

TRENDS IN MICROFINANCE

2010 - 2015



TABLE OF CONTENTS

1	INTRODUCTION	1
2	DEFINITION ISSUE	2
3	KEY ISSUES	3
3.1	DEVELOPMENT OF MICROFINANCE INDUSTRY AND MARKETS	3
3.2	WHAT WILL HAPPEN AT THE MESO LEVEL?.....	5
3.3	THE SUPPLY	6
3.4	THE DEMAND	7
3.5	INITIATIVES TO FURTHER COVER THE MARKETS, INCLUDING RURAL MARKETS	8
3.6	FUNDERS AND FUNDING	10
3.7	LESSONS LEARNED FROM THE FINANCIAL CRISIS	11
4	FURTHER READING.....	13

NOTICE

This document has been prepared for MicroNed by Stefan Platteau and Hedwig Siewertsen from Triodos Facet in The Netherlands. The content of this document is the sole responsibility of the consultants and do not necessarily represent the view of MicroNed members. The document might be further disseminated; it would be appreciated if in such case, the authors and commissioners of the document are mentioned.

Triodos Facet
www.triodosfacet.nl
 +31306933766

MicroNed
www.micro-ned.nl
 +31703765516

4 FURTHER READING

CGAP: Elizabeth Littlefield, Brigit Helms and David Porteous: Financial inclusion 2015: four scenarios for the future of microfinance. 2006.

Elisabeth Rhyne and María Otero: Microfinance through the Next Decade: Visioning the Who, What, Where, and how . 2006.

'Frontier issues in Microfinance- Opportunities and challenges for European actors', conference report European Microfinance Week, November 2008

Honohan Patrick and Beck Thorsten, Making Microfinance work for Africa, 2007

Microfinance Banana Skins 2008: <http://www.cgap.org/p/site/c/template.rc/1.26.1905/>

Molenaar, Klaas: Microfinance, (only) for enterprising people? A diverse market requires a novel approach. 2008.

Syed M Hashemi - CGAP: Global Trends in Microfinance. 2006.

Steger, U., Schwandt, A. and Perissé, M.: Sustainable banking with the poor: evolution, status quo and prospects. Is microfinance losing its social values? International Institute for Management Development, 2007

UNCDF, Building Inclusive Financial sectors, 2006

Microfinance Banana Skins 2008 reveals strong doubts among microfinance practitioners, investors and observers about the ability of many MFIs to adapt to new demands while still retaining their social objectives. Current levels of management experience and financial skills are seen as a challenge for the industry. The fastest rising risk is identified as the growth of competition, driven by the appeal of microfinance to outside investors and commercial banks. Competitive pressures are seen to be undermining standards, cutting into profitability and aggravating staffing problems, though they are also spurring innovation and forcing down prices. Unless MFIs can manage these pressures, some could fail and damage the reputation of microfinance more widely.

Questions about who can get rich and how rich by selling financial services to the poor? That competition alone will not do the job has been shown in the international financial crisis. Four big and very aggressive investment banks and a lot of smaller ones did not lead to better products but basically to more and more risky products. It did not lead to a cap on profit but to an uncontrolled growth of salaries and bonuses. Microfinance is of course at a different level but how many microfinance clients are stuck with a loan because a loan officer was so eager to achieve the monthly goal?

1 INTRODUCTION

Microfinance is the practice of providing small scale financial services to the world's poor, mainly loans and savings and increasingly other products like insurance and money transfer. Worldwide there are an estimated 10,000 Micro Finance Institutions, with charters ranging from non profit NGOs to Credit Unions and Commercial Banks. The 1,300 MFIs who at the end of 2008 were reporting to the Microfinance Information eXchange (MIX) have 70 million borrowers and a similar number of savers. Total loan portfolio stands at US\$ 40bn. In the past years key volume indicators have been growing by 20-30% per year, more in some countries. The stock of foreign capital invested in the sector, which more than tripled to US\$4bn between 2004 and 2006, keeps on growing and now stands at over US\$ 10bn. Much of it is held by specialised microfinance investment vehicles, with an increasing proportion coming from the private sector that sees investment in microfinance as an attractive asset. The industry has definitely entered into a stage of commercialisation although at the same time there is increasing interest in running operations respecting the triple bottom line¹.

How will this paragraph look like by 2015?

