Chapter- 8  CONCLUSION

“Poor people are not a problem to overcome. Rather, they are a vital force whose productive potential must be unleashed.”

U.N.Secretary General Kofi Annan’s, Microcredit Summit

8.1 Conclusive Remarks

While not all MFIs have been successful in achieving their goals of economic sustainability while providing quality financial services to the poor, those who have been successful have done so under the umbrella of a similar framework. While both exogenous and endogenous factors affect MFI growth, sustainability, and ability to reach the poor, it can be argued that without pre-existing exogenous factors such as social capital and established societal hierarchies, the endogenous elements employed by MFIs would not be as successful as they seem to be. These pre-existing social relationships are deeply, culturally embedded in the remote, rural areas of developing countries. With this in mind, the ability of MFIs to reach and screen borrowers in these regions is much greater than it would be in less socially governed communities.

This is not to say that the endogenous aspects of MFI’s, such as lending models and interest rates, are not important. They are important, but only to the extent that they function in cooperation with pre-existing, exogenous factors. In societies where individuals feel a certain social duty to their peers, group lending models have successfully allowed MFIs to overcome numerous information barriers and transaction costs. Thus, incorporating
group lending models in the MFI framework has been a key determinant of success. However, group lending models would lose their ability to reduce transaction costs and overcome information barriers if borrowers did not have a prior knowledge of and sense of duty to their peers. In a case in which borrowers feel no sense of dedication toward their peers, or where the social costs of defaulting on loans are low, a group model would not necessarily lead to increased repayment.

Establishing interest rates which are conducive to both borrower repayment and MFI growth are also crucial in creating MFI success and sustainability. Successful MFIs must strike the proper balance between artificially high interest rates and artificially low interest rates. Repayment incentives are similarly important in MFI success in that without these incentives the risk of default on loans would be much higher. While there needs to be this incentive for repayment, MFIs need to set realistic expectations for borrowers, so as to not discourage them from taking out future loans. Structural elements of MFIs, such as employee policy and non-financial services, are important in remaining loyal to the MFI mission of providing quality financial services to the poor. Employees need to be focused upon the specific needs of poor populations in developing countries, so as to better serve their clientele. Non-financial services are the most important element in creating financial sustainability for borrowers over time. In educating and providing health care services to their clients, MFI’s help in building societies that will be able to financially support themselves in the future. Essentially, by employing the appropriate structural, endogenous elements under the guise of the necessary social conditions, MFIs will have the ability to not only sustainably provide financial services to the poor, but will also
enable poor populations to work and raise money for themselves, eventually leading to their own financial independence.

8.2 Problems / Challenges to Microfinance

The Indian government can help foster a tradition to a system of small banks providing microfinance to India’s poor by creating incentives which encourage experimentation and improvisation in handling the challenges that come with lending to the poor. Interesting policy initiatives include a system of declining subsidies to small banks committed to servicing those in poverty that would eventually end, thus forcing banks to develop methods to ensure profitability. Additionally, India’s government must charter an ever increasing amount of banks as they become increasingly more sustainable, thus fostering competition and forcing the innovation required to lend to the poor at declining interest rates. Overall, India’s challenge is an enormous one. Fostering inclusive development in a country with so many divides, including splits in religion, education, and class, is an incredible challenge that will require sweeping reforms in all areas of Indian life. Microfinance, however, is one of the only reforms that promise to empower India’s poor by making them an integral part of the economy, thus improving India’s economic outlook while ameliorating the plight of its poor. Overview of what we talked about. Importance of inclusive development, microfinance is the only way to keep current economic incentives without killing the golden goose of economic incentives. The gains from entrepreneurial growth we are allowing the poor to play the same game as the rich to enrich themselves and put the political instability to rest. I have find out following problems which restrict growth of microfinance in weaker section:
1. **Long time perspective – Permanency**

There is an increasing focus on building viable local financial systems that work for the poor, in other words a long term perspective on the permission of financial services. A short term program might have an immediate impact but in the long run, this kind of program might have negative impact for their clients, clients get used to living with financial services and organize their businesses and lives thereafter. If these services are taken away the impact for this type of clients can be severe. In addition, short form programme will almost always have repayment problems poor people as all people take advantages of the situation, cashing out their loans without paying back. It is hard to imaging a well functioning society as of today without access of financial services for the majority of the people as an intrinsic part. It is also hard to imagine an economic growth that really benefits the poor without including financial systems that works for the majority.

