Microfinance Services for Disadvantaged and Marginal Clientele Groups

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Presented at the

Second World Congress on Agricultural and Rural Finance

October 31 – November 3, 2007

Bangkok, Thailand

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Introduction

Today millions of poor people in developing countries have access to financial services. The Consultative Group to Assist the Poor (CGAP) studied all types of the so-called "alternative financial institutions" that are dedicated to serving people not normally served by banks. It estimated that these institutions in 2004 held about 660 million small savings and loan accounts. However, when only loans were counted, the number of accounts fell to about 150 million loans outstanding, a relatively small number compared to the millions that were estimated to demand small loans (Christen, Rosenberg, and Jayadeva, 2004). This problem continues 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 some of the successes of microfinance, reviews important constraints to greater progress, and identifies several innovations to further expand the financial frontier.

Achievements of Microfinance

There is much good news to report about microfinance. The achievements can be summarized in terms of three important criteria: outreach, sustainability and impact (Zeller and Meyer).

The most important dimension of outreach is number of clients served. For example, the specialized MFIs have demonstrated great progress in expanding the number of clients served. A data base of 2600 MFIs studied by CGAP revealed a total of 94 million borrowers (Gonzalez and Rosenberg, 2006). Microfinance is dominated by Asia, which accounts for seven out of every eight borrowers. NGOs account for less than a quarter of the total. State-owned institutions and Indian self-help groups (mostly financed by state banks) each account for about 30 percent of the borrowers, while 15 percent are served by licensed private banks and finance companies.

In spite of the industry's rapid growth, millions of potential clients are still not served. Penetration rates measured as the percentage of total population with microloans reach only about 2.5 percent even in South Asia. Penetration rates elsewhere range from close to zero in many countries to a high of 18 percent in Bangladesh where microlending may be moving towards saturation.

Microfinance tends to be concentrated in a few MFIs. Worldwide, only 9 percent of the MFIs account for 75 percent of the total borrowers. Comparing countries, the median share of the largest single MFI in a country accounts for one third of the entire market, while the median share of the top ten MFIs is 95 percent.

The sustainability of MFIs is less impressive. The same CGAP study concluded that most MFIs are unprofitable once subsidies are taken into account. However, since many of the large MFIs are profitable, an estimated 44 percent of all microborrowers are served by profitable institutions. Not surprisingly, profitable MFIs tend to grow much faster than do unprofitable ones. Analysis of the profitable MFIs revealed that half of them broke even in just three years or less. Microlenders tend to be more profitable than commercial banks probably because it is still an immature industry not yet seriously squeezed by competition in most locations. It is also often assumed that operating costs will be lower for larger loans. But, surprisingly, there is little strong evidence to suggest there is a conflict between improving MFI sustainability and reaching poorer clients with smaller loans.

The impact of microfinance is more difficult to measure. On the one hand, the client profiles and case studies provided by NGOs highlight the transforming power of microloans for poor households. On the other hand, carefully designed quantitative impact studies provide a mixed and more nuanced view of the possible benefits (e.g. Meyer, 2007). The high drop out rates observed in some programs suggest 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. It is true many MFIs target women who are usually among the poorest in most countries. For example, the Grameen Bank has historically reported 90% or more of its clients are women. The 231 MFIs that provided detailed data to the MicroBanking Bulletin in 2005 reported an average of 63 percent women clients. The share was highest for MFIs that target poorer clients compared to those that served a broader market (MIX, 2005).

Detailed studies of the loan portfolios of several MFIs tend to show clients are largely clustered around a country's poverty line and relatively few are very poor.[1] This fact has induced some MFIs to create special "credit plus" programs targeted at the very poor. BRAC in Bangladesh has been one of the leaders in this type of special initiative and the Grameen Bank has started a program for poor beggars.[2]

MFIs also face challenges in serving agriculture and rural areas. On the one hand, many of the Asian MFIs operate in rural areas with high population densities. In addition to trading activities, they often make loans for financing livestock and poultry raising. Central American MFIs reported an average of 56% of their clients in rural areas and 15% of their clients were in agriculture or forestry (see tables 1 and 2). Even in highly rural northern Uganda, MFIs reported 40% of their loans made to agriculture (see table 3). On the other hand, the poor in rural areas represent a particularly difficult challenge even for MFIs 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 MFIs tend to avoid agriculture and rural areas and instead compete for clients in densely populated urban and peri-urban areas. This also means they tend not to serve disadvantaged ethnic groups that are often concentrated in rural and marginal areas.

Innovations to Expand the Financial Frontier

Many innovations are being introduced so financial institutions can further expand the financial frontier for agriculture and rural and disadvantaged clients. The following list includes several examples of new products, technologies and institutional linkages.[3]

First, new *products* are being introduced to better serve rural areas and marginal groups. Access to savings services is improving in a variety of ways. Small partial service offices are being opened within existing infrastructure, such as post offices and community-based organizations. Strategic alliances are being created among financial institutions in which one institution operates teller windows within the rural branches of another (e.g. FIE tellers within Pro Mujer rural branches in Bolivia). Mobile banking units are used in Vietnam and Kenya to reach rural areas. Self-help groups in India collect and manage savings accounts in banks. Lockboxes are given to clients by Rural Banks in the Philippines for use in collecting savings for periodic deposit in the banks. Savings collectors in Ghana and Bangladesh make periodic visits to the businesses and homes of savers to pick up small deposits.

