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Microfinance Services for Disadvantaged and Marginal Clientele Groups

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Executive Summary

Introduction

Today millions of poor people in developing countries have access to financial services. "Alternative financial institutions" hold about 660 million small savings and loan accounts. However, that number includes 150 million loans outstanding, a relatively small number compared to the millions that are estimated to demand small loans. This problem exists in spite of the much acclaimed microfinance revolution in which thousands of specialized microfinance institutions (MFIs) have been created specifically to serve the poor with small non-collateralized loans. This paper enumerates the successes of microfinance, reviews important constraints, and identifies several innovations to further expand the financial frontier.

Achievements of Microfinance

The key dimension of outreach is number of clients served. The specialized MFIs have demonstrated great progress in expanding the number of clients served to 94 million borrowers in 2,600 MFIs. Still, millions of potential clients are not served. Penetration rates measured as the percentage of total population with microloans range from close to zero in many countries to a high of 18 percent in Bangladesh where microlending may soon be saturated.

The sustainability of MFIs is less impressive. Most MFIs are unprofitable once subsidies are taken into account. Not surprisingly, profitable MFIs tend to grow much faster than do unprofitable ones.

The impact of microfinance is difficult to measure. On the one hand, case studies highlight the transforming power of microloans. On the other hand, carefully designed quantitative studies provide a mixed nuanced view of the possible benefits. The high drop out rates observed in some programs suggests that some clients may experience difficulties in managing debt and choose to not incur the risk of borrowing another time.

Challenges of Microfinance

Most MFIs argue that they serve the poorest, but there is little evidence to support this assertion. Many MFIs target women who are usually among the poorest in most countries, but detailed studies of loan portfolios tend to show clients are largely clustered around a country's poverty line and relatively few are very poor. MFIs also face challenges in serving agriculture and rural areas because of the high operating costs involved in reaching dispersed populations and in making small loans to farmers with risky enterprises and seasonal cash flows. Even though increased levels of competition are forcing MFIs to expand into new market niches, most tend to avoid agriculture and rural areas and instead compete for clients in densely populated urban and peri-urban areas.

Innovations to Expand the Financial Frontier

Many innovations are being introduced in the form of new products, technologies and linkages so financial institutions can further expand the financial frontier for agriculture and rural and disadvantaged clients. First, new *products* are being introduced to improve access to savings services. For example, small partial service offices are being opened in post offices and community-based organizations. Mobile banking units are used in Vietnam and Kenya. Self-help groups in India collect and manage savings accounts in banks. Lockboxes are given to clients by Rural Banks in the Philippines, and savings collectors in Ghana and Bangladesh make periodic visits to savers to pick up small deposits.

Likewise the explosion in international remittance transfers is sparking several innovations in electronic funds and alliances with specialized remittance-transfer companies. Several new insurance products are being tested. Experiments in weather-based crop insurance are underway, and livestock insurance is offered in several countries. Several life and health insurance products are also being tested.

Second, experiments with improved *technologies* are being introduced. Electronic banking is expanding through the use of information technology to deliver financial services through personal digital assistants (PDAs), automated teller machines (ATMs), debit and credit cards, point of sale (PoS) devices, and cell phones.

A third category of innovations involves the creation of *linkages, partnerships and alliances* so two or more institutions cooperate to provide financial services. The premise is that there are natural complementarities so together two institutions will be able to reduce costs and risks in ways that each would be unable to accomplish by itself.

Conclusions

The microfinance revolution has succeeded in expanding financial services to many poor people. In spite of this success, however, millions of poor people in rural areas have not been reached. Moreover, the very poor and other especially disadvantaged and marginal groups tend to be excluded. Fortunately, many innovations in products, technologies, and linkages between financial institutions are pushing out the financial frontier by lowering financial costs and risks. These changes are critical to expand outreach, ensure the profitability and sustainability of financial institutions, and improve the impact on clients. Even more effort is required, however, to further reduce interest rates so microloans become more affordable while at the same time providing adequate returns for financial institutions. This fundamental problem is increasingly a concern for many policy makers and advocates for the poor.