2. **Reaching large numbers of clients – Scale**

The notion of small is beautiful is well known in many contexts. Does this also apply to microfinance without underestimating the good work done by many small organisations it remains clear that in order to make an impact beyond the individual level, quantity matters? The relation between size, competence and operational costs indicates that smaller institutions have a bigger challenge in providing quality services at a reasonable cost in the long run. The millennium development goods (MDG) where reaching a large proportion of the poor is one of the goals, support this view.
3. Outreach

Being an alternative to the formal sector and with an overall perspective of inducing growth for the poor, dept. of outreach is questionable as an criterion for success. Having said this, there is a debate on the targeting of the poor versus the poorest, how to identify them and to what extent microfinance institutions should specifically target the poorest. One can argue that the very poorest often will not be eligible for credit, due to lack of stable income and assets one the other hand, as is further discussed below, experience shows that important shares of the client of many successful M.F. line below the absolute poverty line. In any case, we are convinced that targeting the poor without necessarily identifying the poorest provides more than enough argument for this basic tenet. When it comes to savings, another way of getting access to lump sums even the poorest are eligible clients and should be targeted by MFI.

4. Financial sustainability

This is a more controversial issue. Is it in line with principles of aid and ethical values to expect that poor people shall finance this kind of operations should we no provide these services free of charge and cover operational costs through other mechanisms are believe. That in order to assure a long term commitment in providing financial services for the poor, we need to build viable institutions in a world with limited donor funds the only way to assure this is to cut the dependency on donor and help the MFI to enter the financial market. Another strong argument is that aiming at financial sustainability also gives strong incentive to cost effectiveness. The presence of effective institutions is a cornerstone of the society.
However, aiming at financial sustainability does not exclude the need for grant and technical assistance in an initial face. However, this must be handled with wisdom. There is graving concern in many microfinance markets on the role of donor funds. For instance in two of the more mature microfinance markets, Uganda an Bolivia, established Microfinance Institutions have raised the questions in continued subsidized donor funding have adverse effects on the industry at large through providing free, or cheap funding of capital, the wrong incentives are given to the market, and this hampering the creation of viable and sustainable financial systems for the poor may be what some markets need is a close down of the non professional institutions.

5. Provision of Additional Services

The needs of the poor are many and even though access to financial services can make a significant difference for the livelihood, it does not pretend to meet all the needs. Many MFI have seen the need for improvements in education and health services to mention the most common areas, for their clients.

Generally, there are two main approaches to this, the parallel and the integrated approach. In the former case, the additional services are provided externally, either from another department within the MFI or from a partner organisation. In the latter, the same staff providing financial services will also take care of the add ones.

Regarding the integrated approach the main benefit seems to be lower costs by using already existing staff in providing the additional services and exploiting already established relationship with the clients. However the
optional downside is considerable seen from the MFI’s side one risks losing quality on both services, the additional service implies extra costs that might be tricky to might also risk internal conflicts within the staff when it comes to prioritizing financial services versus the add – on service.

For the client (compulsion) additional services might easily be seen adding costs, live for instance spending more at group meetings, to the credit in a competitive market, all products that are not in demand will necessarily be withdrawn from the moment in the long run.

Another crucial point is that many potential founders of MFI are critical to organisations were the division between micro finance and other projects is not clean one fear that funds provided for M.F. are financing other activities and thereby threatening the performance of the M.F.I still as an example from RECER in bolo via with education as an additional service shows the integrated approach can be successful. This is an example of a direct positive spillover effect between credit and the additional service.