It very probably will contain a version of the following:

The ambitious goal set forward in the 1997 Microcredit Summit has been achieved and the vision of inclusive microfinance, extending financial services to the majority of the low income population, has been substantially accomplished. Microfinance is an established part of the financial system in most countries and is increasingly integrated into the financial system to an extent that it is difficult to identify a distinct microfinance sector. The old and simply recognizable relation between a poor client and a socially aware MFI has been substituted by all kinds of forms of client - provider relations.

These different client provider relations of the future can be visualised as follows:

PROVIDERS	PRODUCTS	CLIENTS
Banks	Micro loan	(Poor) families
Finance Companies	Small loan	Micro entrepreneurs
NGOs	Educational loan	Small farmers
Savings & Credit coops	Credit card	Families in their different roles:
Big box consumer retailers	Mortgage	as consumers, house builders,
Insurance companies	Consumer loan	parents, savers, insurance takers,
Property developers	Checking account'	part of money flow networks
Money transfer agencies	Savings account	
Mobile phone companies	Foreign currency account	
And other new providers	Remittances	
	Supplier credit	
	Leasing	
	And other new products	

But how will we get there and what are the trends leading to this scenario?

In this paper we present trends that will contribute to or even be decisive for the changes and further growth of the microfinance industry.

¹ Actualized from: Elisabeth Rhyne and Maria Otero: Microfinance through the Next Decade: Visioning the Who, What, Where, and how. 2006.

2 DEFINITION ISSUE

Is it still microfinance when it is regular lending to a micro entrepreneur?
The growth itself of MF reduces the number of unattended people. When are you a MC client?

MIX data for 2004 shows a worldwide total of 30 million borrowers served by 675 organizations. Otero and Rhyne in 2006 wrote: "There is a core group of microfinance institutions reaching roughly 30 to 50 million borrowers. By now, 2009, the MIX market contains reports of 1397 MFIs, with the 10 largest servicing over 30 million borrowers.

Name	Country	Legal form	No. active borrowers
VBSP	Vietnam	Bank	6,793,443 (31/12/08)
Grameen Bank	Bangladesh	Bank	6,707,000 (31/12/07)
BRAC	Bangladesh	Non-Profit (NGO)	6,367,250 (31/12/08)
ASA	Bangladesh	Non-Profit (NGO)	5,877,440 (31/12/08)
BRI	Indonesia	Bank	3,515,812 (31/12/07)
PROSHIKA	Bangladesh	Non-Profit (NGO)	1,761,638 (30/06/08)
SKS	India	Non-Bank Financial Institution	1,629,474 (31/03/08)
Spandana	India	Non-Bank Financial Institution	1,188,861 (31/03/08)
Compartamos Banco	Mexico	Bank	1,155,850 (31/12/08)
SHARE	India	Non-Bank Financial Institution	989,641 (31/03/08)

Then there are movements like the NABARD Self-Help Group Bank Linkage Program in India covering tens of millions of poor people.

These numbers include clients of an increasingly different nature. From very poor people, receiving 50 dollar loans to small enterprises and traders with loans in the tens of thousands. Still the majority of the clients can be considered as poor, and may be more important, not having access to normal banking services. Although here too changes are happening. Like many other sectors of the economy, banks have started to discover the poor and their potential. There is an increasing number of banks downscaling, picking up clients that traditionally would not have been of their interest.

The financial crisis might be a drawback for the view that (semi)public money should get out of microfinance. There is an outcry that because of the credit crunch MFIs lack access to money. That explains recent initiatives like the Microfinance Growth Fund, established on initiative of the US Government to provide loans to MFIs and microfinance investment vehicles (for Latin America and the Caribbean¹³).

New international funders bring a fresh perspective and support innovations and activities that traditional donors cannot easily handle, such as the application of technology to pro-poor finance. They bring to bear their expertise in business, technology, and governance. Their instruments are flexible, and their approach accelerates innovations that lead to hundreds of millions more people accessing financial services. The new entrants understand the idea of building, rather than bypassing, domestic funding¹⁴

3.7 Lessons learned from the Financial Crisis

We can learn two lessons from the financial crisis that should protect the microfinance sector from a similar crunch. One lesson is that clients and financial institutions should understand their products. The second lesson is that too much focus on (financial) performance of staff and management which is fed by (short term oriented, greedy) shareholders creates distortions and unacceptable risks in the system that in the end will destroy it.

There has been a surge in initiatives to educate the financial services client. Not only to strengthen her position towards the MFI but also to improve the impact of microfinance services by teaching households and micro enterprises how to manage their money.

