Lessons for the Involvement of European Development Banks and other IFIs in Microfinance Institutions: The Case Studies of Grameen Bank, BancoSol and ProCredit Bosnia & Herzegovina

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Abstract

Microfinance, handing out small loans to those who cannot supply collateral, has become an immensely popular concept over the past years, even resulting in somewhat of a hype on the subject in the media. This thesis takes a look at three successful microfinance institutions (MFIs) to derive some implications for the microfinance policies of European development banks and other international financial institutions (IFIs).

The academic literature about the three case studies, Grameen Bank from Bangladesh, BancoSol from Bolivia, and ProCredit Bank Bosnia and Herzegovina, is mostly from the late 1990s (in the case of the first two) or barely existent (ProCredit). For this reason, it is useful to use the existing literature as a basis and take a fresh look at these three microfinance banks.

In this thesis, after a short introduction, a light is shed on four aspects of each of the three banks: its origins and its early growth, its current ownership structure, its lending technology and its development impact. Then, in section 2.4, the main differences between the three cases are examined. To extend this comparison to a setting that is closer to a scientific experiment, financial data on BancoSol and the Bolivian ProCredit bank, Banco Los Andes, are put next to each other to see what effect their respective lending technologies have on financial performance and the development impact. In the discussion section, the findings from the case studies are used to consider the different aspects of MFIs that European development banks and other international financial institutions have to take into account when supporting banks in the microfinance sector. The findings are that while microfinance has some significant weaknesses, it brings benefits both to underprivileged populations in developing and transition economies and to the financial sector of those countries. Therefore, it is a good idea for European donors (like the EBRD, the Dutch FMO or the German KfW) to continue supporting them, especially because well-running MFIs usually make a profit and the initial investment can thus be earned back. Effective support usually comes in three forms: technical assistance and the supply of starting capital through equity participation and soft loans. Any involvement should be organised with an exit strategy in mind: either to pull out if the MFI is unsuccessful (this is to be avoided of course) or to cease involvement once the MFI is commercially viable and able to function on its own. In practice, this means limiting technical assistance to a certain period, putting a ceiling on the volume of soft loans, and selling shares to commercial parties when they are interested and committed to the microfinance orientation of the MFI.

Keywords: microfinance, MFIs, Grameen Bank, BancoSol, ProCredit Bosnia and Herzegovina, developing and transition economies, European development banks, microcredit, international financial institutions, IFIs, EBRD, FMO, KfW, IFC
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1. Introduction

Over the past few years, microfinance has become an immensely popular concept. The UN declared 2005 the International Year of Microcredit, and in 2006 Muhammad Yunus, the founder of the famous Grameen Bank, received the Nobel Peace Prize for the bank’s poverty-reducing accomplishments. This thesis deals with the concept in a broad manner to determine which points are important for European donors to consider when involved in microfinance.

The principle of microfinance is quite simple: giving access to credit to those who are being ignored by the traditional banking sector. In developing and transition economies, there is a lot of entrepreneurial potential that cannot unfold because microentrepreneurs often lack even the tiny starting capital they would need to get their business going. Traditional banks in these countries are not willing to lend them any money without collateral, which they cannot provide. This is where microfinance institutions (or MFIs) enter the arena: they use special non-collateral lending technologies tailored to the specific characteristics of their borrowers from the Micro- and Small Enterprise (MSE) sector. The (often very poor) microentrepreneurs thus get a loan to finance the start-up or expansion of their small business and thereby are given the opportunity to improve their situation significantly by generating income for themselves.

The first institutions that used microfinance as a concept started their activities independently of one another at around the same time, around 1973-74, in two places: in Brazil, the American NGO ACCIÓN started giving small loans to villagers using group lending as a way to solve the lack of collateral among the poor, and in Bangladesh Muhammad Yunus did something similar with what would become the Grameen Bank. Grameen Bank became the world’s most famous microcredit NGO and is the subject of the first case study in this thesis, and ACCIÓN would later be involved in the founding of PRODEM, the precursor of BancoSol, our second case study.

The idea of microfinance then spread and developed quite rapidly, drawing major attention from scholars in the 1990s. Popular media also started to pick it up, with coverage increasing considerably in 2005, the Year of Microcredit, and 2006, when
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Yunus got the Nobel Prize. Microfinance became an immensely popular concept, seen by many as a sort of cure-all against poverty. The fascination is easily explainable: the idea is giving people money to help them escape poverty, and getting it back later with interest! There lies a certain danger in this media-hype, however: while microfinance is a useful means to reduce poverty among certain groups and is good for the development of the financial sector in developing and transition countries, it is just one means among several and certainly not a panacea. If expectations become too high and are not met, there may be a negative backlash for the sector.

Donors have been involved in microcredit from the start: in fact, at the beginning almost all microfinance institutions were NGOs themselves. In the early 1990s, profitable MFIs started to appear, and after some time profitability became a prime objective for MFIs and their donors. Today, development banks (such as the European Bank for Reconstruction and development – EBRD, the Dutch FMO, and the German KfW Group) and international financial institutions or IFIs (such as the International Finance Corporation – IFC) usually support microfinance providers in their initial development through technical assistance, equity and soft loans.

Given the substantial amounts of money that flow to MFIs through institutions from Europe, be they at a European or a national level, it seems like a good idea to take a look at how MFIs function. This thesis aims to analyse three famous and successful microcredit banks: Grameen Bank, BancoSol and ProCredit.

Section 2 gives a detailed overview over the three case studies, considering their history, ownership structure, lending technology and development impact. It then continues with a comparison of the three banks and looks closer at how BancoSol performs in comparison with another bank on the Bolivian market, Banco Los Andes, belonging to the ProCredit network. In Section 3, a number of considerations about the findings of Section 2 are discussed according to their relevance for European development banks and IFIs. Section 4 concludes.
2. Case Studies

This section, the core of the thesis, takes a close look at what are probably the three most famous microfinance providers in the world: Grameen Bank from Bangladesh, practically the first large MFI and the best-known example for a charitable MFI; BancoSol from Bolivia, the first NGO to become a full-blown commercial bank; and ProCredit, a successful network of microfinance banks, with the first microfinance bank that it set up from scratch in Bosnia and Herzegovina. The three case studies are then compared in another subsection to see where they are similar and where they differ. To overcome the problems with country-specific factors in comparing case studies from different parts of the world, the section concludes with a detailed comparison of BancoSol and its ProCredit competitor in Bolivia, Banco Los Andes.

2.1 Charitable beginnings: Grameen Bank in Bangladesh

For many, the first association that comes to mind when the word microfinance is mentioned is Muhammad Yunus and the MFI that he founded, Grameen Bank (“bank of the village”). This is due to the fact that Yunus and the bank received the Nobel Peace Prize 2006 “for their efforts to create economic and social development from below”\(^1\). The bank is not only praised, however: it is the subject of a lot of criticism as well.

**Origins and growth**

Yunus, an economics professor educated in the U.S., started lending money from his own pocket to poor Bangladeshi villagers in the early 1970s, around the same time that Acción International was experimenting with microcredit in Brazil. During a field trip in the countryside, he found that many villagers were dependent on credit from informal lenders charging very high interest rates: around 110% per year on average (but it could even be higher, depending on the case\(^2\)). He thus started lending them small amounts of money from his own pocket and thereby helped them to improve their living standards.

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by becoming microentrepreneurs. After seeing how the villagers (mainly women) had used his money to get ahead, he decided to expand the project, resisting objections from traditional banks and even the government of Bangladesh. These objections were mainly based on the classical opinion in banking that lending without collateral is not tenable, a general inclination in the Muslim society of Bangladesh not to trust women with money, and underestimation of the poor by the government.3

The government would change its policy towards Grameen a few years later, with the Agricultural Bank and the Central Bank of Bangladesh supporting the project. Grameen experienced strong growth, and in 1983 it became a bank according to Bangladeshi law, owned by the government.4

Grameen Bank’s primary support at the beginning came from Bangladeshi government bodies, Western government donors, and NGOs from the developed world. In the 1980s and 1990s, the bank continued to grow at an immense speed, with the outstanding loan portfolio increasing more than 30-fold between 1985 and 1995.5

Figure 1: Growth of Grameen Bank in terms of loans outstanding and number of members, 1983-2005

Figure 1 shows Grameen’s growth performance from the year it got its bank charter. In this case, the number of bank members can be seen as a proxy for the number of active clients. Unfortunately, the bank’s website does not give us exact numbers on the latter.

4 Schicks (2007), p. 555
5 Morduch (1999a), Table 2, p. 237
Using the number of members is somewhat problematic because many among them may not have a loan at Grameen at present. On the other hand, some borrowers have not become members of the bank because their groups have not yet been able to save a sufficient amount of money to automatically become a member. In any case, the number of people reached by Grameen is substantial (even in the case that only, say, half of the members are actually borrowers): as we can see, the bank had over 5.5 million members in 2005.

As for the evolution of the bank’s size, we see that there was rapid growth in the first ten years, that the mid-1990s were a period of relative stability, and that the portfolio outstanding decreased at the end of that decade. A period of very rapid growth started in 2002.

2002 was also the year that the bank introduced “Grameen Bank II”, a reform of its lending policies. The background was an increase in arrears rates since 1995\(^7\), when large numbers of borrowers, in protest against a rule that borrowers leaving their groups could not retrieve the amount they had paid into the group fund, started boycotting their group meetings and refused to make their payments. This repayment problem became a crisis in 1998, when an enormous flood put more than half of the country underwater; because of the calamity, many borrowers saw their livelihood destroyed and naturally were not able to repay their loans. The Grameen leadership then determined that it was time for an overhaul in the bank’s loan regulations. The controversial group fund was scrapped, and borrowing became more flexible: shorter term loans became possible, and some delays in repayment without being marked as a defaulter were allowed through the possibility to renegotiate loans. Although praised by Grameen bank sources, the results of this flexibilisation since 2002 cannot really be seen in the few debt indicators for which Grameen offers annual data\(^8\): bad debt tripled in the three years following the introduction of Grameen II (from $ 9.41 million in 2002 to 30.4 in 2005), only to decrease a little in 2006. Bad-debt recovery rates grew slightly until they made a steep jump in 2005.

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\(^7\) Yunus (2002)

In 1995, Grameen stated it wanted to get independent of donor funds, raising commercial funds and using client’s deposits. This was partly to shake off the policy prescriptions imposed by donors in exchange for funds (such as requirements for more transparency). Today, there is some controversy over the question if Grameen is really independent of donors or not. Morduch (1999a), in a thorough analysis of the bank’s financial data, determines that it is still highly dependent on indirect subsidies in the form of grants for training programmes, R&D, and areas of particular interest to donors⁹ (e.g. women’s emancipation), and soft loans. It is also exempt from taxes¹⁰.

At the same time, the bank is very keen on showing to the world that it makes a profit. In fact, as it is pointed out by several sources¹¹, Grameen insists so much on this point that it sometimes uses tricks in its accounts that would not be allowed under conventional accounting standards. For instance, Schicks (2007) points out that the bank counts only loans that have been overdue for more than a year as such. Normally, even a single day of arrears should be accounted for. Also, the bank’s loan loss provisions are far smaller than what is customary (and mandatory) at conventional commercial banks, and subsidies and grants are counted as income when profits are being calculated. In any case, there is a consensus in the literature that Grameen Bank is not a self-sustainable MFI.

Another example of Grameen stretching the numbers is repayment rates. Grameen has always reported very high rates of repayment (98% in 1995¹², and currently even 99% according to the 2005 annual report), as this is a very good way to claim commercial success. Morduch (1999a) identifies the most important trick used to keep the repayment rate high: for simplicity, Grameen determines two overdue rates, one as a percentage of loans outstanding that have not been paid for a year and another one where the period is two years. The percentage is calculated by dividing the amount overdue (for more than one or two years) by the current loan portfolio. It is clear that this is problematic: when the loan portfolio grows rapidly (as certainly has been the case of Grameen in the past), the amount of loans overdue shrinks also shrinks very rapidly in relative terms. Using this method, in the extreme case that the loan portfolio doubles...