The explosion in the international flow of remittances is sparking several innovations to facilitate remittance transfers. For example, the World Council of Credit Unions (WOCCU) has created a remittance network using electronic funds transfer to serve more than 40 countries and some 36 U.S. states. Competition has increased, remittance charges have dropped, and new clients have been attracted. Likewise, some MFIs are now offering remittance services through alliances with specialized remittance-transfer companies. Partnerships are also expanding. In Ecuador, Banco Solidario is offering additional products to remittance-receiving clients in partnership with a Spanish bank. They include a short-term loan to the migrant to cover urgent needs in Spain, and a dollar savings account for use by migrant's family in Ecuador or for the migrant's use upon return. Partner Spanish savings banks also offer migrants access to bank accounts and to debit and credit cards.

Several new insurance products are being tested by lenders and insurance companies to reduce the risks of lending to the poor. Experiments in weather-based crop insurance are underway in India, Mexico, and several other countries. Livestock insurance is offered in several countries for borrowers of livestock loans, either as a stand alone financial product or in partnership with local insurance agencies. Several types of life and health insurance products are being tested, especially to cover high-risk borrowers such as HIV/AIDS patients.

Second, another category of innovations involves experimenting with improved *technologies* for reducing the costs and risks of supplying financial services. 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. SafeSave in Bangladesh and several ACCION affiliates in Latin America use Palm Pilots for loan assessments and recording loan payments. In the Philippines, SMART communications uses cell phones for making financial transactions. The Hewlett-Packard Company is testing a Remote Transaction System (RTS) in Uganda. It permits cash deposits and withdrawals by MFI clients through a network of loan officers, rural branches, and/or agents. It electronically captures transaction data of clients through a point of sale (PoS) device with a card reader and a cell phone managed by an MFI agent. NABARD in India is backing a special manually operated credit card for farmers, and lines of credit have been extended to 25 million farmers for use with agricultural suppliers. Computerized credit-scoring models are also being tested by MFIs as a way to evaluate the credit risk of lending to low-income, self-employed borrowers.

A third category of innovations involves the creation of *linkages, partnerships and alliances* so that two or more institutions cooperate to provide financial services (Pagura, 2007). 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. For example, BASIX in India offers livestock insurance to its borrowers in partnership with a private general insurance company. The commercial ICICI Bank in India links with microfinance intermediaries that serve individuals and self-help groups to reach larger numbers of poor clients. Likewise, AVIVA, an international insurance company, is providing insurance services in rural areas by linking up with MFIs that have a comparative advantage in effectively servicing rural clients. In Bali Indonesia, small commercial banks called BPDs lend to non-bank village level financial institutions (LPDs) at a commercial interest rate, and the LPDs, in turn, re-lend the funds to their local clients, applying their own credit policies. In Mali, the BNDA (Banque Nationale de Développment Agricole) is the main intermediary offering financial services to networks of local microfinance institutions. The People's Credit and Finance Corporation (PCFC) in the Philippines lends long-term funds to MFIs to allow them to expand credit into new areas without having to immediately engage in savings mobilization.

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.

Table 1. Rural and Agricultural Microfinance in Central America, 2006

Country	MFIs	Clients	Portfolio (millions US)	% women	% rural
Guatemala	20	180,145	111.8	71	58
El Salvador	11	64,025	80.0	69	51
Honduras	24	163,746	100.9	69	46
Nicaragua	20	307,693	176.9	62	49
Costa Rica	21	20,000	45.0	50	65
Panama	9	11,403	12.8	41	67
Total	105	747,012	529.4	68	56

Source: "Microfinanzas en Centroamerica," REDCAMIF, Bulletin No. 6, April 2007

Table 2. Microfinance in Central America, Share (%) of Clients by Economic Activity (excluding other), Dec. 31, 2006

Country	MFIs	Ag and Forestry	Com-merce	Ser-vices	Small industry	Housing	Con-sump-tion
Guatemala	19	12.1	63.0	6.0	10.1	4.9	1.8
El Salvador	10	6.9	50.7	5.2	17.2	11.6	8.4
Honduras	24	6.2	65.0	10.6	4.7	11.4	1.8
Nicaragua	20	22.1	40.1	5.9	2.1	8.1	21.5
Costa Rica	12	33.0	29.6	21.2	6.5	1.0	1.5
Total	85	14.9	52.1	7.1	5.9	8.2	10.8

Source: "Microfinanzas en Centroamerica," REDCAMIF, Bulletin No. 6, April 2007

Annex 3. Number and Amount of Loans Made in Uganda during 2006 by Rural MFIs (regions of Lira, Nakasongola, Apac, Masindi and Amolatar)

Loan type	Number of loans during 2006	Amount lent in US$	Av. Loan US$	% of total amount lent in 2006
Agricultural Production	1,697	242,920	143	14
Farm Produce Buying	697	285,170	409	16
Farm Produce Processing	422	112,551	267	6
Agricultural Investment	35	38,850	1,110	2
Total Agriculture	2,851	679,491	238	38
Other Loans	4,328	1,066,425	246	62
Totals	7,179	1,745,916	243	100

Source: Bank of Uganda, unpublished survey data, 2007. Data obtained from 37 MFIs including companies, NGO-MFIs, and SACCOs (cooperative savings and credit societies).

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[1] The first detailed study of the poverty level of clients in the loan portfolio of several MFIs was conducted by Navajas, et. al, 2000. ACCION International has studied the poverty of clients in the portfolio of several of its affiliates. See www.accion.org.

[2] BRAC pioneered the Income Generation for Vulnerable Groups Development (IGVGD) program that provides the best documented evidence that the poorest can be bankable if provided sufficient non-financial support services. It targets destitute, rural Bangladeshi women who have few or no income-earning opportunities. Nearly a million participants have received food-grain assistance and savings and credit services over a ten-year period. Two-thirds of these women have graduated from absolute poverty to become microfinance clients, and have not slipped back into requiring government handouts (CGAP, 2001).

[3] Several ideas included in this section were discussed in greater detail in Nagarajan and Meyer (2005).