The advantages of a parallel provision are several. By using specialized staff it is easier to maintain a high quality of all the services linking up to other organisations does not imply any limit to the number of services that can be provided on the negative side, it is likely that total operational costs will be higher with this setup. Both BRAC in Bangladesh and promujer in Bolivia provide additional services from other staff within the same organisation and rely on income other than financial margin to comer operational costs on these cross subsidizing from the Microfinance programme can cover for parts of the expenses, but it is likely that additional funding will be required in the vast majority of the cases also in the future.
The poor does not live on credits loan, access to other services is important for the poor and is positively related to the performance of the MFI. A healthy person having a job is more capable of meeting the down payments than an unemployed sick one. As the discussion above indicates the best way of assuring permanent provision of high quality services is to clearly separate Microfinance from other services, either within the same organisation or through strategic partnership.

An improved rural financial system is needed for efficient rural financial intermediation to serve the rural population effectively. Efficiency is one of the most important criteria for a rural financial model, be it cooperative, commercial, or informal finance. For example, if the government insists on the so-called cooperative system and requires RCCs to make all loans locally, we may end up with NPLs as large as two thirds of loan amount. On the other hand, if the government requires that only 50% of RCC loan amount be allocated locally, RCCs may be able to sustain themselves commercially. If commercial operation is allowed, 50% of the deposits from rural areas can be used locally, the support for rural areas will be much stronger, and local governments can hen be freed from “paying” for NPLs made by commercial institutions. Therefore, the guiding principles of rural finance reform are to open the rural financial markets and encourage various forms of financial institutions to compete on a level playing field. This should also be the major difference between this round of reform and the previous ones.

Rural financial markets in Gujarat province have tremendous potential. First, the province has a large number of migrant workers, and their remittances are an inexhaustible source of funds for financial institutions. Second, with
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appropriate mechanisms, reforms in the near future will retain part or all of postal savings. Third, Gujarat has become an integral part of the national economic system over the past 20 years, and regional division of labor is emerging. If it can take the initiative, the province will be able to catch and create opportunities. Fourth, financial institutions have tremendous potential for innovation. Various types of credit guarantee and risk sharing arrangements such as microfinance, and group guarantees will greatly enhance credit quality. Financial institutions can be profitable if the financial markets open up, if fair competition is allowed, and if exit mechanisms are available for under-performing institutions. Fifth, the withdrawal of SOCBs from rural areas has provided a large platform for the development of grassroots financial institutions. Sixth, PBC is adjusting on-lending to the central and western regions under the fixed total volume of loans supporting agriculture. Lastly, some RCCs are making innovations with support from local governments in an effort to reduce credit risks. Some RCCs have also made good efforts to meet the credit demands of specialized agriculture as the incomes of the rural households engaged in agricultural industrialization are much higher than those of other households. New mechanisms must be designed to curb the present outflow of human and financial resources from poverty-stricken areas. Such mechanisms should enable RCCs to make profits on loans to rural households and to achieve economies of scale while satisfying local demand for financial services. However, it is not desirable to have a mechanism that only sustains RCCs but that does not satisfy local needs and creates a vicious cycle of low levels of economic development, low per capita incomes, low savings rates, low investment levels, and a lack of dynamic for development. Financial institutions in poverty-stricken areas
need preferential policy and capital support, but more importantly, they need efficient mechanisms. Rural financial reform requires systemic efforts; concentrating only on RCC reform cannot succeed.

8.3 Commercialization of Microfinance

During the past twenty years, microfinance programs have been introduced in many developing economies. Well-known examples of microfinance institutions include Grameen Bank, ASA and BRAC in Bangladesh, Banco Sol in Bolivia and Bank Rakyat in Indonesia. Between December 1997 and December 2007, the number of people who received credit from microfinance institutions (MFIs) rose from 16.5 to 154.8 million. The number of poorest clients reported increased from 9 million to more than 106 million during this period (Armendariz and Morduch, 2010).