Trends lesson 1

- Raising client awareness and knowledge about financial products
- Raise awareness of public institutions, NGOs, financial institutions with regard to the need for increasing financial literacy of low-income households.
- Promoting policies and mechanisms that contribute to client protection
- Capacity building of organizations specialized in enhancing financial education and training
- Advocacy for consumer rights
- Support to financial institutions to improve information provision about their products and what the mean for the clients financial household.
- Social Performance Measurement as a tool to measure and steer the focus of MFIs on the people side of their business.

As they become increasingly demanding on the relation between the MF providers and their clients, donors and funds might suddenly find themselves in opposition to their MFI clients

Support to initiatives

- Policy measures to improve consumer protection.
- Support to MFIs in the information provision to clients
- Support to specialized agencies and NGOs working on enhancing financial education
- Tools development and cost-effective models to deliver financial education services
- training local stakeholders in delivering financial education

¹³ <http://www.microcapital.org/microcapital-story-us-president-barack-obama-announces-100m-microfinance-growth-fund-for-latin-america-and-the-caribbean-at-fifth-summit-of-the-americas/>

¹⁴ Elizabeth Littlefield, Brigit Helms and David Porteous: Financial inclusion 2015: four scenarios for the future of microfinance. 2006. Page 10.

3.6 Funders and Funding

Where will the funding come from? What are the trends in the development of local capital markets? Is there still a role for public money?

Trends

- No lack of funding for this profitable and socially rewarding market
- Increased competition between micro finance funds
- Domestic sources of funds will become more important: savings, bank funding, bond issues. Start of regional funds with regionally raised resources.
- Securitization of MF portfolio becomes a standard instrument for raising funds.
- Pressure on funds based on public resources (development banks) to pull out and look for riskier development business
- Support to improve negotiation and valuation skills of MFIs (in transformation process, offering of shares)
- Money becomes more demanding in terms of social performance and sustainability orientation of the MFIs
- Growth of regional (South based) MF investment funds
- Equity investment in microfinance has become a mature business.

Microfinance has become an attractive asset category. Not only for social investors but also for (local) commercial investors. The financial crisis might have made them more cautious, but the money is going to come back and will do so in even larger amounts. Partly because microfinance as an investment opportunity has demonstrated its strength and resilience in the face of the crisis.

Parties like Compartamos (Mexico) and WWB Cali/Colombia have been pioneers in raising money on the local commercial markets (bond issues). These bonds were bought by institutional investors such as pension funds and insurance companies and will increasingly become sources of funding. Local market bond issues have the advantages of avoiding foreign exchange risk for the institution and of strengthening the local capital market. Of course this funding will be easier in countries with a well developed capital market. In other countries the dependence on foreign funding will continue but will eventually also decrease.

Innovative ways of engaging the capital markets will develop, although at this stage it is difficult to predict the mechanisms, partly because as a result of the financial crisis the capital markets themselves will change considerably. We have already seen the first steps into securitizing microfinance, with private placements and wholesale purchases of microfinance portfolios taking place in Kenya and India. Securitization will become a standard tool for raising funds in microfinance. Such tools will allow capital to flow from both local and international markets and will integrate whole new groups of investors into microfinance¹².

MFIs are becoming better negotiators with equity and debt investors. A couple of years ago, when an investor bought shares, he did it at book value. Or not even that. Already now MFIs who issue shares or increase capital focus more on the valuation of their business and want the share price to take that into account. What will MFIs need to be professional partners and good negotiators in their relation with the funds? Issues like the valuation of MFIs and the mutual control on governance are relevant.

Microfinance has become attractive enough to attract international and national private capital. That gives more and more ground to those is one school, the one that accuses public funds based on public money to crowd out commercial money.

¹² Rhyne & Otero, page 46.

3 KEY ISSUES

3.1 Development of microfinance industry and markets

What are the trends and forces that are shaping the future of the microfinance industry? And what will this do to the poverty focus?

Trends

- Key words here are growth, scaling up, increased use of technology, integration in mainstream finance and de-segmentation. These trends have started in the past years and are likely to continue.
- Another trend is further commercialization, although this does not exclude the trend of increased attention for social and environmental performance. Big providers might even take the lead in making the focus on the triple bottom line a standard feature of the industry. Mission drift (away from the poor) and increased interest in sustainability will co-exist.
- Industry development, once “development led” (from the North) will be taken over by commercial initiatives, increasingly coming from inside the developing world.

