOP) strategy for alleviating poverty. According to the paper, in recent years Libertarian movement that emphasizes the need for free markets in order to reduce poverty has grown. This approach assumes that the poor are fully capable and willing participants in the free market economy. However, the view of the poor as creative entrepreneurs is far from the truth. It ends up harming the poor by: (a) Paying little attention to the legal, regulatory and social mechanisms that ought to protect them as vulnerable consumers; (b) Overemphasizing microcredit and under-estimating the need for modern enterprises that would provide employment opportunities for the poor; (c) Not giving enough importance to the critical role of the State in poverty reduction. Finally, the paper concludes that it is necessary to impose limits on markets to prevent the poor being exploited. The State must also provide basic services such as infrastructure, public health and education, responsibilities that are even more critical in the context of poverty reduction.


This paper analyzes some of the recent evidences on the impact of microfinance activities on poverty reduction. The paper is organized into four sections: (a) Overview of some of the features of microfinance activities in Asia; (b) Correlation between microfinance programs and concepts from poverty literature; (c) Evidence from recent research studies on the following issues: (i) Extent to which microfinance activities have helped in pulling households out of poverty on a permanent basis, (ii) Extent to which microfinance programs reach only the wealthier amongst the poor, leaving the bottom down unaffected; (iii) Evaluation of how far microfinance is a cost-effective means of transferring income to the poor. The author concludes that: 1. There exists a necessity for diversification of
Chowdhury, A. (2009), Microfinance as a Poverty Reduction Tool: A Critical Assessment

This paper critically analyzes the effectiveness of microfinance as a universal poverty reduction tool. Microfinance has developed some innovative management and business strategies. However, its impact on poverty reduction remains doubtful. Microfinance certainly plays an important role in providing a safety-net and broadening consumption. Microfinance borrowers possibly also benefit from learning while doing things and in boosts their self-esteem. The paper states that: (a) Microfinance advocates have usually focused on supply side factors, paying little attention to the demand side; (b) Microfinance ignores the crucial role of scale economies; (c) Too many microenterprises due to a constant entrance of new MFIs, cause market saturation, and a hyper-competitive situation; (d) Businesses funded by microfinance will most likely replicate a scarce economy in the absence of a vibrant domestic market. In addition, other factors are required to make micro enterprises more productive. The potential for increased productivity is necessary linked to an increase in the demand. Finally, without a supportive macroeconomic, trade and industry policy framework, microenterprises will remain small, with dialogue between them or employment creation possibilities.

Aneel Karnani (2007), Microfinance Misses Its Mark

This article was published in the Stanford Social Innovation Review, a magazine of Stanford Graduate School of Business, and it argues against investment in microfinance. As the essay’s title articulates, “Microfinance Misses its Mark,” the professor affirms that microfinance “does not significantly alleviate poverty.” Karnani characterizes the poor as mostly entrepreneurial failures. “The vast majority [of micro credit clients] is caught in subsistence activities… They usually have no skills, and so must compete with all the other self-employed poor people in entry-level trades… No paid staff, [owning] few assets, and [operating] at too small a scale … most micro enterprises are very small and many fail.” The analysis of the macroeconomic data suggests that although microcredit brings about some noneconomic benefits, it does not significantly alleviate poverty. Indeed, in some instances microcredit worsens life at the bottom of the pyramid. According to the author, the best way to eradicate poverty is to create jobs and to increase worker productivity, not microcredit. The reasons he puts forward are the high interest rates charged by microcredit organizations and the businesses it support is supposed to fund. A microcredit client is an entrepreneur in the literal sense: She raises the capital, manages the business, and takes home the earnings. But the only “entrepreneurs” who have been successful and acquired fame in the developed world are usually visionaries who convert new ideas into successful business models. Although some microcredit clients have created visionary businesses, the vast majority direct the loans to subsistence activities. The author suggests that governments and investors, instead of pursuing microfinance, should invest in manufacturers’ establishment in the world’s poor regions. If it were ensured that manufacturers maintained high productivity and reasonable wages, Karnani writes, factory jobs would help workers leave poverty.