The enormous increase in microfinance programs was an immediate response to the public image that microfinance is about profitable lending to small groups of extremely poor women who benefit strongly from access to credit. In many conversations on microfinance it has been argued that the microfinance industry would be able to offer a combination of financial returns and positive social impact. Hence, the idea that MFIs were able to achieve a so-called double bottom line received considerable support.

Attention to microfinance and its potential role in reducing poverty increased even further when Mohammad Yunus received the Nobel Peace Prize in 2006, prompting an almost euphoric attitude among policy makers and aid organizations about its potential promise. However, several recent developments challenge the extremely positive view on microfinance.
Empirical testing of the impact of microcredit appears to be very difficult and controversial (see, for instance, Armendariz and Morduch, 2010, chapter 9). Fortunately, in the last few years, several new empirical analyses on the impact of microcredit have been started, using superior methodologies, often based on so-called randomized controlled trials. Well-known examples include Karlan and Zinman (2009), who study the impact of microcredit on investment in Manila, the Philippines, and Banerjee et al. (2009), who focus on MFIs in the slums of Hyderabad. These studies show mixed results. Most importantly, the studies were not able to find strong positive effects of microfinance. Another recent study, by Roodman and Morduch (2009), who attempt to replicate the well-known study by Pitt and Khandker (1998) on the impact of microfinance in Bangladesh, also could not provide evidence for a positive impact of microfinance. Bateman (2010) even is much more negative by arguing that microfinance constitutes a main obstacle to sustainable development. He e.g. states that the neoliberal microfinance wave mainly resulted in the financing of unproductive small enterprises, at the expense of the most productive SME sector.

Moreover, recently the practices of MFIs are subject to growing ethical concerns (Hudon and Sandberg, 2012). MFIs have been criticized for their lending practices that led to over indebted clients. The southern Indian state of Andhra Pradesh even plunged into a microcredit crisis after the microfinance-induced suicides in 2010. Branches of several large MFIs in Ecuador, India and Nicaragua have been closed by the authorities. The Nobel laureate Muhammad Yunus was even accused of stealing 100 million USD from the Grameen Bank. In addition, the past decade has seen the
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commercialization of microfinance. As a result of commercialization, MFIs have increased the interest rates. It is now common to see interest rates above 50% on a yearly basis. The high rates of interest charged on microloans resulted in one of the most salient ethical debates with respect to microcredit (for a discussion of fair interest rates, see e.g. Hudson, 2007 and Hudson and Sandberg, 2011).

Commercial banks now play increasing roles in funding microfinance institutions and help expand the traditional services offered by MFIs. Whereas once they focused only on microcredit, in the form of small loans to the poor, today they have shifted from microcredit to microfinance, including savings, and insurance. The funding situation of MFIs also has started to change rapidly. Whereas once they relied mainly on private and public donors and aid organizations, more and more MFIs turn to the capital market for funding.

Some argue that the commercialization of microfinance is a blessing since it both improves MFI performance and the availability of funds for the poor. Others, such as Bateman (2010), state that the commercialization of microfinance will even accelerate the negative impacts of microfinance. Critics fear that the commercialization will encourage MFIs to put shareholders above the poor they serve. Moreover, the commercialization may lead to a mission drift, such that MFIs start to concentrate on richer clients, and reduce or even stop lending to the poorest of the poor. This also raises ethical concerns since in the microfinance literature there is a discussion whether there is a human right to credit (see e.g. Hudon, 2009).
This literature argues that extreme poverty is a violation of human rights, and that microcredit may help to alleviate poverty.

**Recent developments**

Traditionally MFIs have been funded mainly by subsidies from private and public donors and aid organizations (for references on subsidies in microfinance, see Chapter 10 in Armendáriz and Morduch, 2010). Several MFIs also attract savings from their members. However, about ten years ago, microfinance started to become more commercial, and this commercialization is increasing very strongly. In the literature, commercialization refers to either the attempt of MFIs to operate without subsidies, or to the broader process of applying market-based principles (Armendáriz and Morduch, 2010). In this paper, we use the term commercialization in the broadest sense. Mainstream financial institutions, including commercial banks and private and institutional investors; appear more and more interested in the microfinance market. So-called social investors, who value the social, as well as financial, performance of their investments, have started to invest. In the course of the global financial crisis, pension funds also display increasing interest in microfinance, in the search for innovative investment opportunities with low co-variant risk and higher social returns. In the Netherlands for instance, the retail bank SNS launched the Institutional Microfinance Fund, almost entirely funded by Dutch pension funds.