The analysis of a sample of 487 MF providers (reporting to the MIX²) over just a three year period clearly shows the scaling up of operations and as result the growing importance of large institutions. In 2005 almost 50% of these MFIs had less than 10,000 clients. Within two years that changed dramatically (see table). Completely in line with this, the table shows that the average number of clients per institution is growing rapidly³.

By 2015 small MFIs will still be there but their relative weight in the market will be minimal. At least from a quantitative point of view. Small MFIs might continue to play an important role as innovators or providers of services to special groups, but their scale will definitely put them in a weak position when it comes to investment capacity, access to technology and retaining of human resources.

Outreach and size ⁴						
Scale of MFI	2005	2006	2007	%	%	%
Small	221	199	164	45.4%	40.9%	33.7%
Medium	139	128	138	28.5%	26.3%	28.3%
Large	127	160	185	26.1%	32.9%	38.0%
Total	487	487	487	100.0%	100.0%	100.0%
Avg. Clientele	63,582	80,825	100,978			

Parallel to this the trend of more and more MFIs becoming regulated entities with a commercial charter will continue. The analysis of the same sample of 487 institutions clearly shows the shift away from the NGO type to banks and most of all to Non Bank Financial Institutions⁵ (see table).

Institutions per charter type						
CHARTER TYPE	2005	2006	2007	%	%	%
Bank	46	48	50	9.4%	9.9%	10.3%
Credit Union	35	35	35	7.2%	7.2%	7.2%
NBFI	143	169	172	29.4%	34.7%	35.3%
NGO	222	196	190	45.6%	40.2%	39.0%
Rural Bank	41	39	40	8.4%	8.0%	8.2%
	487	487	487	100.0%	100.0%	100.0%

² Source: The MIX Market. The sample consists of MFIs who have been reporting to the MIX over the period 2005-2007.

³ We are aware that the average is heavily influenced by a couple of huge MFIs like ASA Bangladesh.

⁴ Small Institution: < 10,000 clients; Medium: > 10,000 < 30,000; Big: > 30,000 clients

⁵ For a lot of NBFIs this status is the purgatory on the road to heaven – being a bank.

Formal financial institutions are increasingly important and the percentage of services delivered by banks is increasing over time. This is not surprising because of the banks' capacity to leverage their capital and grow their operations⁶.

The growth of the industry will largely be autonomous, i.e. institutions growing by themselves, attracting sufficient equity, liabilities and deposits to fund growing portfolios. Will the long predicted consolidation of MFIs occur? The mechanisms exist (mergers, acquisitions, buy outs by banks, partnerships) but so far little has happened⁷. We think that most MFIs with a growth vision will continue to go for it by themselves. Other important growth mechanisms will be the continued geographical expansion of specialized banking and MFI groups (e.g. PROCREDIT, ACCION) and the growth of commercial banks adding "microfinance" to their core business.

As for the small MFIs they will continue to exist, partly because they operate in niche markets, partly because of offering closeness to the client. Another reason will be that they are not attractive enough to be "eaten" or acquired by a bigger player.

New type of owners and promoters

We do expect a continued change in ownership patterns. Ten years ago ownership of microfinance institutions was of the NGO type. Nowadays there is a mixture of NGOs, social investors, commercial capital (local and international). The portion owned by commercial capital will continue to increase. But as commercial capital will from within pay more attention to the triple bottom line, the commercial ownership will have its social lining. We foresee harder times for independent MFIs who do not belong to a network, who have only themselves (personnel, board) to count on. And who in the end depend on a couple of foreign investors.

As banks and NBFIs become more important, microfinance will become increasingly integrated in the mainstream financial markets. Microfinance as a separate term, from the time of clear market segmentation, will disappear. Even "pro poor finance" might become as strange a term as "pro rich finance". Although both of course exist.

A clear trend is the shift in the origin of initiatives for promoting, setting up and supporting microfinance. Traditionally coming from the development scene in the North, the focus is changing.

Specialized ventures promoting and setting up greenfield microfinance banks will increasingly become important.⁸ The people behind this are a mix of visionary entrepreneurs, social investors and specialized MFIs wanting to do more than just bring in more new clients in their institution and capitalizing on their experience.