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⁹ Morduch (1999a), p. 238
¹⁰ Grameen Bank Annual Report 2005, p. 54
¹² Morduch (1999a), p. 231
from one year to the other, the percentage overdue is only half of what it would have been if it had been calculated in the year that it actually became overdue. The distortion becomes even more severe if we count loans that have been overdue for more than two years. While there are good arguments for waiting with declaring a loan overdue (after all, borrowers might very well become able to pay after a few months delay), this is no reason to use a method that results in distortions: the amount overdue should be looked at in retrospect, combining it with the loan portfolio at the moment when it became overdue. This is exactly what Morduch does in his calculations, and arrives at payment rates between 92-95% for the period from 1985 to 1995. This is still a decent score, but it is not 98%.

Basically, there is little wrong with the situation that Grameen is in fact not self-sustainable. It certainly is a sustainable MFI in the sense that it will be able to continue its operations: being the most famous microfinance provider in the world with a very charismatic leader, Grameen will always be able to attract sufficient assistance from donors. What is criticised by Schmidt (2006) and Morduch (1999a) is the lack of transparency in the bank’s accounts, and the fact that there are many efforts to conceal its donor dependency.

Ownership structure
When it received a bank charter, Grameen Bank was owned by the Bangladeshi government, with a minority share of 40% foreseen to be held by the Bank’s members in the original charter13. Today, as the bank’s website states, Grameen is “owned by the poor”. This came about through gradual increases in the percentage of the bank’s ownership reserved for members.

13 Grameen Bank with the Norwegian Embassy in Bangladesh (1999), p. 78
This becomes quite clear when we look at Figure 2 above: essentially, the government and two commercial banks are only marginal shareholders; it’s the members of Grameen (i.e. its borrowers) that own nearly 95% of the shares, with women outnumbering men by about 1 to 20. How does it work? Basically, all borrowers become members of the bank as soon as all members of a solidarity group have saved 100 taka each (about € 1). The high percentage of women is due to the fact that Grameen specifically targets women in rural areas, as they are considered to maximise the development impact of the loan: many studies have shown that women tend to invest more in the long-term well-being of their families, while men spend more of the money made on things that increase their personal short-term wellbeing.

With the given ownership structure, it is clear that Grameen’s main objective is not to make a profit but rather to serve its members’ interests. Given that most Grameen members are poor and from rural areas, they support low interest rates and making more and more loans available to members to help them escape poverty. When highlighting its success, the bank therefore focuses on outreach and development impact, measured by the number of members and the number amongst them that have passed the bank’s definition of the poverty threshold (defined as being able to provide the family with some basic requirements, such as a decent roof or mattresses to sleep on). This is what matters to Grameen, not financial profitability.
Although its members own the bank, the question remains to what extent they can actually influence the bank’s course. The annual report does not mention shareholders’ meetings (which anyway would be very complicated to organise given the millions of members). It appears that the members’ interest is primarily represented by nine so-called borrower members on the board of directors, who are indirectly elected by the members, through regional representatives. The three other members on the board are the chairman, two government officials and Muhammad Yunus as the managing director. Given his charisma, it seems that Yunus can exert substantial influence on the other board members, some of whom are villagers who cannot read. The bank thus appears to be somewhat of a one-man show at the highest level. It would be interesting to see what happens to the bank if Yunus suddenly dies or falls seriously ill (he is currently 67): will the bank be able to continue its success without his guidance?

**Lending technology**

The lending technology used by Grameen Bank is strongly based on trust. No collateral is compulsory (or available), and borrowers are not required to take on any legal obligations. Therefore, there needs to be some other form of guarantee. Grameen uses what it calls a “group-based approach”, but unlike what we see at other MFIs (such as the BancoSol case that follows) or what is commonly thought (even by some scholars), this does not mean that members of the solidarity groups at Grameen are liable for each other’s loans. Every group member is financially responsible only for her (or in some rare cases his) own payments. The function of the group is merely to keep an eye on other member’s activities and contribute to a good track record of the group. Of course, when group members do not repay, they spoil the group’s ability to grow in its borrowing possibilities, and this is what gives a strong incentive for peer monitoring.

Groups consist of five members, selected by so-called “bicycle bankers”, credit officers who travel around to conduct Grameen’s business. In the first stage, the group has to prove that it is reliable when the first two members receive a loan and repay it in time. The other three have to wait, but will apply pressure on the two to ensure that the initial loans are actually repaid. Then, after a while, two more members are granted loans, and if they do well the last member also gets one. In a way, there thus is collective

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responsibility and interdependence, even if it is not collective liability. This collective responsibility replaces collateral as a guaranteeing factor. The bank charges 20% on a declining basis, which becomes 16% in real terms when we take inflation into account\textsuperscript{15}.

In the new system that was introduced with Grameen II in 2002, there are three main loan products: the basic loan, the housing loan, and the higher education loan (the latter being for children of members who can directly access these loans and pay them back once they start earning money of their own). The basic loan has as an option to be converted into a “flexi-loan” in case of repayment difficulties. Yunus (2002) calls the system a “micro-credit highway” where borrowers can take a temporary “detour” by taking an exit and continuing on a road where movement is slower (longer time to repay loans), to return to the highway when they are ready. There is a great incentive against getting off the highway: borrowers who get a flexi-loan revert to the loan ceiling they had when they started borrowing at Grameen. The track record that has been built is then gone, and the maximum loan available is the same as for those who just entered Grameen. Additionally, members who have a 100% payment record for seven consecutive years become “gold members”, and get very favourable borrowing conditions.

Any loan is combined with obligatory payments into a personal savings account (free access), special time deposits (withdrawal allowed only once every three years, also used to buy Grameen shares) and a pension fund (for those who have loans bigger than an amount of about €100). The latter is also accessible for non-borrowers, and represents a great source of finance for Grameen. Additionally to the three main types of loans, there is the “struggling member” programme for beggars (started in 2003). This is one of the charitable activities that Grameen engages in: beggars are given small, interest-free loans to help them set up activities in place of or besides their begging. The rules for repayment can be determined fully according to the beggars’ needs, and they don’t need to be part of a group. Until mid-2005, 47,500 beggars had been reached, while repayment rates lay around 50\textsuperscript{16}; the beggar loans are thus a charitable activity that the bank loses quite some money on.

\textsuperscript{15} Schicks (2007), p. 557
\textsuperscript{16} Grameen Bank at a glance: http://www.grameen-info.org/bank/ataglance/GBGlance.htm
Another special type of loan is the village phone loan. Rural women are given the chance to purchase or lease a mobile phone, which they then use to provide telecom access to their villages, quite a profitable activity. Borrowers are also able to insure themselves and their family against default in case of death or disease by taking loan insurance. All Grameen members also automatically enrol in a life-insurance programme that does not imply additional costs for them: it is part of the general conditions that apply to all shareholders, and thus part of Grameen’s regular expenses. However, at around € 15, the amount paid out at death is minor.

What is puzzling about Grameen’s lending technology is that, despite the fact that the bank is the best-known microfinance institution in the world, most scholars who don’t fully dive into its lending technology seem convinced that Grameen’s solidarity groups also imply collective liability. However, both on the Grameen website and in a critical piece by Schmidt (2006) it is clearly stated that the Bangladeshi bank does NOT use true group lending with collective liability. Collective liability would mean that group members would be required to guarantee each others loans, putting a significant risk burden on each others shoulders. This is not the case: each group member is individually liable for her own loan. While the Grameen website is a bit ambiguous on this point, it is clear that the group as a whole does suffer repercussions in terms of borrowing conditions when one member does not pay in time, damaging the group track record.

If both Grameen itself and one of its strongest critics within the microfinance world17 are aware of the fact that Grameen group members are not liable for each other, and if both parties communicate this, how come many scholars and the media don’t know? First of all, many might already be mislead by the fact that “solidarity groups” are used. Given that collective group liability is very common in other MFIs18, it may very well be that people just assume that the hybrid form of group lending used at Grameen means that group members also have to guarantee each other’s loans, as it is elsewhere. Schmidt argues that western donors prefer group lending with full financial solidarity, because it is the most common solution to a lack of collateral and teaches group

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17 Schmidt is associated with IPC, the German microfinance consulting firm that founded ProCredit Bank, our third case study.
18 Hermes and Landsink (2007) cite a study where 68% of MFI clients get loans through “group lending”, a term that the authors use to indicate lending to groups with collective liability.
members the concept of solidarity. This is his explanation why, as he claims, Grameen bank tries to hide the fact that it uses a different technology, as it is still highly dependent on indirect subsidies. This claim of Grameen hiding the true nature of its lending technology is more or less refuted when we take a look at the Grameen Bank at a glance web page, where it says clearly “No Group-Guarantee or Joint Liability”. Perhaps Schmidt’s point is valid if the bank has only recently been this frank about the nature of its solidarity groups.

Criticism of Grameen’s methods comes from two sides: those who disapprove of the way the bank tries to hide its continuing dependence on donors, and those who accuse it of setting up debt-traps and being ruthless towards those who can’t pay. A recent report on the French news channel France 24\textsuperscript{19} uncovers a rarely shown side of Grameen: one where debt collectors in a very harsh way try to enforce payment from villagers, some of whom have been borrowing for 25 years and have always received new loans when they were unable to pay, leading to a spiral of debt. The reaction of Grameen Bank management to some critical questions from the French journalists is to have them thrown out of the bank’s headquarters, confirming the accusation of a lack of transparency that has been mentioned before. While the report may be one-sided, focussing on the negative effect of some Grameen loans, it does raise some questions about the methods used by Grameen to achieve its high repayment rates.

**Development impact**

Grameen Bank is quite clearly a charitable NGO. Its clients are poor, often very poor. This is illustrated by the low average loan size: with 5.58 million members in 2005 and a loan portfolio of $ 416 million, the amount outstanding per member is $ 74.54. Even the highest class of borrowers, what is called the “micro-enterprise category” in the bank’s annual report\textsuperscript{20}, receive loans with an average size of only $ 352, with the biggest loan ever supplied being less than $ 8000. Being targeted to the poor, Grameen engages in a substantial number of activities that are purely charitable, such as its beggar loan programme, its provision of free life insurance for members, its scholarship


\textsuperscript{20} Grameen Bank Annual Report 2005, p. 10. One wonders what the category for the smallest borrowers is called. “Mini-microfinance?”
programme for talented children of members, and its disaster relief fund. Also, loans are provided at interest rates that are substantially lower than those a profit-oriented MFI would charge; as a matter of fact, Grameen may quite easily become self-sustainable by raising interest rates: Schreiner (1997)\(^{21}\) guesses that “customers get so much surplus that Grameen could double or triple prices without much less demand or much more default”. However, even though he may be right, the bank clearly prefers to be partially dependent on donors and use the donor money to maximise its benefits to the poor.

The bank has its own system to determine whether a member has crossed the poverty line\(^{22}\): ten conditions need to be met that refer to such things as having shelter, sleeping on a mattress, having access to safe drinking water, possessing warm winter clothing and sending children to school. This is a more reliable way to determine an escape from poverty than a mere income-based measure. Grameen rewards branches that have reached certain goals (both in terms of self-sustainability of the branch and human development of its members) with a system of colour-coded stars, and the most prestigious red star is given when all the borrowers at a branch have passed this poverty threshold. To make sure red stars are not given without justification, bank officials keep track of the development status of borrowers and thus ensure regular measurement of the poverty-alleviating progress being made. The bank itself claims that “according to a recent internal survey\(^{23}\), 65% of its borrowers have crossed the poverty line. This probably refers to the bank’s own definition, or, if the bank wants to look good, to the national poverty line in Bangladesh, which lays somewhere between $ 1 and $ 2 per day (given that 45% of Bangladeshis live below the poverty line but 84% live on less than $ 2 and 41% on less than $ 1 per day)\(^{24}\).

\(^{21}\)Schreiner (1997), p. 182  
\(^{22}\)Mainsah et al. (2004), p. 5  
\(^{24}\)Source: UNDP Human Development Report 2007/2008. See also Table 4.
2.2 Commercial pioneers: BancoSol in Bolivia

Grameen Bank is the most famous microfinance institution in the world, but the second place is definitely taken by BancoSol, the best-known example of a charitable MFI that turned into a commercial bank. Many studies of microfinance institutions, such as Schicks (2007) and Schreiner (1997) focus on these two examples. BancoSol, Bolivia’s biggest Microfinance Institution, looks like everybody’s darling, winning awards for its accomplishments, both as an MFI and as a commercial bank: the first thing one sees when entering the bank’s website is that it has been named “best bank in Bolivia” for four consecutive years and has also recently won the Inter-American Development Bank’s award for excellence in microfinance. The case of BancoSol is very relevant, as it shows how an NGO set up with donor money became a bank that can sustain itself.