In several developing countries large state banks and private banks have started to provide microfinance services. In Pakistan, for instance, a number of private commercial banks have moved into microfinance. In Malaysia,
Nepal, and Thailand there are programs stimulating commercial banks to become involved in microfinance. In India the National Bank of Agriculture and Rural Development (NABARD) recently initiated a program to involve private banks in microfinance. According to recent studies the growth of microfinance in India is led by a number of commercial banks such as ICICI, HSBC and ABN AMRO, together with private venture capital funds and social venture capitalists.

There is also an increase in MFIs for which capital market funding becomes important. The first example of commercial capitalization of MFIs was the creation of an investment fund called Profound, which raised $23 million to finance Latin American MFIs. Some microfinance institutions have even gone public, and became commercial banks. The most well-known example is Compartamos in Mexico. Compartamos started in 1990 as a standard MFI by providing joint-liability loans to female borrowers. In 1998 Compartamos became a regulated financial institution, a so-called Sociedad Financier de Objeto Limitado (SFOL). In 2002 Compartamos, as one of the first MFIs, issued public debt. In April 2007 Compartamos went public and transformed itself into a commercial bank. Another example is SKS microfinance in India. SKS microfinance recently went public, with an initial public offering (IPO) of $354 million. In the last two years, 40% of all private equity deals in India are due to MFIs.

Currently, approximately 50 percent of the funding of foreign capital to MFIs is channeled through specialized Microfinance Investment Vehicles (MIVs). The number of MIVs has increased rapidly and there are now over 80 in
existence MIVs. The main investors in MIVs are individual investors, among others pension funds (for a discussion, see e.g. Galema, Lensink and Spierdijk, 2011).

MFIs that traditionally have focused on providing microcredit to the poor in the informal sector also have started to recognize that savings and insurance products can be even more important than providing loans. Diversification represents an essential step in the development of microfinance. As a result of this shift toward microfinance, MFIs now collect savings, and provide insurance products. Especially life insurance is a popular product. Mostly, life insurance is offered as part of a microcredit package, in the form of credit-life contracts. These contracts ensure that, if somebody dies, the outstanding loans will be paid off and a fixed payout will be provided to the family. In addition to life insurance products, MFIs start to develop health insurance plans as well as property and crop insurance. Micro finance institutions even have begun experimenting with pension schemes. These micro pensions focus on long-term savings, with the aim of providing income security to the aged poor who have worked in the informal sector and are not covered by formal retirement schemes. The well-known Grameen Bank in Bangladesh, for instance, introduced the Grameen Pension Scheme (GPS) in 2001. Several other MFIs and non-governmental organizations (NGOs), including the Dhan Foundation in India and BRAC in Bangladesh, are now developing micro pension products for their clients. With their close connections and regular meetings with low-income workers in the unorganized sector, MFIs could be ideal financial institutions to channel micro pension products to the poor in informal sectors.
In addition, new banking technology, such as charge cards, ATMs, the use of cell phones and the internet has begun to enter the microfinance business, helping to reduce costs and improve the delivery of services. Finally, in many developing countries, induced by the commercialization of microfinance, and the increased role for micro savings products, governments started installing regulations to help improving the stability of the microfinance business.

**Commercialization: A Discussion**

The commercialization of microfinance has led to severe discussions and ethical debates among academics. These discussions focus on (1) why are international investors investing in MFIs? Are MFIs interesting investment opportunities?, (2) What does commercialization and the focus on efficiency imply for outreach? Is the double bottom line in microfinance a utopia? And (3) what are the implications for the interest rates? I will briefly discuss these issues below.