We also see a trend whereby the North, the developed world and its institutions oriented at poverty reduction, will become less important as promoters of microfinance. India's and Brazil's strategies for poor people's financial access are homegrown, not derived from developed country counsel⁹. Players in such countries, which include also China and Russia and may be some "regional powers" like South Africa will venture outside their own borders and set up microfinance operations in interesting countries. Regional microfinance funds will become active and try to conquer markets by offering equity and liabilities with a geographical touch.

For a development institution based in the North, teaming up with such players can be very interesting and offer important complementarities.

⁶ Elisabeth Rhyne and Maria Otero: Microfinance through the Next Decade. 2006. Page 24.

⁷ Reasons for the lack of consolidation include the lack of trust in portfolios built up by "others", theoretically candidates for take over, their continued access to (international) funding and the "big egos" and views of "we are unique" in a lot of institutions.

⁸ Example: Catalyst Microfinance Investors, a joint venture of ASA, one of the worlds biggest MFIs, and Sequoia, an international corporate finance advisory and private equity firm. Work has started on setting up MF banks in China, The Philippines and Nigeria.

⁹ CGAP: Elizabeth Littlefield, Brigit Helms and David Porteous: Financial inclusion 2015: four scenarios for the future of microfinance. 2006. Page 3.

The providers will remain the major force to increase outreach. They will be driven by competition, obliging them to enter into new markets, continue to increase their efficiency and motivating them to diversify their product offer to attract formerly excluded clients. In acting alongside these lines, the quantitative gap will be gradually closed, more and more people, households and SMEs will get access to financial services.

Enhanced use of technology

Technology will play an important role in achieving the goal of making financial services available to poor people and people living in remote or low populated areas. As the technological infrastructure (internet, cellphone networks) continues to improve, people will be able to do their transactions without any physical contact with a bank branch or a MF credit officer. Transaction costs will thus be significantly reduced and "exclusion" on grounds of being too far from a physical outlet will continue to diminish.

According to the United Nations International Telecommunications Union (ITU), the number of mobile cellular subscribers worldwide has reached the 4 billion mark by the end of 2008. The number of subscribers has surged nearly 25 per cent annually for the past eight years. Mobile penetration stood at only 12 per cent in 2000, growing to reach over 60 per cent by the end of 2008¹⁰. Developing nations account for the majority of the mobile phone users although penetration rates vary by region and even within countries. Rapidly developing economies such as Brazil, Russia, India and China are driving the growth in the number of cellular subscribers, with these nations alone accounting for over 1.3 billion of them by the end of 2008.

The technologies to transform microfinance already exist. Among the available technologies are magnetic stripe and chip (smart) cards, point of sale devices, ATMs, cell phones, satellite communications, the internet, credit scoring, biometric recognition and more. These technologies will require microfinance institutions to redesign their business models and educate their employees and customers to master new ways to deliver and receive services¹¹. Such changes will not always be easy, but the benefits will be dramatic.

This is about technology at the front end, in the direct relation with the client. From the intake (on line loan request, credit scoring,...) to paying bills by cell phone. But of course technology will also show its potential at the back end, in the processes, in the data management.

Knowledge will act alongside technology. Faced with difficult markets, and having learned lessons from overexposure to "easy markets", financial institutions will increasingly gather and process information about clients, markets and sectors. There will be demand for systems to analyze the risks in agricultural lending, for information about value chains, for knowledge about clients' financial needs. Improved risk assessment might however result in some institutions staying away from risky clients.

Assuring access to financial services by the poorest parts of the population will remain a challenge and requires "preparatory action". Such action can take place at different levels, one of them is teaching skills or helping poor people to generate an initial capital to set up an economic activity and to "appear" on the radar screen of MFIs. Even more basic is fundamental support to assure access to basic education, health and a decent place to live, pre-conditions to graduate poor people out of (extreme) poverty. This type of poverty eradicating investments cannot be judged on their financial sustainability and require subsidy. We talk about social interventions to eradicate poverty and decrease vulnerability and in the end strengthen the economic fabric.

Marginal markets

Certain segments of the population continue to be excluded, because of their extreme poverty and lack of economic activity or because of (temporary) emergency situations, wars, disasters. There is a role for initiatives to bring such groups on the radar screen of the financial institutions. By providing them with basic services allowing them to enter into a more decent and stable stage of life. Initiatives to cover the very poor will continue, like for example Grameen bank offering credit to beggars.