Origins and growth
BancoSol (short for Banco Solidario S.A., sometimes also written as Banco Sol) started out in 1986 as a charitable organisation named PRODEM (Promoción y Desarrollo de la Microempresa), founded by the American NGO Acción International (one of the pioneers of microfinance in Latin America, starting microcredit programmes in the early 1970s) and a number of Bolivian entrepreneurs. At the time when Prodem set up shop, Bolivia was just recovering from a period of hyperinflation. In the economic environment created by the government’s reform programme (liberalisation of the economy including privatisation) there was a strong surge in the number of (informal) microenterprises: the economy was stabilising, while at the same time labour was shed from state-owned enterprises, and substantial migration from the countryside also increased the number of idle workers in the cities. These workers often had self-employment as their only perspective. Given that most of these (mainly informal) microentrepreneurs did not have access to conventional credit, Prodem found itself in a situation where there was a lot of demand for its loans.

Prodem’s first donors were government and NGO institutions from abroad and from Bolivia itself. The formula used was one of "solidarity groups"\(^{25}\), and turned out to be very successful. Solidarity groups in this case are groups that are collectively liable for

\(^{25}\) Banco Sol (2007); this type of solidarity group is not to be confused with the one at Grameen bank, for this type does include collective liability.
each other’s loans in case of payment difficulties\textsuperscript{26}. By 1992, Prodem’s loan portfolio had grown to around $4 million, with about 14,300 clients\textsuperscript{27}. During this period of strong growth, however, the leaders of Prodem realised more and more that being an NGO was a constraint to further growth, and that even with its rapid growth the MFI could not meet the existing demand for microcredit. As an NGO, it was not allowed to offer other financial products such as insurance and savings accounts, and without formal supervision it was impossible to raise commercial funds in significant quantities\textsuperscript{28}. Prodem's goal was clearly stated: to maximise the number of customers. To achieve this, its leadership decided to transform the NGO into a commercial bank. They expected that this would strongly reduce dependence on donors through market financing, increase efficiency, and that formal banking supervision would make the institution more trustworthy to its clients.

Thus Prodem became BancoSol in February 1992. Prodem itself continued as a partial owner of BancoSol and with some smaller microcredit activities in rural areas\textsuperscript{29}. The bank inherited a number of essential intangible assets from Prodem: its lending technology, its information about and relationships with borrowers, its staff and its good reputation. Armed with these assets, BancoSol was able to achieve impressive growth in its early years. Some\textsuperscript{30}, citing BancoSol as an example, argue that it is actually not possible or very hard to start a self-sustainable microfinance bank from scratch without this kind of intangible assets previously developed in a microfinance NGO funded by donors. However, when we look at the case study of ProCredit Bank BiH that we will deal with next, we may be able to refute this argument, as this bank was started from scratch.

Around the turn of the century, BancoSol entered more stormy waters. The financial crisis that had hit Latin America led to a recession, and the banking sector was plagued by bad consumer loans. BancoSol therefore started to require that borrowers be insured against health problems (including death) that could interfere with the proper

\textsuperscript{26} More details will come later in the subsection about BancoSol’s lending technology
\textsuperscript{27} Gonzalez-Vega, Schreiner et al. (1996), p. 5
\textsuperscript{28} Banco Sol (2007)
\textsuperscript{29} Gonzalez-Vega, Schreiner et al. (1996), p. 4
\textsuperscript{30} Schreiner (1997) writes on page 78: “Investors might buy BancoSol now, but they will not start MFOs like BancoSol or Grameen from scratch.”
functioning of an entrepreneur’s business. The bank started offering health and life insurance itself, and in the process of widening its scope also introduced other new financial products (such as ATM cards and money transfers) to offer a complete financial package to its microentrepreneurial customers. At the same time, the bank was more centralised to increase the control of the headquarters over individual branches. This also included some layoffs of mid-level managers, which cut costs.

Figure 3: Growth of BancoSol in terms of portfolio outstanding and number of borrowers, 1997-2007

Source: created using data from Asofin Bolivia and Acción International

Figure 3 shows us the impact of the economic crisis and BancoSol’s reaction: following the economic crisis in the late 1990s, growth stalled, with the amount of outstanding loans staying more or less stable and the number of credit customers decreasing. Then, as the bank recovered from 2002 onwards, we see that the portfolio outstanding grew very rapidly, more than doubling, while the number of borrowers entered a rather unstable phase: up to 2006 it also increased a lot, but we then see a steep fall from 2006 to 2007. This steep fall in the number of borrowers is accompanied by a sharp rise in the portfolio outstanding. What can we conclude from this? BancoSol’s current outreach in terms of the number of borrowers reached is at levels comparable to those a decade ago (76,215 in 1997 and 82,051 in 2007). At the same time, the average loan size per borrower has increased substantially because of the large growth of the outstanding portfolio (from $827 in 1997 to $1,589 in 2002, $1,581 in 2006, and $2,546 in 2007).

31 Banco Sol (2007?), p. 17
This shows clearly that BancoSol has been moving upmarket, handing out bigger loans. The question is what causes the strong increase in average loan size.

When we look at the data available on the composition of the loan portfolio in terms of loan size, we find that there has been an upwards move within BancoSol’s “middle class” borrowers, those borrowing between $1,000 and $10,000. In 2007, a higher percentage borrowed more than $5,000. More importantly, we can also see that in 2007, the bank lost three quarters of its lowest-range borrowers (also in absolute numbers: from 41,682 to 8,083 borrowers). This is clearly a sudden move up-market, away from the poorest borrowers towards those in the medium range. Given that increasing wealth of borrowers is a rather gradual process, this sudden move cannot be explained by poor borrowers becoming richer and moving towards bigger loans (which, as we will see, have more favourable conditions). Apparently, a large number of loans smaller than $500 have recently been terminated. Unfortunately, BancoSol’s 2007 annual report is presently not available (the 2006 report came out in June 2007, so the latest report will probably also take that long), and the company website does not give information about this either, making it very hard to determine what brought about this change in strategy. The number of borrowers borrowing more than $10,000 has not made extreme movements, so the move up-market is not total but affects mainly median size loans. Nonetheless, BancoSol’s poverty impact may be severely limited by this move.

BancoSol is an operationally and financially sustainable MFI\(^{33}\), even though Schicks (2007) states that the bank is still not privately profitable in the sense that it can offer returns that are competitive on the market. In 2006, the bank’s return on assets numbered 2.4% and return on equity was 24.5%\(^{34}\), which is actually quite good. It looks

\[\text{Table 1: Composition of portfolio outstanding}\]

<table>
<thead>
<tr>
<th>Loan sizes at BancoSol</th>
<th>2002</th>
<th>2006</th>
<th>2007</th>
</tr>
</thead>
<tbody>
<tr>
<td>&gt; $ 100,000</td>
<td>0.03%</td>
<td>0.02%</td>
<td>0.02%</td>
</tr>
<tr>
<td>$ 50,000 to 100,000</td>
<td>0.2%</td>
<td>0.1%</td>
<td>0.1%</td>
</tr>
<tr>
<td>$ 20,000 to 50,000</td>
<td>1.4%</td>
<td>0.6%</td>
<td>0.8%</td>
</tr>
<tr>
<td>$ 10,000 to 20,000</td>
<td>3.8%</td>
<td>1.9%</td>
<td>3.4%</td>
</tr>
<tr>
<td>$ 5,000 to 10,000</td>
<td>11.5%</td>
<td>8.7%</td>
<td>16.4%</td>
</tr>
<tr>
<td>$ 2,000 to 5,000</td>
<td>34.9%</td>
<td>22.5%</td>
<td>35.6%</td>
</tr>
<tr>
<td>$ 1,000 to 2,000</td>
<td>24.4%</td>
<td>14.6%</td>
<td>19.2%</td>
</tr>
<tr>
<td>$ 500 to 1,000</td>
<td>15.2%</td>
<td>11.5%</td>
<td>14.6%</td>
</tr>
<tr>
<td>&lt; $ 500</td>
<td>8.6%</td>
<td><strong>40.2%</strong></td>
<td><strong>9.6%</strong></td>
</tr>
<tr>
<td>100%</td>
<td>100%</td>
<td>100%</td>
<td>100%</td>
</tr>
</tbody>
</table>

Source: created with data from the Asofin Bolivia website

\(^{33}\) Schicks (2007), p. 554

\(^{34}\) BancoSol Annual Report 2006, p. 35
like Schicks based her assessment on older figures. In any case, low profits are not a problem for its owners, as they are mainly NGOs and not in it for profits.

Ownership structure
In terms of BancoSol’s ownership structure, its website and annual report are not very transparent. The only thing that is given is a list of nine main shareholders, but there is neither an indication of the percentages owned by these entities nor a description of their character. Back in 1996, 75% was owned by NGOs and donors, while the rest was owned by local businessmen. Have these structures changed over time? Fortunately, the website of the Bolivian financial supervision authority (Superintendencia de pensiones, valores y seguros) gives us Banco Solidario’s ownership structure:

We can see that different entities connected to Acción together form the biggest shareholder of BancoSol. With Prodem, BancoSol predecessor and originally an Acción initiative, NGOs thus still form a clear majority of shareholders (61.9%). While it was a bit difficult to track the nature of the other shareholders, it appears that they are private investment firms in majority, although some (like Antares Equity) have an objective to support microfinance that is not purely profit-oriented. This structure is illustrative for BancoSol’s “altruistic mission through a profit-maximising strategy”: the firm is

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35 Gonzalez-Vega, Schreiner et al. (1996), p. 4
37 Gonzalez-Vega, Schreiner et al. (1996), p.4
private, but its shareholders are NGOs by majority and thus ensure that the bank does not lose track of its principal mission: maximising the outreach to poor microentrepreneurs by supplying profitable loans. As we have seen in the previous section, the bank’s recent move up-market could jeopardise that goal, but this remains to be seen.

**Lending technology**

What is the lending technology used by BancoSol? The original loan product that was developed in the Prodem days is now called *Credito Solidario* and is essentially a group loan with collective liability. Three to four people receive loans, with the total amount not exceeding $6,000. Family links are forbidden within the groups, but apart from that a strong sense of community within groups is very much encouraged. Additionally, the entrepreneurs have to work close to each other in terms of distance to facilitate peer monitoring.

In all its actions, BancoSol aims to build a long-term relationship with its clients. This is accomplished using a strong incentive system: a group initially gets very small loans, at rather restrictive conditions. Terms to maturity are quite short, and payments are required very frequently. Then, as a group starts to develop a decent track record, it can get access to bigger loans with longer terms to maturity and less frequent payments, combined with lower effective interest rates\(^{38}\). In the long run, individual loans are also a possibility. However, if a group does not meet all the requirements, this will throw them back in the process of getting more favourable conditions.

Payments are to be made in time, for the group as a whole, at BancoSol’s branches that are numerous and quite easy to reach (it takes eight minutes on average\(^{39}\)). If there are arrears, there is an immediate response in the form of a visit by a loan officer, as early as the next day. Any arrears will delay the process of the group obtaining better borrowing conditions. In the case of a default on a loan (that is in case not even collective liability can ensure payment), the whole group is denied any future loans, and this information is shared with other microfinance institutions and banks. This way, collective liability seldom needs to be enforced by the bank itself: group members want

\(^{38}\) Gonzalez-Vega, Schreiner et al. (1996), p. 15  
\(^{39}\) Gonzalez-Vega, Schreiner et al. (1996), p. 10
to preserve the group’s track record and so will usually pay for those in the group who can’t, without letting BancoSol notice that there are some problems. This implies that rather than using individual loans and spreading the costs of arrears across all borrowers, the bank’s lending technology results in a small number of solvent group members carrying the heavy burden of one or more dissolvent group members in some cases, while in other groups there are no dissolvent members and thus no cross-subsidisation.

This system of incentives has been one of the main factors leading to BancoSol’s success and fame: even though borrowing conditions are not very favourable at the beginning, customers have a very good reason to do their very best to meet all requirements: bigger, easier and cheaper loans in the future, and the risk of losing the right to borrow altogether. Additionally, the personal approach taken by the bank and its loan officers creates some social incentives as well: avoiding the shame of having to face a familiar loan officer in case of arrears motivates entrepreneurs even further.