Investing in microfinance may be interesting for international private investors for several reasons. First, there is an increased attention for social responsible entrepreneurship. Microfinance could be an interesting alternative for private investors who, for altruistic motives, want to contribute to the fight against poverty. By directly targeting the poor, and therefore circumventing inefficient/corrupt government structures, micro lending could be an efficient means of doing well. However, as I have argued above, there is little empirical evidence for a huge poverty reducing effect of microfinance. Moreover, commercial banks may try to use subsidized loans
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to the poor as an instrument to enlarge their future profit making portfolio, based on the assumption that lending to these poor will make them more wealthy clients in the future, who can afford paying market-based interest rates. Second, the potential size of the microfinance market is still very big. There are currently up to 3 billion people without access to proper financial services. There are also an estimated 500 million micro-entrepreneurs worldwide. Thus, there is a largely untapped source of microcredits for international investment banks that can be pooled together and sold to investors all around the world. Third, micro lending probably gives higher returns than traditional lending. Typically, a poor farmer or entrepreneur in the developing world generates much higher returns on her assets than corresponding business in the developed world. Thus, as is argued by some, many poor can afford to pay much higher lending rates. Some empirical evidence indeed suggests that interest rates can be much higher for lending to the poor. For instance, moneylenders in developing countries ask sometimes daily interest rates of 20% (which is more than 5000% a year!). Fourth, default rates in microfinance are said to be low. The empirical literature on microfinance lending indeed suggests that default rates in microfinance are very low, often below five percent. These low default rates are in part caused by innovative MFI lending techniques, such as group lending, dynamic incentives, and obligatory weekly repayments. The low default rates, in combination with high lending rates, imply a high risk-adjusted rate. However, there is also some evidence that default figures are deflated. Moreover, MFIs are heavily subsidized and the credit quality of average borrowers could fall if the client base is widened due to the commercialisation. Finally, microfinance also may provide attractive
opportunities for portfolio diversification, because the risk-adjusted returns likely exhibit low correlations with other assets; that is, many microfinance clients are part of the informal economy, which is less sensitive to macroeconomic cycles.

The common assumption of reduced exposure of MFIs to financial and economic market movements (e.g. Hermes and Meesters, 2009; Hermes, Lensink and Meesters, 2010) rests on several features, including (1) the minimal integration into the formal sector of business activities undertaken by microfinance clients; (2) high incentives and great loyalty among microfinance borrowers, which prompt them to repay their loans; (3) the reliance of MFIs on highly dedicated, socially oriented funding sources, which tend to be less affiliated with business cycles and can provide MFIs with continuous access to funding (Walter and Krauss, 2009); (4) a combination of short maturities of outstanding loans and long maturities of MFI funding, which leaves significant room to adjust outstanding loan portfolios in times of tight liquidity (JP Morgan, 2009); and (5) relatively low fixed costs for both clients’ businesses and MFIs, which support quick adjustments to changing market conditions.

Surprisingly little research undertakes rigorous testing of the assumption that microfinance provides attractive opportunities for portfolio diversification. Some studies support this common assumption about reduced exposure to fluctuations in international markets (Galema, Lensink and Spierdijk, 2011; Walter and Krauss, 2009) and domestic macroeconomic markets (Gonzalez, 2007). Galema, Lensink and Spierdijk (2011) examine the benefits of
investing in MFIs. They show that it can indeed provide risk-return benefits for institutional investors. However, they also show that the returns depend heavily on the location of and type of MFI. Not surprisingly, their analysis suggests that investing in more commercialised MFIs may be beneficial, but investing in more traditional MFIs and those in Africa do not provide effective risk–return benefits. Others, however, reject the claim that microfinance is resilient to macroeconomic developments and find a significant relationship between MFI performance and domestic economic growth (Ahlin, 2006; Hermes and Meesters, 2009).