Abhijit Banerjee, Esther Dufló, Rachel Glennerster and Cynthia Kinnan (2010), The miracle of microfinance? Evidence from a randomized evaluation
This paper reports on the impact of introducing microcredit in a new market. Half of 104 slums in Hyderabad, India were randomly selected for the opening of an MFI branch while the remainder did not. They showed that the intervention boosted total MFI borrowing, and then, studied the effects on the creation and the profitability of small businesses, investment, and consumption. Fifteen to 18 months after lending began in treated areas, the access to microcredit produced no change on average monthly expenditure per capita. However, expenditure on durable goods increased in treated areas and as well as a one third increase in the number of new businesses. The effects of microcredit access are heterogeneous: households with an existing business at the time of the program invest more in durable goods, while their nondurable consumption remains unchanged. Households with high propensity to become new business owners increase their durable goods spending and see a decrease in nondurable consumption, consistent with the need to pay a fixed cost to enter entrepreneurship. Households with low propensity to become business owners increase their nondurable spending. We found no impact on measures of health, education, or women’s decision-making.


Leading advocates for microfinance have put forward an appealing “win-win” proposition: microfinance institutions that follow the principles of good banking will also be those that help alleviate poverty. This vision is the core idea surrounding the “best practices”. However, this vision is not supported by logic empirical evidence. It is necessary to recognize the limits so as to reach a more constructive dialogue between microfinance advocates that privilege financial development and those that privilege social impacts. Subsidized credit most often ends up in the hands of non-poor households: politically powerful groups, usually not poor, make their way in and managed to grab a share. The problem was compounded by the fact that most programs were government-run, hence redirecting the loans and turning them into political pay-offs. The concern with targeting introduces a floor to interest rates -it does not mean that interest rates need be at break-even rates. The floor is determined by the rates at which the politically powerful can get loans.


According to the report, it is absolutely essential that we recognize two facts: firstly, that credit services can cause harm as well as good because they induce debt; and secondly that the sector is now so diverse that we have to assess specific individual microfinance interventions and relate to them in appropriate ways rather than universally. It is necessary to define the approach the UK government and other stakeholders should take in relation to microfinance. For not-for-profit, socially focused microfinance this may mean continuing subsidies, as well as encouraging increased focus on the evaluation of social outcomes. For commercial microfinance it is more likely to involve appropriate, rigorous, but not extremely onerous regulation. Main recommendation: More investment is needed in the research base to develop evidence about what microfinance interventions work the best to reduce poverty. Donors and investors have a big role to play here because most academically rigorous studies can be expensive, take many years, and many MFIs may need support to engage in rigorous data-gathering.

Providing credits seems to be an effective tool for improving the welfare of the poor. Therefore, it is expected that microcredit funding to poor people will expand rapidly over the coming years. Wiig argues that if a sound monitoring mechanism is not developed, this credit expansion may create unintended negative effects. Based on a Grameen Bank study, three problems or dilemmas related to credit expansion are analyzed: (i) Does a larger supply of microcredit increase the possibility of cross-financing? (ii) Does capital deepening tend to favor the best ("richest") of the poor? (iii) Does economic success lead to poor repayment behavior? Survey methods revealing the extent of these problems are presented. It is argued that some of these methods should be copied by the implementing agencies to improve the effectiveness of credit provision to the poor.


A key objective of microfinance programs is to provide financial services to poor people who are excluded from such services by the traditional banking system. In this vein, governments, development partners, and donor agencies continue to provide support to such institutions so as to extend their outreach. This paper examines the type of poor people served by one of the leading microfinance institutions in Ghana. By comparing the living standards of clients of Sinapi Aba Trust (SAT) with those of non-clients, representing the general population in its operational areas, the paper concludes that the microfinance institution reaches disproportionately a smaller percentage of very poor people. Program placement has proved to be the key variable when the types of clients reached by SAT need to be determined since most of their branches are located in urban centers. It finds that the objective of financial sustainability being pursued by SAT has eventually caused it to shift the provision of financial services from very poor households to the less poor.


The authors construct a theoretical framework that describes the social importance of a microfinance organization based on the depth, worth to users, cost to users, breadth, length, and scope of its output. By analyzing evidence of depth of outreach for five microfinance organizations in Bolivia, they conclude that most of the poor households reached by the microfinance organizations were near the poverty line—they were the richest of the poor. Group lenders had more depth of outreach than individual lenders. The urban poorest were more likely to be borrowers, but rural borrowers were more likely to be among the poorest.