Besides Credito Solidario, BancoSol also offers individual loans to clients who have significant experience with microcredit and a good track record, be it at BancoSol or at other banks. Individual loans range from $ 50 up to $ 250,000. Established clients also have access to mortgages, loans for vehicles (comparable to a mortgage) and emergency short-term credit of up to $ 1,000. Consumer credit is granted for wage earners at companies with established track records, and BancoSol also acts as a pawnbroker to give emergency loans with jewellery as collateral.

There are a number of non-credit financial products which BancoSol is able to offer because it adheres to the framework set by the Bolivian Superintendency of Banks and Financial Institutions: savings accounts and longer-term time deposits, money transfers, medical insurance and life insurance. Additionally, there is a mortgage programme for Bolivians living in the US or Spain. These products are part of the comprehensive approach BancoSol takes: for bigger loans, borrowers are required to have insurance to protect themselves (and the bank) from being unable to pay, and short-term savings accounts are convenient when a lot of cash is being accumulated without interest. As a full-blown commercial bank, BancoSol is able to offer their clients these products, be it in combination with a loan or not.
Development impact
As can be seen from the portfolio distribution in Table 4, BancoSol’s focus is not on the very poor, but rather on those that are poor but on the verge of escaping poverty. Most borrowers would still not have access to conventional forms of credit however\(^{40}\), and this is how the bank plays a role in giving a hand to people trying to escape poverty. Also, a certain percentage of borrowers belong to the very poor (even though the number of very small loans has significantly decreased very recently, as we have seen), meaning that if BancoSol reaches a great number of borrowers there is also a large absolute number of poor that is given the opportunity to escape poverty through entrepreneurship. This may even be a higher number than that reached by a small charitable MFI that, over its lifetime, requires larger amounts of donor money to start up and keep running than BancoSol.

A study by Acción International (2005) finds that BancoSol’s borrowers may not be representative for Bolivia as a whole, but that their poverty numbers are comparable to those of urban Bolivians (BancoSol’s clients are somewhat less poor). This is due to the fact that, indeed, the bank operates mainly in bigger cities. Despite the claim that “BancoSol serves the richest of the poor\(^{41}\),” 15% of its clients are considered “very poor” in the Acción study. Thus, while charitable MFIs focus mainly on the very poor, the self-sustaining BancoSol does not have as a specific mission to serve the poorest but also succeeds in helping significant numbers of very poor people escape poverty. It remains to be seen to what extent the recent move up-market that was discussed above will inhibit the bank’s poverty-reducing effects.

2.3 A profitable partnership: ProCredit Bank in Bosnia and Herzegovina

There are three types of MFIs: those that are charitable and have only a minor profit objective (like Grameen), those that have grown from being a charitable MFI to being a self-sustainable commercial bank (like BancoSol), and those that were started from scratch with a profit objective. ProCredit Bank falls in the latter category. This network

\(^{40}\) Schicks (2007)
\(^{41}\) Can be read in Schicks (2007), p. 554
of commercial microfinance banks, often lauded for its truly entrepreneurial approach to microfinance, has become a household name in the transition countries of Eastern and Central Europe. Within the network, ProCredit Bank Bosnia and Herzegovina (or short ProCredit BiH) was the first greenfield investment.

Origins and growth

ProCredit Bank Bosnia and Herzegovina was founded in 1997 under the name Micro Enterprise Bank (MEB) by IPC, a German consulting company specialising in microfinance, in a contract with the EBRD and the IFC. What was special about this contract was that IPC would not only provide initial management consulting services but also take a share in the greenfield bank and continue managing it after its establishment. In 1998, to attract more capital for Micro Enterprise Bank and a number of microfinance banks that were being set up in other countries, IPC founded IMI (Internationale Micro Investitionen), the company that would later develop into ProCredit Holding. IMI rapidly expanded its activities across Eastern Europe, also founding banks in Georgia, Albania and Kosovo before the turn of the century. Today ProCredit has banks in eleven transition countries in Eastern Europe, and is also present in seven states in Latin America and four African countries (amongst which the Democratic Republic of the Congo-Kinshasa).

Figure 5: Growth of ProCredit BiH, portfolio outstanding and number of borrowers, 1998-2007

Source: Website ProCredit Holding

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42 See for example the Economist (2005)
43 All figures in this sub-section come from a number of excel files with statistics from the different ProCredit Banks that can be found at http://www.procredit-holding.com/cms/front_content.php?idcat=8; accessed on 23 April 2008
Looking at ProCredit BiH’s growth process during the first decade of its existence, we see a clear picture of steady expansion that is increasing in speed. From modest beginnings in the late 1990s, the bank’s growth really started picking up speed around five years ago. The value of the outstanding loan portfolio was initially growing faster than the number of loans, meaning the average loan size rose, but this process reversed in 2003 and average loan size has since halved.

Unlike the two previous case studies, the Bosnian ProCredit bank has seen only expansionary growth, without a slowdown or contraction phase. This is due to the fact that its history is shorter and that the Bosnian economy has been in a phase of post-war rebuilding, meaning the economic conditions were favourable to the development of small- and medium-size enterprises.

The composition of the loans provided by ProCredit BiH shows us that the bank serves the entire SME sector: while most loans are of a size between € 1,000 and 10,000 (54%), a comparable percentage (44%) consists of microloans. A small minority of outstanding loans are bigger than € 10,000.

The evolution of the portfolio composition tells us that the bank has moved from providing a large majority of loans to SMEs (with as an apex the year 2002, when microloans made up only 10%) to a situation where a sizable 44% of loans are true microloans. ProCredit BiH thus serves mainly customers who borrow less than € 10,000, but does not have a dogma against providing bigger loans.

In terms of profitability, ProCredit BiH (or MEB BiH initially) took losses only during the first two years in its existence, and started posting accounting profits from 1999 onwards. These profits were not very stable, varying from year to year, but pre-tax profits always turned out between € 500,000 and € 2 million. This indicates the bank

<table>
<thead>
<tr>
<th>Year</th>
<th>&lt;1,000</th>
<th>1,000-10,000</th>
<th>10,000-50,000</th>
<th>&gt;50,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>1997</td>
<td>21%</td>
<td>77%</td>
<td>2%</td>
<td>0.0%</td>
</tr>
<tr>
<td>1998</td>
<td>23%</td>
<td>77%</td>
<td>0%</td>
<td>0.0%</td>
</tr>
<tr>
<td>1999</td>
<td>24%</td>
<td>74%</td>
<td>2%</td>
<td>0.0%</td>
</tr>
<tr>
<td>2000</td>
<td>25%</td>
<td>73%</td>
<td>2%</td>
<td>0.0%</td>
</tr>
<tr>
<td>2001</td>
<td>20%</td>
<td>75%</td>
<td>4%</td>
<td>0.6%</td>
</tr>
<tr>
<td>2002</td>
<td>10%</td>
<td>76%</td>
<td>12%</td>
<td>1.8%</td>
</tr>
<tr>
<td>2003</td>
<td>32%</td>
<td>62%</td>
<td>5%</td>
<td>0.8%</td>
</tr>
<tr>
<td>2004</td>
<td>44%</td>
<td>51%</td>
<td>4%</td>
<td>0.6%</td>
</tr>
<tr>
<td>2005</td>
<td>45%</td>
<td>51%</td>
<td>4%</td>
<td>0.5%</td>
</tr>
<tr>
<td>2006</td>
<td>44%</td>
<td>52%</td>
<td>3%</td>
<td>0.6%</td>
</tr>
<tr>
<td>2007</td>
<td>44%</td>
<td>54%</td>
<td>2%</td>
<td>0.4%</td>
</tr>
</tbody>
</table>

Source: statistics on ProCredit Holding website
should be able to grow sustainably until the demand for microfinance in Bosnia and Herzegovina is satisfied.

In its early stage, the bank got substantial technical assistance from the US government, the EBRD and the federal government of Germany, which partly explains why profitability was achieved so quickly\(^{44}\). Besides technical assistance, the bank got help in the form of long-term finance; commercial banks were only willing to give short-term money market lines with maturities of less than a year, and so the credit provided by ProCredit’s publicly-owned partners was vital in making its rapid growth possible. Another source of funds comes from the bank’s own customers’ deposits: while the deposit volume was clearly outnumbered by the loan portfolio volume until around 2004, today the deposits volume represents 88% of the loan portfolio, which is quite high if we compare it to fully profit-maximising banks\(^ {45} \). This is a picture that can also be seen at mature ProCredit banks in other countries: the number of deposits grows as the banks establish a good reputation.

**Ownership structure**

There are two shareholders: ProCredit Holding (92.4%), the Frankfurt-based network of microfinance banks that ProCredit BiH is part of, and Commerzbank (7.6%). Development banks (KfW and the EBRD) used to be involved until 2006, but have withdrawn since. In Table 3 we can see how ProCredit Holding has increased its share in the bank over time, with the European Bank for Reconstruction and Development selling its share in the course of 2006 and the German KfW Group of development banks pulling out in 2007. Now that the holding group is the only significant shareholder, it is interesting to ask ourselves the question by whom it itself is owned.

\begin{table}[h]
\centering
\begin{tabular}{|l|c|c|c|}
\hline
ProCredit Bosnia and Herzegovina ownership structure & 2005 & 2006 & 2007 \\
\hline
ProCredit Holding & 56.7\% & 79.8\% & 92.4\% \\
EBRD & 23.1\% & - & - \\
Commerzbank & 12.5\% & 12.5\% & 7.6\% \\
KfW Group & 7.7\% & 7.7\% & - \\
\hline
\end{tabular}
\caption{ProCredit BiH shareholders}
\end{table}

\textit{Source: annual reports 2005 and 2006, ProCredit website}

\(^{44}\) Alexander (2004), p. 291

Figure 6: Ownership structure ProCredit Holding, voting shares (February 2008)

Source: ProCredit website

As Figure 6 shows, ProCredit Holding (formerly IMI) is owned to one quarter by its founder IPC, a German consulting firm specialising in microfinance. A share of about half that size is in the hands of IPC Invest, which is a means for both IPC and ProCredit employees to participate financially in ProCredit. KfW and FMO are state-owned development banks from Germany and the Netherlands, respectively, DOEN is a Dutch charitable organisation funded with lottery revenues, and IFC is part of the World Bank group. The smaller shareholders are investment companies with some social objectives. Additionally to the capital owned by these voting shareholders (around €125 million), ProCredit also has some shares that do not give voting rights (capital of around €60 million). The main non-voting shareholders are the American pension fund TIAA-CREF, the IFC and BIO, the Belgian development bank.

ProCredit Holding is thus a public-private partnership in the sense that its shareholders are private companies and foundations as well as public development organisations. All shareholders are in it for more than just profit, however: IPC and IPC Invest want to make sure that the bank stays true to the principles and lending technology developed by the consulting firm, the development organisations and charities support ProCredit because it is a microcredit provider and thus stimulates MSE/SME development, while the investment companies and pension funds probably see it as an investment opportunity with social benefits.

Lending technology

ProCredit Bank, although a commercial bank, tries to distance itself as much as possible from the grandeur that traditional banks often display. Its philosophy is simple: microcredit has low profit margins, so keeping costs low is imperative. This implies that the bank cannot afford too many status symbols for its managers, such as fancy company cars or splendid offices. Lending to small entrepreneurs and offering accounts to low-income families, two groups that are often neglected by traditional banks, also implies being a “small people’s bank”: employees dress as they would in everyday life in order not to create too large a distance between themselves and customers.

Unlike the two other case studies, the Bosnian bank (just like the other banks in the ProCredit network) refrains from using any kind of groups when lending to customers: loans are the sole responsibility of the borrowers themselves. Instead, in the absence of collateral, the method used by ProCredit is to carefully scrutinise the payment ability of potential borrowers. A business that has been running for at least three months can apply for a loan. A bank officer then visits the owner several times to assess the quality of business operations. This is very labour intensive, especially because small borrowers very often do not keep formal records of their activities; extensive conversations with the owner and lengthy observation of the business in action are necessary to determine how things are currently going and what the potential for expansion is. Then, when a customer’s business is deemed credit-worthy, a loan is granted. This approach seems to be working: the arrears rate (payments that are more than 30 days overdue as a percentage of the present portfolio) for ProCredit BiH was 1.6% in 2007, which is quite impressive. The downside to this low-risk approach is that the labour-intensive borrower evaluations make administrative costs quite high and eat away at profit margins (the average effective interest rate being a very competitive 15.9%). Additionally, substantial costs need to be incurred to train employees so they develop the skills necessary for this type of far-reaching analysis.