Although the literature is not entirely unambiguous, it seems as if investing in microfinance induced by the commercialization of microfinance may be interesting for international investors. However, some hurdles need to be taken. Most mainstream investors deal with regulated entities that work in a clearly defined legal environment. This implies that MFIs needs to be transformed from NGOs with weak corporate governance into regulated banks. Moreover, the macro policy and government regulations have to be adapted to accommodate commercial micro lending. In addition, if international capital markets are to be tapped on a larger scale, the MFI investors have to be able to hedge the foreign exchange risk that appears when they borrow/lend in a foreign currency. However, MFIs are often in countries were there are no possibilities to reduce exchange rate risk since often the currencies are not convertible. Finally, lending on subsidized terms may lead to crowding out of commercial lending.
There is also a discussion on the impact of commercialization on outreach. Some argue that commercial microfinance, or the for-profit side of the microfinance sector, is necessary to increase funding for MFIs. In most developing countries there is still a huge amount of potential borrowers with no access to financial services. Only in India, there are some 120 million families without access to financial services. The microfinance sector needs to scale up in order to meet this additional demand. Hence, commercialization seems to be needed. Clearly, a possible advantage of the move of commercial banks into microfinance is that these banks can provide credit to the poor, without being dependent on donor subsidies. Commercial banks have diversified portfolios, and are able to use profits from lending to wealthy clients to finance (subsidized) loans to the poor, i.e. cross-subsidization would take place. Hence, commercialisation may increase the availability of funds and therefore may improve outreach. Moreover, the commercialisation may lead to more loans with longer maturities and more diversified funding sources.

However, there are also some concerns. Bateman (2010) is extremely pessimistic about commercialization of microfinance. In his view, the commercialization goes together with “a whole host of anti-social and anti-poor developments” (Bateman, 2010, p.153). A potential disadvantage of the increased involvement of commercial banks is that traditional microfinance institutions are confronted with increased competition in the market for micro loans. While increased competition may lead to increased efficiency and stimulate financial sustainability, it may also reduce the scope for lending to the core poor. Moreover, increased competition and increased supply of loans
may result in higher levels of indebtedness of the clients as they may take up multiple loans from different sources at the same time. The commercialization may also lead to a strong increase in interest rates of MFIs, which even further increases indebtedness of the clients. As I have stated before, the possible increase in interest rates raised salient ethical discussions. Indeed, due to the commercialization MFIs have increased the interest rates. It is now common to see interest rates far above 50% on a yearly basis. Some may argue that high interest are not problematic since the poor are mainly interested in access to credit, and even with high interest rates they are able to make profitable investments since marginal returns of scarce capital are very high. However, is this true? Already for decades, economists debate whether interest rates should be subsidized or whether the poor can afford high interest rates. In the 1950s and 1960s, most economists argued that poor people cannot afford to pay high interest rates and therefore need cheap capital to adopt profitable investments. Consequently, many subsidized credit programs were developed. These policies came under attack during the 1970s. It was pointed out that offering “cheap credit” is a wasteful way of encouraging (agricultural) development. Cheap credit would lead to unproductive use of credit, create opportunities for corruption and favoritism, and results in discrimination against the poor since typically the better-off farmers receive the cheap credit. Moreover, low interest rates would discourage savings. Yet, the most recent empirical literature does not support the idea that the poor do not care about high interest rates. From the wider economic literature, especially on health inputs, we can learn that demand of the poor is extremely price elastic (Cohen and Dupas, 2010). More importantly, recent studies based on randomized controlled trials show that
the demand for credit by the poor is also extremely price elastic, even more than that of the not-so-poor (Dehejia, ET AL., 2011 AND Karlan and Zinnman, 2008). Hence, while high interest rates are good for profits of the MFIs, they seem to be bad for the poor.