Anton Simanowitz and Walter, A. (2002), Ensuring Impact: Reaching the Poorest while Building Financially Self-Sufficient Institutions, and Showing Improvement in the Lives of the Poorest Women and their Families

Microfinance does serve very poor clients, although in general, they do not participate in large numbers. Although very poor people are present in most programs, the majority of clients are from the moderately poor and vulnerable non-poor categories, i.e., those just below and above the poverty line. Evidence from poverty assessments by the Consultative Group to Assist the Poorest (CGAP) on a number of MFIs indicates that although all those surveyed were reaching some very poor clients (defined as those in the bottom third of the population), few were reaching large numbers from this group. Most
MFIs were inclined towards less poor clients, or at best reflected the general population distribution. The CGAP experience demonstrates that MFIs do not automatically reach large numbers of very poor clients by using the conventional scheme of small loan sizes. It is striking that of the organizations researched the four that have analyzed and designed their programs to focus on the needs of the very poor are the only ones who could actually reach the very poor. Those that use active poverty targeting are especially effective in biasing their outreach towards the poor and very poor. Two examples are the Small Enterprise Foundation (SEF) in South Africa and Caisses Feminines in Madagascar are particularly interesting. Both organizations have two programs, the first designed along the lines of conventional non-poverty focus, the second designed with the needs of the very poor explicitly in mind and with active poverty targeting. There is a striking contrast between the poverty profiles of these two programs, with both poverty-focused programs significantly biased towards the poor and very poor, and the non-targeted program biased towards the middle poor and non-poor.


The paper discusses nonparametric methods and statistical tests that are appropriate to assess poverty targeting in public programs. These methods explicitly bear in mind that the population distributions of participants and non-participants might cross. When applying these methods to the data of a microfinance program in Jharkhand, India, the authors found evidence that very poorest households are left out from the program.

Asad K. Ghalib (2010), Does Microfinance Reach the Poorest? Empirical Evidence of Programme Outreach From Rural Pakistan, Chronic Poverty Research Center, Manchester University.

Microfinance has developed globally as a key strategy to reduce poverty and promote development. However, most of the relevant literature concentrates on breadth as opposed to depth of program outreach. This paper is based on a primary household survey of 1,132 respondents in the Punjab Province of Pakistan in order to determine which category of the poor is being tackled by microfinance institutions. Are they the very poor, middle poor or less poor ones? In order to make comparisons, borrower (treatment) and non-borrower (control) households are interviewed and by using the Principal Component Analysis (PCA), each household is given a specific poverty score, in relation to all other households in the sample. As soon as the poverty index is obtained, the sampled households are ranked according to the varying poverty levels. In order to estimate program outreach, comparisons are later made between borrower and non-borrower households. The paper evinces that the depth of poverty outreach is significantly lower than what has been stated by service providers and analyzes the policy implications to enhance depth (as opposed to breadth) of program outreach so as to better address the needs of the poorest of the poor in order to contribute seriously and effectively combat poverty.

Coco, G. & Pignataro, G. (2009), Inequality of Opportunity in the Credit Market: Do the poor have equal opportunity to participate in the credit market?

This paper explores the relationship between equality of opportunity and the credit market. The objective is to find out if collateral is the determinant factor so as to access credit. Credit market imperfections impede the poor from making successful investments. With full information each project is funded only by an evaluation of the borrower’s effort. Notwithstanding, under conditions of asymmetric information other features such as wealth and collateral start playing an important role when having to determine who receives the credit. The authors build a model that depicts how a
competitive equilibrium performs in terms of equality of opportunity. It demonstrates that: (a) Richer individuals are more likely to get credit for a given aversion to effort due to larger cross subsidization in high collateral classes of borrowers; (b) Inequality of opportunity equals inefficient allocation of resources among various borrower classes; (c) Marginal borrower in classes that have more collateral efforts less than the marginal borrower in low collateral classes. For equity and efficiency reasons the authors conclude that public credit policies should be directed towards poorer classes of borrowers.