48 Administrative costs equal 9.1% of total assets, while at the profit-maximising Raiffeisen Bank this is only 2.9% (calculated with figures from the Raiffeisen BiH annual report, http://www.raiffeisenbank.ba/en/o_rbbh/2006/rzb06.pdf?page=61)
49 ProCredit BiH Annual Report 2006, p. 47
Besides catering to the credit needs of enterprises, ProCredit BiH is a full-blown commercial bank, offering the same products as most banks in Western Europe, to both consumers and businesses: deposit accounts, savings accounts, time deposits, short-term overdraft loans and money transfers. Special savings accounts for children and discounted student packages are also part of the assortment. While the bank claims in its mission statement not to promote consumer loans\textsuperscript{50}, it does offer them for earners who receive their salaries through ProCredit accounts: they can borrow up to 10,000 convertible marks (€ 5,000) for such products as furniture, televisions and vacations according to the website, and account overdraft is also facilitated. This means either that the bank has changed its stance on consumer credit in the course of 2007 or that by “not promoting” it means it does not advertise it specifically. In any case, the bank apparently thinks that it can avoid the situation where its customers get caught in a debt trap because the consumer loans are offered only to employees whose salary comes in at ProCredit accounts and is thus easy to monitor. The bank does not promote these loans to the extent that other commercial banks do.

ProCredit BiH does not offer insurance, unlike Grameen Bank and BancoSol. This may present a diversification option in the future, given the usefulness of life insurance in the provision of loans. However, insurance is a whole different game, and diversifying into this field may be very costly for the bank. Leaving the insurance business to other companies seems to be a viable option.

**Development impact**

On its website, on the page on business philosophy, ProCredit holding clearly states it finds “the claims and hype regarding what microfinance can achieve to be excessive. […] the importance attached to microfinance –presented as the cure-all to eliminate poverty– will raise expectations that cannot be fulfilled”. The focus in ProCredit’s mission is rather on the development of a functioning and inclusive financial system in developing and transition countries. Of course this does not mean that the bank does not have a positive impact on the poverty situation in BiH.

Bosnia and Herzegovina is a very poor country according to European standards. Unemployment is still very high at between 25 and 45 percent (it is hard to determine

\textsuperscript{50} See the mission statement in the 2006 ProCredit BiH annual report, p.4
the true number due to the size of the informal economy\textsuperscript{51}, and the per capita GDP (PPP) is $6,600. In an economy like that, with a lot of idle labour and post-war rebuilding, small loans of less than €1,000 are bound to make a difference for microentrepreneurs. ProCredit’s outreach is substantial: in a country with a population of 4.5 million, 70,000 loans outstanding is not bad at all, probably covering over 1% of the population\textsuperscript{52}, and in all probability an even higher percentage of the 1.25 million living below the official poverty line (given that ProCredit serves the lower segment of the loan market, with 44% of the loans handed out smaller than €1,000). While it is hard to assess the exact multiplier effect of the loans handed out by ProCredit BiH in the absence of Bosnia-related studies on this subject, it is clear that besides offering self-employment, growing microenterprises very frequently are also able to hire employees and thus contribute further to lower unemployment.

ProCredit BiH also significantly contributes to the development of the country’s human resources in the financial sector: the special skills that are required for the bank’s comprehensive borrower evaluations imply substantial training for all its 770 employees. Mid-level managers are sent to ProCredit’s regional academy in Skopje, Macedonia, and the biggest talents get the opportunity to follow a three-year part-time “ProCredit Banker” study programme in Germany, which focuses not only on banking and management skills but also includes general humanistic courses. The idea is to form a group of global leaders for the company, who can later become the top managers in countries different from their own (ProCredit has a policy of putting foreign nationals in charge of the respective banks in order to insulate them from being influenced in their decisions by their social network). While ProCredit employees are generally quite loyal to the company, the skills they acquire working at the bank also benefit the Bosnian banking sector as a whole when they leave to work at other, more traditionally organised banks.

As a result of its human resources efforts, the bank has received a prize for Investor of the Year in the category job creation from the Foreign Investment Promotion Association of BiH.


\textsuperscript{52} It is hard to determine what percentage of borrowers has more than one loan outstanding, and unfortunately ProCredit does not give numbers of clients in its statistics. However, it can be expected that 70,000 loans are held by at least 45,000 individual borrowers, and thus 1% of the population.
### 2.4 Comparing the three case studies

#### Table 4: Comparing data on the three MFIs

<table>
<thead>
<tr>
<th></th>
<th>Bangladesh</th>
<th>Bolivia</th>
<th>Bosnia and Herzegovina</th>
</tr>
</thead>
<tbody>
<tr>
<td>Population</td>
<td>153.5 mln</td>
<td>9.2 mln</td>
<td>4.5 mln</td>
</tr>
<tr>
<td>PPP GDP per capita</td>
<td>$1,400</td>
<td>$4,400</td>
<td>$6,600</td>
</tr>
<tr>
<td>Real GDP growth</td>
<td>6%</td>
<td>4%</td>
<td>5.50%</td>
</tr>
<tr>
<td>Proportion of population living on less than $2 a day</td>
<td>84%</td>
<td>42.20%</td>
<td>n.a.</td>
</tr>
<tr>
<td>Proportion of population below national poverty line</td>
<td>45%</td>
<td>60%</td>
<td>25%</td>
</tr>
<tr>
<td>UNDP human development index</td>
<td>0.547</td>
<td>0.695</td>
<td>0.803</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>Bangladesh</th>
<th>Bolivia</th>
<th>Bosnia and Herzegovina</th>
</tr>
</thead>
<tbody>
<tr>
<td>Grameen Bank</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Number of loans outstanding</td>
<td>n.a.</td>
<td>88,541</td>
<td>68,752</td>
</tr>
<tr>
<td>Number of borrowers/members</td>
<td>5,579,399</td>
<td>82,051</td>
<td>n.a.</td>
</tr>
<tr>
<td>Portfolio outstanding</td>
<td>$ 415.8 mln</td>
<td>$ 209.0 mln</td>
<td>€ 162.6 mln(^{53})</td>
</tr>
<tr>
<td>Deposit volume</td>
<td>$ 481.2 mln</td>
<td>$ 62.8 mln</td>
<td>€ 140.2 mln</td>
</tr>
<tr>
<td>Deposit volume as a percentage of loan portfolio</td>
<td>116%</td>
<td>30%</td>
<td>86%</td>
</tr>
<tr>
<td>Number of employees</td>
<td>25,211</td>
<td>996</td>
<td>769</td>
</tr>
<tr>
<td>Average outstanding amount per borrower/member</td>
<td>$ 75</td>
<td>$ 2,546</td>
<td>n.a.</td>
</tr>
<tr>
<td>Portfolio outstanding per employee</td>
<td>$ 16,493</td>
<td>$ 209,839</td>
<td>€ 182,315</td>
</tr>
<tr>
<td>Members/borrowers/loans per employee</td>
<td>221</td>
<td>82</td>
<td>89</td>
</tr>
<tr>
<td>Average loan size</td>
<td>n.a.</td>
<td>$ 2,360</td>
<td>€ 2,365</td>
</tr>
<tr>
<td>Average effective interest rate</td>
<td>20.0%</td>
<td>22.4%</td>
<td>15.9%</td>
</tr>
</tbody>
</table>

Sources: Country figures from the CIA World Factbook and the 2007 UNDP development report; bank figures from the websites and annual reports of Grameen Bank, BancoSol, Asofin Bolivia and ProCredit Holding

\(^{53}\) I have chosen not to convert these euro amounts into dollars because the purchasing power of a dollar and a euro in their respective home economies are still comparable; by converting the euros this would give somewhat of a distorted picture of ProCredit as the euro is currently overvalued against the dollar.  
We have learnt about the background and current performance of three very famous microfinance institutions; now it is time to make a detailed comparison of the three, using the data that are available. Table 4 offers an overview over some figures that indicate the size and development of the different countries, and the outreach of the banks.

The first thing we notice are the large differences between Bangladesh on the one hand and Bolivia and Bosnia on the other hand: Bangladesh is a very big and very poor country, while Bolivia and BiH are small and clearly less poor, with Bosnia as the most developed of the three countries. This coincides with the big differences between the three banks: Grameen Bank is very large, in absolute but also relative terms: 3.63% of Bangladeshis are Grameen members. The loans supplied by Grameen are very small ($75 on average), clearly much smaller than what is customary at the two other banks (over $2,000). Why is this? How come Grameen bank, which is several dozen times as big as BancoSol, only has twice as much portfolio outstanding? One explanation is the much lower development status of Bangladesh and the higher marginal purchasing power that a dollar or a euro therefore has there; another is that Grameen’s efforts are directed towards the very poor, who require and are able to absorb only much smaller loans than small entrepreneurs in middle income countries like Bolivia and Bosnia, and that Yunus’s bank does not mind that the profit margins when serving these customers are extremely low (if not negative) since it has no profit objective past the intention to make revenues equal expenditures. Grameen’s way of attracting customers is also clearly different: basically, when a branch is set up in a village, in principle all villagers (including beggars) are encouraged to join a group of borrowers and take a loan to fuel their economic activities and improve their situation. BancoSol and ProCredit work the other way round: they do present and promote themselves to potential borrowers, but the selection among those desiring to take a loan is precise (see also the lending technology subsection in the ProCredit case study), and so new borrowers come in gradually. This is most true for ProCredit as it does not use group lending.

BancoSol and ProCredit thus have a smaller outreach than Grameen (3.63% of the population), with BancoSol borrowers representing around 0.9% of the Bolivian
population and the number of ProCredit loans outstanding divided by the Bosnian population equalling 1.5%. Assuming that all three banks have customers that are poor (more or less), this is a logical result, as a much larger proportion of the population is poor in Bangladesh. Also, Grameen has a longer history and appears to have become a real institution in the Bangladeshi economy. Could BancoSol or ProCredit BiH achieve a similar degree of importance?

When we look at the growth graphs that accompany these two case studies and extrapolate the trends (which, of course, is highly speculative) BancoSol will probably stagnate at less than 100,000 clients\(^{55}\) that receive larger loans over time, while ProCredit BiH would continue to grow rapidly, both in terms of borrowers and portfolio. In fact, at the current rate of growth, both the number of borrowers and the loan portfolio more than double every two years at the Bosnian bank. This is naturally a much faster pace of growth than that of the economy or the population, so within a few years ProCredit could attain an economic importance in Bosnia and Herzegovina that is comparable to that of Grameen in Bangladesh. However, it is much more a commercial bank than Grameen: the Bangladeshi MFI is more like a social institution than a bank, with a set of 16 “decisions” for members that refer to the way they conduct their daily lives\(^{56}\) (e.g. decision nr. 6: “we shall keep our families small”). As such, ProCredit, while it sees itself as a “neighbourhood bank” that has good personal relations with its customers, does not intend to interfere as much in the lives of its clients as Grameen does.

When it comes to the potential of further growth for Grameen Bank itself, it appears to be ample: the bank’s growth has been accelerating over the past years (both in terms of members and portfolio outstanding), and as long as the Bangladeshi population keeps growing at 2% a year\(^{57}\) (thus adding millions of new poor) and Yunus is able to attract donor assistance, there is little reason to assume the long term growth trend would stagnate.

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\(^{55}\) See Figure 3: in the past, whenever BancoSol hit a peak in terms of number of borrowers, the year afterwards it had clearly decreased again.

\(^{56}\) The 16 decisions can be found at [http://www.grameen-info.org/bank/the16.html](http://www.grameen-info.org/bank/the16.html); accessed on 25 April 2008

\(^{57}\) CIA World Factbook Bangladesh
In terms of the number of employees, there is quite some disparity between Grameen Bank and our two other case studies: at Grameen, each employee deals with around 220 members on average, while BancoSol employees handle 82 borrowers and the ratio of employees per loan at ProCredit BiH is 89. Does this mean that Grameen is more than twice as efficient? This depends on the percentage of current borrowers among Grameen members, which unfortunately cannot be determined with the data available from the bank, another sign of the lack of transparency that characterises Grameen. If a high percentage of members (say, at least 80%) are currently borrowing money, the group structures and village-bound technology at Grameen could explain the high ratio: when visiting a village in rural Bangladesh, it is quite easy to handle large numbers of borrowers at once. On the other hand, in case there is a large percentage of inactive members, the ratio comes down considerably and it might actually turn out that Grameen uses more employees per active loan than the other two. Also, when we look at the portfolio outstanding per employee, we find that Grameen employees handle less than a tenth of the amount BancoSol and ProCredit BiH personnel deal with on average, so in terms of loan size, the Grameen employees are much less efficient.