Some even argue that microfinance is the new subprime, especially after recent stories about loan-shark-style micro financiers who have driven borrowers to suicide in the Indian state of Andhra Pradesh. There is not much serious research available on the effect of competition among microfinance institutions. An exception is a study by McIntosh, De Janvry and Sadoulet (2005). These authors suggest that wealthier borrowers are likely to benefit from increasing competition among microfinance institutions, while poorer borrowers will suffer in terms of lower levels of welfare. In addition, commercialization and the related emphasis on financial sustainability has raised concerns with respect to the consequences for the outreach of microfinance, i.e. the number (breadth) and socioeconomic level (depth) of the clients that are served by MFIs. Since lending to poor borrowers can be very costly, outreach and sustainability may be conflicting. Cull, Demirgüç-Kunt and Morduch (2007) provide some evidence for a trade-off between sustainability and outreach. They also suggest that individual-based MFIs increasingly focus on wealthier clients, a process termed as mission drift. This may imply that the possible positive effect of commercialisation in terms of an increase in loans with longer maturities that are available for the poor (see above) will be counteracted. Hermes, Lensink and Meesters (2011) also provide evidence on the existence of the trade-off between sustainability and outreach. Their study strongly suggests that outreach is negatively related
to efficiency of MFIs. This may be bad news in view of the current move to commercialization of the microfinance industry since commercialization probably induces a stronger emphasis on efficiency. However, it may also be the case that, due to spill-over effects, MFIs that strive for efficiency, and score low on outreach to the poor, may ultimately cause a higher poverty reduction at the macro level than MFIs that score high on outreach indicators.

The commercialization of microfinance has clearly invited a strong debate among microfinance practitioners and academics. Some point at positive effects, others are much more skeptical. The main problem is that both views are not yet backed by serious academic studies. There are some recent studies available, which suggests that there probably is a trade-off between commercialization and outreach to the poor. However, most discussions on the advantages and disadvantages of commercialization of microfinance are based on anecdotal evidence. More research is needed before the commercialization of microfinance can be validated.

8.4 Examples of Recent Innovations in Microfinance

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. 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. In its infancy
stage, the credit unions have noted an interest from agriculture-based clients in such a savings management program.

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 sanctioned loan amount in as many as three instalments.

3. **Prodem in Bolivia** has introduced a combination of biometric fingerprint and Smart Cards to deliver financial services to its clients. Biometric technology measures an individual's unique physical or behavioral characteristics, such as fingerprints, facial characteristics, voice pattern, and gait, to recognize and confirm identity. Although the technology is still new, growing awareness of the importance of data security is increasing adoption steadily. Prodem's fingerprint verification has reduced fraud, error, and repudiation of transactions. Staff had not had to deal with forgotten PIN numbers or unauthorized use of cards and accounts so they 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, expanding the possibilities for sending 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 an interest-bearing voluntary savings account.

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 because 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.

6. **Managed ASCAs:** A number of local organisations in the Nyeri District of Kenya provide management services to group-based loan funds. The groups operate as Accumulating Savings and Credit Associations (ASCAs) and receive management services provided by ASCA Management Agencies (AMAs). The AMA model serves a wider 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 strata, 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.

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 uses 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 nurtures the expanded use of the credit bureau by rural banks, which was started in 2001 to minimize client over indebtedness and defaults. MABS has helped to integrate the rural banks' microenterprise loan clients into an existing national credit bureau, by creating an e-mail encryption program that allows rural banks to share information electronically at a low cost.

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

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 soundness. 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.

11. **The National Microfinance Bank in Tanzania (NMB)** was created to retain the extensive rural branch network of the National Bank of Commerce (NBC) when it was privatized in 1997. The key to making it commercially
viable has been rigorous control of costs through drastic simplification of the business model and tight managerial oversight. Key initiatives have been correct 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.

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 days. Expenses for paperwork dropped by 60% and data entry expenses dropped by 50%. Loan officer caseloads and other productivity measures increased by about 35%.

13. **The international NGO Techno serve** 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 all of their 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, which serves as collateral. This loan permits them to clear their accumulated debts and satisfy immediate cash requirements. Then, when prices have risen in the off-season, the farmers either sell the stored crop or redeem it for home consumption.
14. **Savings-based, Agriculture-oriented Rural Credit Unions - SICREDI - 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 balloon 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.

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 on-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.

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 potential of this
vast infrastructure to offer pensioners other kinds of financial services is tremendous.

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.

**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 also sell stationery and newspaper and act as 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.

18. **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.