What role does the ownership structure of our three cases play in the way they conduct their business? As we have seen, Grameen is owned by its poor members, BancoSol by two charities combined with some private investors (with or without a social objective), and ProCredit is a private-public partnership between a microfinance consultant (IPC), some private investors, development banks and other IFIs, and charitable foundations, with Commerzbank as a minority shareholder for the Bosnian bank. Again, it is Grameen Bank that stands out: it has a very large number of very small shareholders. This has repercussions: Grameen has comparatively far less equity, resulting in a relatively much smaller loan volume than the two others.

BancoSol and ProCredit may be fully commercial banks in their operations, but their shareholders have invested in the company for development reasons rather than to get high returns. This means the banks are not under intense market pressure to deliver competitive rates of return, and can focus on maximising the outreach.

58 Looking through publications by more independent sources, I have also been unable to find any borrower numbers that are distinct from the number of members.
The one field where we don’t see a basic split between Grameen on the one hand and ProCredit and BancoSol on the other is lending technology. All three banks use different techniques: BancoSol uses group lending with full collective liability, with starter loans at conditions that are in fact rather unfavourable at the beginning but improve as groups establish good track records. Grameen uses group lending without collective liability and with loans at flat rates, but where there is also a strong focus on track record resulting in substantial peer pressure within groups, despite the absence of collective liability. In fact, the differences between Grameen and BancoSol in the way group lending is used are not very big: in both cases, through the rigorous consideration of track records by the banks, there are very strong incentives for groups as a whole to repay their loans; the fact that BancoSol has collective liability as an instrument of last resort does not change things too much, as payment problems are usually resolved (effectively because group members pay for non-solvent others) before it comes to its use.

ProCredit’s lending technology is fundamentally different from that of the other two banks: it is much more like a conventional bank in that it hands out loans to individuals (or individual enterprises) only. While Grameen and BancoSol use solidarity and peer pressure within groups as a guarantee for repayment, ProCredit relies on the character of the business itself, which it meticulously assesses to evaluate the potential for repayment.

Grameen and BancoSol both also offer insurance to their clients, originally to supplement loans that required some kind of insurance for calamities. ProCredit BiH does not do this, leaving the insurance market to conventional firms.

When it comes to interest rates, all three banks charge rates that would be considered high in Western European economies, but that are quite low when we consider the complexity of microfinance and the riskier economic environment in the countries of operation. BancoSol charges the highest average effective interest rate, at 22.4%. Given the decreasing nature of the rates as borrowers develop good track records, the initial rate for small borrowers can be expected to be much higher (but the bank is not too frank about how high that would be).

Given the economic situation in Bangladesh, the interest rate that Grameen Bank charges, 20% on a declining balance basis (more or less, rates do decrease for borrowers with a good track record), is below what a more profit-oriented MFI would demand. As
mentioned before, this could be raised to make Grameen more profitable and thus more appealing to investors, and increase the amount of capital available for loans to members. Given the shareholder structure at Grameen, it would take a very long time for the member shareholders to lose their totally dominant share to market parties, and thus there need not be worries about mission drift at Grameen. Besides, if interest rates are higher this means either that there is more money available for charitable activities or that it benefits the shareholders, who are borrowers themselves.

ProCredit BiH is getting quite close to rates in Western Europe, a clear sign that the Bosnian economy is the most developed of the three. The rate charged is nonetheless high enough to earn the bank a profit.

Table 5: an overview over the non-numerical characteristics of the three banks

<table>
<thead>
<tr>
<th></th>
<th>Grameen Bank</th>
<th>BancoSol</th>
<th>ProCredit BiH</th>
</tr>
</thead>
<tbody>
<tr>
<td>Character</td>
<td>Charitable MFI</td>
<td>Self-sustaining MFI</td>
<td>Self-sustaining MFI</td>
</tr>
<tr>
<td>Area of activity</td>
<td>Mainly rural</td>
<td>Mainly urban</td>
<td>Both rural and urban</td>
</tr>
<tr>
<td>Borrower characteristics</td>
<td>Very poor to poor</td>
<td>Poor to middle class</td>
<td>Poor to middle class</td>
</tr>
<tr>
<td>First time borrowers required to form groups?</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>Collective liability within groups?</td>
<td>No</td>
<td>Yes</td>
<td>-</td>
</tr>
<tr>
<td>Means to ensure repayment</td>
<td>Peer pressure within groups</td>
<td>Full group liability</td>
<td>Assessment of borrowers</td>
</tr>
</tbody>
</table>

The overall picture we see when we compare these three microfinance institutions is thus that Grameen is very different from the other two in terms of size and portfolio composition, and that ProCredit uses a dissimilar lending technology. However, the cultures that can be found on the three continents and the circumstances that the banks operate in differ greatly: to what extent can we really satisfactorily compare a bank that operates in villages in Bangladesh, a very poor muslim country on the Indian subcontinent, with one that operates in the informal settlements of Bolivian cities (with their Latin American catholic culture) and with another one that conducts its business in a country that is recovering from civil war, where muslim, catholic, orthodox and secular traditions meet? Another difficulty arises with available data: each bank has a different way of giving statistics. Added to these problems is that Grameen does not
adhere to Western accounting standards\textsuperscript{59}, thus making a full-blown financial comparison of all three banks nearly impossible. Comparing ProCredit BiH and BancoSol would be feasible, but still somewhat problematic.

Ideally, when we want to compare two approaches to microfinance in a comprehensive and scientific way, we need two cases that operate in the same environment and about which data comes from the same source. As it happens, ProCredit is active not only in European transition countries and Africa, but also in Latin America, including Bolivia. Banco Los Andes ProCredit is the Bolivian ProCredit bank, and it has many similarities with BancoSol. The same data are available about both banks at the website of the Asociación de Entidades Reguladas por la Superintendencia de Bancos y Entidades Financieras (Asofin). In the next section, let us therefore use these data to compare the financial effects of the principles and lending technologies used by the two banks.

\textbf{2.5 A comparison of the concepts of BancoSol and ProCredit in Bolivia}

As just mentioned, the comparison made between Grameen, BancoSol and the Bosnian ProCredit Bank is not a satisfactory one in terms of showing how outreach and profitability are related due to differences in data availability and reliability, and is strongly distorted by country-related factors such as culture and economic development. To support and strengthen the findings from the case studies, it is therefore useful to take a look at the almost experimental setting that the well-developed Bolivian microfinance market offers us. Besides Bangladesh, Bolivia was one of the countries where microfinance first started to develop. Unlike in Bangladesh, where Grameen is by far the biggest MFI, in Bolivia the market is rather fragmented. There are a number of MFIs that are small compared to Grameen but together serve over 5\% of the Bolivian population. Among these banks, BancoSol and Banco los Andes ProCredit are the biggest. We have already covered BancoSol; Banco los Andes is the Bolivian ProCredit Bank, using essentially the same lending technology as our case study from Bosnia. In fact, the lending technology used is one of the few categories where we have a clear difference between the two Bolivian banks: in terms of size they are very comparable.

\textsuperscript{59} Schmidt (2006)
This makes the two banks convenient for an (imperfect) experiment: what influence does the lending technology (the “treatment” of the experiment) have on outreach and profitability in these cases? The experiment is imperfect, but its results can be expected to be more reliable than our previous comparison of three banks on three continents because of the single source and the virtually identical environment.

A short overview over Banco Los Andes:
Banco Los Andes was founded as an NGO called ProCrédito in the early 1990s. From its beginnings, the German microfinance consulting firm IPC provided technical assistance to the MFI. ProCrédito was then turned into a financial institution with a partial banking license named FFP Los Andes in 1995, and similarly to the BancoSol case, the original NGO became a shareholder in the new institution (and also in IMI, that later adopted its name and became ProCredit holding). Los Andes grew very quickly, coming at a par with BancoSol in the Bolivian microfinance market. In 2005 it acquired a full banking license, and ProCredit Holding became the majority shareholder (owning 99.96% of shares).

Table 6 gives a picture of two banks that are really very comparable in terms of size: Los Andes is only somewhat bigger than BancoSol, handing out a loan volume that is about a third larger, with around 12,000 more credit clients. When we look at the data gathered, basically all the figures and indicators are within a comparable category. There are only two significant areas where a clear difference becomes apparent: the composition of the loan portfolio and the financial performance. Cost structures also differ, as Table 7 shows.
Table 6: BancoSol vs. Banco los Andes ProCredit (31 December 2007)

<table>
<thead>
<tr>
<th></th>
<th>BancoSol</th>
<th>Los Andes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Savings account volume ($ 1000)</td>
<td>62,751</td>
<td>45,527</td>
</tr>
<tr>
<td>Portfolio outstanding ($ 1000)</td>
<td>208,959</td>
<td>271,078</td>
</tr>
<tr>
<td>Distribution by number of borrowers</td>
<td></td>
<td></td>
</tr>
<tr>
<td>&gt; $ 100,000</td>
<td>0.02%</td>
<td>0.30%</td>
</tr>
<tr>
<td>$ 50,000 to 100,000</td>
<td>0.1%</td>
<td>0.3%</td>
</tr>
<tr>
<td>$ 20,000 to 50,000</td>
<td>0.8%</td>
<td>1.5%</td>
</tr>
<tr>
<td>$ 10,000 to 20,000</td>
<td>3.4%</td>
<td>3.0%</td>
</tr>
<tr>
<td>$ 5,000 to 10,000</td>
<td>16.4%</td>
<td>7.8%</td>
</tr>
<tr>
<td>$ 2,000 to 5,000</td>
<td>35.6%</td>
<td>21.4%</td>
</tr>
<tr>
<td>$ 1,000 to 2,000</td>
<td>19.2%</td>
<td>21.8%</td>
</tr>
<tr>
<td>$ 500 to 1,000</td>
<td>14.6%</td>
<td>22.7%</td>
</tr>
<tr>
<td>&lt; $ 500</td>
<td>9.6%</td>
<td>21.2%</td>
</tr>
<tr>
<td></td>
<td>100%</td>
<td>100%</td>
</tr>
<tr>
<td>Number of credit clients</td>
<td>82,051</td>
<td>94,326</td>
</tr>
<tr>
<td>Number of savings accounts</td>
<td>176,379</td>
<td>189,240</td>
</tr>
<tr>
<td>Number of branches</td>
<td>49</td>
<td>42</td>
</tr>
<tr>
<td>Number of employees</td>
<td>996</td>
<td>1340</td>
</tr>
<tr>
<td>Average amount outstanding per credit client</td>
<td>$ 2,547</td>
<td>$ 2,874</td>
</tr>
<tr>
<td>Average portfolio outstanding per employee</td>
<td>$ 209,798</td>
<td>$ 202,297</td>
</tr>
<tr>
<td>Average number of credit clients per employee</td>
<td>82</td>
<td>70</td>
</tr>
<tr>
<td>Savings accounts volume/loan portfolio</td>
<td>0.30</td>
<td>0.17</td>
</tr>
<tr>
<td>Net profit ($ 1000)</td>
<td>7,668</td>
<td>3,459</td>
</tr>
<tr>
<td>Expenditures for personnel ($ 1000)</td>
<td>12,746</td>
<td>12,600</td>
</tr>
<tr>
<td>Expenditures for personnel per credit client</td>
<td>$ 155</td>
<td>$ 134</td>
</tr>
<tr>
<td>Administrative costs as % gross portfolio outstanding</td>
<td>11.5%</td>
<td>10.6%</td>
</tr>
<tr>
<td>% of portfolio at risk</td>
<td>1.0%</td>
<td>1.2%</td>
</tr>
<tr>
<td>Net profit margin</td>
<td>4.11%</td>
<td>1.55%</td>
</tr>
<tr>
<td>Return on Equity (ROE)</td>
<td>37.43%</td>
<td>13.15%</td>
</tr>
<tr>
<td>Return on Assets (ROA)</td>
<td>3.12%</td>
<td>1.24%</td>
</tr>
</tbody>
</table>

Source: website Asofin\(^\text{60}\)

The composition of the loan portfolio shows us a difference between the target groups of the two microfinance banks: Los Andes is more broadly oriented, with a large percentage of loans going to the smallest borrower groups, but it also supplies more really large loans that would no longer really be considered microcredit. BancoSol’s lending is much more concentrated: The most important group of loans is clearly the $2,000 to 5,000 range; loans below $1,000 make up 24.2% of the volume. At Los Andes, the four lowest loan categories all have about the same weight, and 43.9% is smaller than 1,000. While both banks serve very small customers, it is apparent that BancoSol serves more than twice as many true microborrowers in the classical sense.

While the percentage of really big borrowers (above $ 50,000) is negligible at both banks, Los Andes still serves around six times as many (around 600).

What does this focus on smaller loans at Los Andes mean for the bank’s costs? One would expect that serving a larger number of true microentrepreneurs on an individual basis (not using group lending) is much more labour intensive as borrowers need to be carefully scrutinised. However, looking at the statistics in Table 6, it appears that Los Andes coped with this challenge in a quite efficient manner: the number of clients per employee is lower, but the personnel cost per client (which is what matters to the bank in financial terms) is actually lower than at BancoSol. Apparently employees at the ProCredit bank receive lower wages. Also, administrative costs as a percentage of the loan portfolio outstanding are lower at Los Andes.

Despite this apparently cheaper way of administrating loans, Banco Los Andes ProCredit clearly performs less well than BancoSol in financial terms. Net profits at BancoSol are more than twice as high in absolute terms, even though the bank is only slightly smaller in terms of size. The financial performance indicators clearly confirm this picture: the net profit margin, return on assets and return on equity are all two to three times as big at BancoSol. How come? We have just seen that the difference does not lie in higher costs for administrating loans.

The Asofin website gives a detailed breakdown of the banks’ profit margins:

<table>
<thead>
<tr>
<th>everything as a % of the gross average portfolio outstanding</th>
<th>BancoSol</th>
<th>Los Andes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenues from portfolio</td>
<td>20.57%</td>
<td>18.27%</td>
</tr>
<tr>
<td>Other financial revenues</td>
<td>1.25%</td>
<td>0.71%</td>
</tr>
<tr>
<td>Other operational revenues</td>
<td>3.08%</td>
<td>2.13%</td>
</tr>
<tr>
<td>Total revenues</td>
<td>24.90%</td>
<td>21.11%</td>
</tr>
<tr>
<td>Financial costs</td>
<td>-5.77%</td>
<td>-5.98%</td>
</tr>
<tr>
<td>Net delinquency costs</td>
<td>-1.48%</td>
<td>-0.97%</td>
</tr>
<tr>
<td>Administrative&amp;operational costs and earnings tax</td>
<td>-13.58%</td>
<td>-11.67%</td>
</tr>
<tr>
<td>Total costs</td>
<td>-20.83%</td>
<td>-18.62%</td>
</tr>
<tr>
<td>Incidental results (inflation, exceptional results, previous operations)</td>
<td>0.10%</td>
<td>-0.94%</td>
</tr>
<tr>
<td><strong>Net profit margin</strong></td>
<td><strong>4.17%</strong></td>
<td><strong>1.55%</strong></td>
</tr>
</tbody>
</table>

*Source: Asofin website*
What we see in Table 7 is that first of all, BancoSol gets more revenues: apparently, its bigger borrowers increase interest revenues, and its interest rates and fees are higher. Los Andes, in its annual report, states interest rates charged lie between 8.5 and 28% per annum\(^{61}\), while BancoSol’s report\(^{62}\) states the weighted average active interest rate is 22.4%. Especially for the lower segment of the market, where BancoSol itself states it starts out with a high rate in order to give borrowers a stronger incentive to pay in time, this means interest rates can be expected to exceed 25%. If the interest rates for these groups are indeed lower at Los Andes, this may explain why that bank hands out more microloans than BancoSol.

Secondly, Los Andes is doing better in terms of costs: delinquency is lower, as are administrative and operational costs. However, these lower costs do not suffice to compensate the lower revenues. An additional blow (increasing the difference by 1.04 percentage point) is dealt to the Los Andes profit margin by incidental results, mainly caused by inflation. The reason why Los Andes was hit by inflation and BancoSol was not is somewhat difficult to determine, but it probably has to do with loans being denominated in dollars rather than bolivianos: loans are on the asset side (with the volume outnumbering that of the deposits on the liability side), and when inflation is high (it increased from 4.5% in 2006 to 12% in 2007\(^{63}\)) the loans denominated in bolivianos decrease in value. Loans denominated in dollars are insulated against this. BancoSol apparently has a larger share of loans denominated in dollars\(^{64}\).

We can thus conclude that both Banco Los Andes, with ProCredit’s individual loan approach, and BancoSol, using group lending with collective liability, are successful self-sustaining and profitable enterprises. BancoSol is more successful in financial terms, while Los Andes has a greater outreach towards small borrowers. The two banks currently have more or less the same size in terms of borrowers and loan portfolio: should BancoSol keep up the better financial performance and therefore grow faster in the future with the help of market capital while keeping the proportion of microloans stable, this would show that a shift of focus towards a larger category of borrowers may

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\(^{61}\) Banco Los Andes ProCredit Annual Report 2006, p. 60
\(^{62}\) BancoSol Annual Report 2006, p. 84
\(^{63}\) BancoSol Annual Report and CIA World Factbook Bolivia
\(^{64}\) According to Morduch (1999b), 70 to 80 percent of loans at BancoSol are denominated in dollars; p. 1576
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pay off to ensure attractiveness to investors and therefore enable more growth, also for small lenders. However, when we look at the two bank’s growth performance over the past decade, we see that BancoSol (like Los Andes) does grow consistently in terms of portfolio outstanding but that the number of borrowers tends to be growing far less quickly than at Los Andes, even decreasing at times. Also, apparently, ProCredit’s method of scrutinising borrowers on an individual basis does not lead to higher administrative costs and saves some delinquency costs. Should the current trends continue, the ProCredit business model (careful examination of a large numbers of microborrowers and a small number of rather large loans) will prove to be better at maximising outreach, while BancoSol’s (using group lending with mid-size loans) will have high profits and turn more and more into a conventional bank.

3. Discussion

The three case studies presented have given us important insights into the development and functioning of successful microfinance institutions. These insights are relevant for Western development banks (such as the EBRD, the Dutch FMO and the German KfW Group) and International Financial Institutions (such as the IFC and the European Commission) who often support MFIs in their start-up phase. This section covers a number of considerations that these institutions need to take into account when dealing with MFIs.

Lending technology

From the three case studies, three different lending technologies emerge. Can we say that one of them is to be considered the best practice? Our comparison between BancoSol and Banco Los Andes ProCredit has shown that, at least in Bolivia, the use of individual lending or group lending with mutual liability does not make a huge difference in terms of costs: the ProCredit method of carefully examining borrowers appears to be a little cheaper because it leads to lower arrears, but BancoSol has higher revenues because it charges higher rates.

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While group lending may seem like an easy way to ensure repayment, especially in rural environments, the concept has some major drawbacks: borrowers have to put quite some effort and time into monitoring other group members and taking part in meetings of the group to coordinate repayments; when a group member defaults, the other members have the choice of either paying for this member or forcing the person to somehow get hold of the money; and when there is a critical mass group members that can’t repay, to the extent that the group’s track record is almost unsaveable, the others have an incentive to default as well, resulting in a significant loss for the provider of the group loan. The effectiveness of group lending depends on the extent of group solidarity and loyalty towards the loan provider.

If there are no very clear differences between lending technologies in terms of effectiveness, the question of which lending technology to use involves a value judgement: should borrowers be burdened with the obligations that come with group lending when the bank’s costs for individual loans are comparable? Most borrowers would prefer an individual loan: when an entrepreneur has more confidence in her own abilities than those of others that a group would be formed with, she will prefer to be responsible only for her own repayment. This problem could be tackled if borrower groups were only formed by people who totally trust each other, but then group formation is usually more complicated than that: it is not easy to say no to someone who proposes this kind of cooperation without offending that person at least a little bit. For borrowers, taking loans individually is also more convenient because they don’t have to spend time keeping an eye on fellow group members. It is very probable that borrowers would be willing to pay a higher interest in order to avoid being partly responsible or even liable for the payment performance of others. This high willingness to pay may present a solution to the lower revenues that Los Andes gets in comparison to BancoSol: the bank could probably afford to raise its rates without losing too many customers, raising profit margins in the process.

The height of interest is a controversial issue in the microfinance world. Many MFIs, especially if they’re profitable, are accused of charging too high rates, benefiting from the despair among the poor just like loan sharks do, plunging them into a spiral of debt. While it is true that a perfectly charitable MFI that is only interested in getting people
out of poverty would charge very low interest rates, it is also obvious that the amount of
donor money available for microfinance could never finance microfinance operations of
this low-interest type at the scale at which self-sustaining microfinance banks across the
globe offer its services today. The higher risks and administrative costs that come along
with small loans have to be covered by someone, and given the high-yield nature of
micro- and small enterprises borrowers are actually able to do so.

Should donors and investors set any conditionalities when it comes to lending
technologies at MFIs? It could be useful to determine best practices and stimulate MFIs
to use these techniques. On the other hand, if a consensus emerges about how best to do
microfinance and donors force the MFIs they support to apply it, a form of rigidity
could enter the world of microfinance, where innovative concepts would no longer be
introduced because they wouldn’t match the best practice. It is probably better to give
MFIs the freedom to develop their own lending technologies and pull out if the concepts
don’t work. Also, what works well in one area may work less well in another.

**Location-specific factors**
The reason why the section with the case studies concluded with a direct comparison of
two MFIs in the same country (Bolivia) was that countries differ greatly, making direct
comparisons difficult as different MFI concepts may function well in some locations
and less well in others. A group-based approach, for example, requires that there is a
strong feeling of community among the borrowers in the group; this is why group
lending is more suited for a rural setting, where villagers usually have been part of the
community for all their lives. In an urban setting this is much less the case, given that in
the informal settlements that microenterprise thrives in, the majority of the population
consists of recent migrants from all over the country who may not feel very loyal to
their new neighbours.

Despite cultural, political and economic differences between regions, the ProCredit
bank network, applying more or less one lending technology everywhere, operates in a
broad range of different countries: from some of the poorest and most corrupted
European countries like Moldova and Albania to African countries recovering from
civil war (Sierra Leone and the Democratic Republic of the Congo-Kinshasa). Is the
ProCredit method of carefully scrutinising customers before lending to them universal?
This still remains to be seen: the banks in Africa, for example, have been founded quite recently and we need more time to see whether they really will be a long-term success and if they will keep using the same method as the banks in Europe.

In any case, cultural differences are to be taken into account when introducing an MFI in a country. One should never make the mistake of implementing a lending technology that worked elsewhere without testing it first under the new conditions.

**Is there a trade-off between profitability and benefits to the poor?**

In the discussion on the height of interest rates, we have already come across a question that is fundamental: should MFIs be really profitable operations or should they merely cover their expenses? Critics of profitable MFIs accuse them of distributing income from starting microentrepreneurs to shareholders. To some extent, this is true: as soon as revenues exceed total costs, the MFI starts making a profit, and this profit benefits shareholders rather than the poor customers. However, in general microenterprises are better off if they have access to loans (even if interest rates are high) than if they don’t, and profitability is likely to increase the outreach of microfinance.

Unless the developed world is willing to substantially increase the development budgets available for microfinance (by spending much more on development cooperation or by reallocating funds from other objects), maximising the outreach of microfinance requires the existence of profitable MFIs. They fit much better into the financial system, and thereby are able to attract both more equity and more debt through market channels. Mere self-sufficiency does not suffice if we want MFIs to tap the virtually unlimited amount of capital available in global markets by offering market returns. The latter would be necessary to achieve the growth that is necessary to meet the worldwide demand for microfinance; after all, the billions of poor in the world represent an enormous potential for microfinance in the future.

Additionally, besides offering viable market returns, profitable MFIs are more reliable business partners for business-to-business contacts (such as other banks). At charitable MFIs, given the year-to-year basis of donations by donors, these may unexpectedly be withdrawn, leaving hole in the budget. It is therefore much harder for charitable MFIs to get loans from commercial banks or to sign other kinds of long-term contracts.
A recent article in the International Herald Tribune\textsuperscript{66} gives us the case of Compartamos, a Mexican MFI that in 2007 went public and entered the stock market to raise funds. Its growth has been very impressive: over the past seven years, it grew from 60,000 to 840,000 customers served. While the bank is being criticised for its high interest rates, it is able to attract substantial funds from the market and grow quickly. Admittingly, a substantial percentage of its shareholders are still development- rather than profit-oriented organisations (such as Acción), but they can combine their objective of stimulating the supply of microfinance with an increase in the capital they have at their disposal by investing in profitable MFIs yielding high returns.

On the level of individual borrowers, MFIs are faced with a trade-off between maximising development impact and realising returns that are competitive on the market: the choice is between benefitting poor borrowers more and making more profit. On a more comprehensive level, however, we can say that making more profit enables more growth and thus makes it possible to lend to more people who lack access to credit. In some ways, this question is comparable to that about minimum wages in the context of employment relations: lower interest rates are the entrepreneurial equivalent of the higher minimum wage, and the lower number of poor borrowers reached because of limited funds is the equivalent of a higher unemployment rate because of higher labour costs.

\textbf{Limits to the opportunities of microfinance}

Since the 2006 Nobel Prize, the media seem to have picked up the message that Muhammad Yunus sends out to promote Grameen Bank and microfinance in general: giving the world’s poor access to credit is \textit{the} answer to poverty in the world, with MFIs giving everyone, even the poorest peasants and beggars, the opportunity to get out of their hardship.

This is exaggerated, however: while microfinance can make an important contribution to economic development in a country, offering people a way to get out of poverty and contributing to the development of a healthy banking sector, it benefits mainly the more

\textsuperscript{66} Malkin (2008)
talented among the poor: those that have the skills to make their businesses a veritable success. Those who lack entrepreneurial talent and have not received any skills through schooling will in most cases not be able to repay a loan if they get one because the business they set up does not give the desired results.

Even in the case that the necessary skills are present, if a large percentage of inhabitants in a certain area get a loan, there may be so much competition (e.g. several bakeries set up in one village) that most of the new enterprises will not be able to develop properly. This appears to be the problem that Grameen Bank faces at times, leading to situations as described in the France 24 report mentioned before. While the bank lifts substantial numbers of people out of poverty and lends to everyone, those who have structural problems with repayment are left behind (which, as the France 24 report shows, leads to high suicide rates). The ProCredit approach discussed in the case study filters out both those who lack the skills to run their business and those who try to set up a business in an unfavourable environment: essentially, this economically viable approach only accepts borrowers who are already running an enterprise with potential and thus automatically excludes a substantial fraction of the population.

Microfinance is not a panacea to global poverty: lack of access to credit is just one problem that the poor in developing countries face. The fact that it enables the creation of more enterprises does not mean that it will solve or circumvent the problems of lacking health care, poor education and bad government. Donor interventions should focus on these problems, and fund microfinance mainly through seed capital in the form of equity and soft loans, and through technical assistance. Where there is great poverty-alleviating potential for microfinance, development cooperation funds can be used to give incentives to MFIs to serve these specific groups. The good thing about microfinance is that, once there are a number of MFIs in place in a country and a profitable market has developed (as is the case), donors can withdraw more and more, letting the market expand in its own right.

**Involvement of European donors**

All the banks mentioned in the three case studies have at some point in the past been or are still being supported by Western donors. Given the merits of microfinance, it is a good idea for European development banks and IFIs to continue supporting starting MFIs in countries where they otherwise would not develop.
In the first stage of an MFI, the involvement by donors is the most significant. There is technical assistance to a large extent (which is how IPC, the driving force behind ProCredit, got big), and the majority of the start-up capital is provided by them, in the form of equity and soft loans. In a nutshell, these are the three forms of assistance that are most commonly used, also at later stages in the MFI’s development. At the same time, the starting MFI may receive subsidies from local governments.

Technical assistance is necessary because providing microfinance requires know-how and skills that often are not yet present. Flying in experts is expensive, however, which is why Western donors often take over these costs. Gathering equity capital and getting access to loans is also very difficult for starting MFIs: the commercial banks in the countries of operation, convinced as they are that microfinance is not a profitable activity, usually are hesitant to provide loans for microfinance, and for equity the MFIs are certainly dependent on benevolent investors at first. For MFIs to start working in a certain country, as long as microfinance is not a mainstream banking activity that is fully guided by market forces, they will need some support when starting up the bank. These three common practice forms of support to start-up MFIs can be justified. They do not distort the incentive structures of the market the way direct subsidies would.

Support to MFIs should be planned from an exit-strategy perspective: Western donors should always pull out after a few years, either because the institution failed (of course one should try to avoid this by careful research before the support is given) or because it was able to stand on its own feet. Setting clear limits to support is therefore necessary: technical assistance should only last a certain number of months, the volume of soft loans handed out should not exceed a certain amount, and equity participations should be sold to private parties when the MFI can be expected to provide quality microfinance even under the new owners. This would also avoid the situation where the management of an MFI puts more effort into convincing donors to stay involved than to the actual microfinance business; if it is clear that the donor will pull out, there is no use in lobbying.
4. Conclusions

Microfinance, handing out small loans to those who cannot supply collateral, has become an immensely popular concept over the past years. To some extent, we could say there is a media hype on the subject, where the concept emerges as a panacea to global poverty. While this is exaggerated, microfinance institutions can make an important contribution to poverty reduction as well as financial sector development in developing and transition economies. This thesis has examined a number of MFIs on three continents to determine the best practice for the role of European development banks and other international financial institutions in the development of microfinance.

Grameen Bank, founded in Bangladesh by Muhammad Yunus, is the front-runner in microfinance and today serves as the best example for a charitable MFI. Using initial start-up capital from the government, Grameen grew to a size of over five million members who are also its shareholders. The bank, with a break-even rather than a veritable profit objective, focuses on the Bangladeshi poor, supplying them with loans that are considered very small even within the world of microfinance. In terms of lending technology, Grameen uses a hybrid form of group lending, one where there is no mutual liability but there is nonetheless substantial peer pressure within groups. The bank’s development impact is substantial: according to its own figures and definitions, 65% of borrowers have crossed the poverty line, interest rates are below what profitable MFIs would charge, and the Grameen even provides interest-free loans to beggars. This illustrates the most important objective as laid out by Yunus: lifting the poor out of poverty. The bank has a problem with transparency, however: it manipulates the information it gives in order to paint as rosy a picture as possible in order to please and attract donors. Grameen is a unique case, and very successful, but it is justified to have doubts about the applicability of the bank’s philosophy elsewhere.

BancoSol is a commercial MFI that evolved from an NGO to a bank in Bolivia. It has grown very quickly throughout the 1990s, but at the beginning of this century the number of borrowers fluctuated quite a bit (reaching around 82,000 in 2007). With mainly NGOs and benevolent investors as its owners, the bank has an altruistic mission through a profit-maximising strategy. Lately, this profit-maximising strategy appears to
have resulted in a move upmarket, with more focus being placed on small borrowers in the medium rather than the micro segment. The lending technology used for beginning borrowers at BancoSol is group lending in the classical sense: each group is collectively responsible for payment and liable in case a group member is not able to comply. BancoSol, despite not focusing on the poorest of the poor in Bolivia, offers opportunities to a large number of underprivileged, and if it continues to grow as a whole while keeping the percentage of small borrowers stable it could significantly contribute to poverty alleviation.

ProCredit Bank Bosnia and Herzegovina was set up as a greenfield commercial bank by IPC, a German microfinance consulting firm, and in the first decade of its existence has shown very fast growth (to around 70,000 loans outstanding in 2007), and it is still accelerating. The ProCredit network today is active in two dozen countries in Eastern Europe, Latin America and Africa, and is owned in a public-private partnership by IPC, European development banks, charitable foundations, benevolent private investors, and international financial institutions.

What is special about ProCredit compared to many other MFIs is that it does not use any form of group lending: all loans are handed out on an individual basis after a meticulous and labour-intensive evaluation of the microenterprises’ potential. While a large number of poor potential borrowers may not be able to access ProCredit loans because they cannot prove that their business has sufficient potential, the Bosnian bank still provides 44% of its loans in the lowest segment (less than € 1,000), and as such gives a large number of microentrepreneurs the opportunity to expand their business and improve their living conditions. Through its training programmes, ProCredit BiH also contributes to the development of human resources in the Bosnian banking sector.

When comparing the three case studies, we find that in terms of size, borrower characteristics and country characteristics the main differences are between Grameen bank on the one hand and BancoSol and ProCredit BiH on the other. Grameen operates in a big and very poor country, and as a consequence serves millions of members who are generally quite poor. BancoSol’s and ProCredit BiH’s activities take place in middle-income countries where the populations are not as poor.

In terms of lending technology, ProCredit stands out: by providing only strictly individual loans, it has a different approach than the other two.
The interest rates charged by the three microfinance institutions are all quite low for MFIs, below 30% (average effective interest rate). At BancoSol, this is due to the competitiveness of the Bolivian microfinance market, which is probably the most mature in the world, at Grameen it is due to the charitable nature of the bank, and at ProCredit BiH it is due to the relatively high development level of the country. All three banks still have considerable growth potential (at least when we look at recent high growth rates), although BancoSol seems to be scratching its ceiling at times owing to the competitive nature of the Bolivian market.

A direct comparison of two microfinance banks in Bolivia, BancoSol and ProCredit’s Banco Los Andes shows that the ProCredit approach is more directed to very small borrowers, and that its labour-intensive lending technology is actually not more expensive per borrower. BancoSol shows a better financial performance, however, due to its higher interest rates and lower vulnerability to inflation through dollar-denominated loans.

It is hard to determine a lending technology that emerges as a clear best practice from our case studies; both group lending and individual lending after careful scrutiny seem to be working quite well. Given that the results are comparable, from a client perspective we may have a preference for the ProCredit method because it does not burden borrowers with the obligations that come with group borrowing (attending meetings, being dependent on someone else’s business results and sustaining great social pressure in case of payment difficulties).

The hardest question in microfinance is about the trade-off between benefiting individual poor borrowers and profitability. This is directly linked to the height of interest rates: profit-maximising levels of interest rates take some of the surplus created by microentrepreneurs away from them and channel it to shareholders. When looking at cases of individual clients, this does not feel right. However, a high degree of profitability makes it possible for MFIs to become fully independent of donors and grow by attracting equity and accessing loans on international capital markets. Through this growth, a large additional number of poor can be reached. Basically, the trade-off is then one between benefiting current poor customers more or bringing (smaller) benefits to much larger numbers of poor. Given the limited availability of Western donor funds,
maximising the outreach of microfinance worldwide requires profitable and self-sustainable MFI.

Microfinance, despite its great potential to benefit a large number of poor in developing and transition economies, is certainly not a panacea to poverty. First of all, a large percentage of the world’s poor do not have the talent and/or the skills that are necessary to make their microenterprise flourish. Secondly, the fact that microfinance enables the creation of more enterprises does not mean that it will solve or circumvent the problems of lacking health care, poor education and bad government. Donors should not be allowed to divert their attention from these problems in favour of microfinance programmes.

In spite of the drawbacks of microfinance, its benefits are such that it is a good idea for European development banks and international financial institutions to continue supporting start-up MFI in areas where they would otherwise not develop through purely commercial initiatives. The three instruments most commonly used for this, namely start-up capital in the form of equity and soft loans, and technical assistance, are very useful: they do not distort the market in the way direct subsidies would, and give the European donors a say in the MFI’s early decision process. Of course, support should not last forever. Any involvement should be organised with an exit strategy in mind: either to pull out if the MFI is unsuccessful (this is to be avoided of course) or to cease involvement once the MFI is commercially viable and able to function on its own. In practice, this means limiting technical assistance to a certain period, putting a ceiling on the volume of soft loans, and selling shares to commercial parties when they are interested and committed to the microfinance orientation of the MFI.

To conclude: the case studies have given us important insights into the functioning of successful MFI. The three banks have all been supported by Western donors in the past, and given the merits of microfinance, European development banks and other international financial institutions should continue supporting start-up MFI in developing and transition countries.

Of course, for a more thorough analysis of the three case studies it would be very useful to gather all the necessary financial information by seeking the banks’ cooperation,
something that was not possible within the timeframe of this thesis. For example, it would be great if a development institution were to perform a detailed survey of a number of successful MFIs, e.g. taking five or six countries across several continents and select two MFIs for each country, and then perform detailed data analysis to really show which approach work best.

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