¹⁰ http://portal.unesco.org/ci/en/ev.php-URL_ID=27530&URL_DO=DO_TOPIC&URL_SECTION=201.html

¹¹ Rhyne & Otero, 2006.

- A focus on "Financial literacy" that not only will help to avoid clients from buying the wrong products or getting over indebted but will help the provider to learn what the client really wants.
- Linked to this strengthen the providers capability to "listen to the customer."
- Smart use of the economic and financial information available. The introduction of new products or the entering into new markets is still based quite often on intuition, piecemeal information or external/donor promoted opportunities and not on professionally prepared market research. Countries in Eastern Europe and Asia have a lot of statistical information about the population, their economic profiles, their savings, etc... . Data mining can lead to a more intelligent reaction to the clients needs.
- Support to "fill" the gap between supply and demand. Financial institutions often do not have the ability to distinguish, define and meet the demand. A donor can intervene analyzing the needs for financial products and fund the building up and dissemination of market knowledge.
- Banks and financial institutions are submitted to regulations. Capital adequacy, minimum provisioning for portfolio in arrears, etc... . There is now room for introducing regulations at the level of the client. A red signal if a client has > 30% of her free disposable income tied down in payments on loans. Or if for 6 months there have been no deposits on the bank account, only withdrawals.

Financial education initiatives are also going to contribute to clients being more demanding, wanting tailor made products and wanting to fully understand the implications of buying the product. Their power as clients, if well organized and voiced, can be an effective mechanism to make financial institutions deliver products that really fit the needs.

Focus has been on the demand for credit although for years everybody has agreed that other financial services are also important. And that demand will continue to grow, be it for the simple reason that the population in most developing countries continues to increase. And there is no indication that the formal labour market will be able to absorb the growing number of youth nor the migrants to ever growing cities. The number of "microenterprises", the informal sector, will be on the rise. Self-employment will remain the occupation for hundreds of millions of people, among them a high % of women. They will need access to capital to run their businesses and to overcome needs for cash. And to other financial services for their business and families (savings, payment services, insurance, remittances, mortgages). So the demand is there and is growing

3.5 Initiatives to further cover the markets, including rural markets

The outreach of microfinance has increased dramatically in the past ten years. Yet there are still "white spots": geographically, sector wise, socially. What is going to happen to cover these white spots? Are established MFIs interested to step in as competition in "easier markets" increases? Will this remain a market for niche players? Is outside support necessary to motivate (new) providers to step in?

Trends

- Financial institutions' continued search for efficiency and growth will continue to increase outreach. The quantity gap will be closing.
- Competition will stimulate financial institutions to tackle "frontier" markets.
- Social goals will stimulate less commercial institutions to enter deeper into poorer markets.
- Technology will substantially contribute to reaching remote clients and will reduce transaction costs for providers and clients.
- Donors will focus on frontier markets (very poor and rural).
- Social investments (education, health, life skills) lead to more people that can become financial product clients.
- For frontier markets, riskier markets: there will be increasing demand for knowledge and information.
- Covering the quality gap will be an ongoing process.

Commercialization alongside triple bottom line

These trends indicate increasing commercialization. So what about mission drift, the possible distortion of microfinance's historical mission of social improvement?

So far there is little evidence that the social-oriented values of microfinance are being lost or that commercialization goes against access for the poor. The best defence against mission drift might come from within the institutions. We foresee a continued trend towards financial services being offered by institutions who work along the triple bottom line. Partly because even purely commercial ventures are focusing more and more beyond the uni-dimensional objective of profit.

This as a result of a worldwide trend that people and planet are important, that these dimensions should be a normal part of a company's bottom line. Staying with the poor will also be strengthened by the view that at the bottom of the pyramid there simply is a huge market.

Still further market development at the bottom of that pyramid will continue to require support by non commercial initiatives and development institutions, to bring new clients on the radar screen of commercial provider and screen them, to pilot new processes and products. Opening up of new markets will remain an activity that requires investment and vision.

Development oriented institutions will no longer focus on developing supply capacity and will try to strengthen the demand side. Financial education and consumer protection will flourish and governments will oblige financial institutions to put "smoking is dangerous" type of stickers on financial products.

3.2 What will happen at the meso level?

It is generally recognized that the development of structures at meso level (credit bureaus, training centres and consultancy services, micro finance associations, local wholesalers) has contributed a lot to a sound development of the MF industry. They provide services that make it easier for MFIs to manage their risks and that allow to concentrate on their core business.

Trends

- Microfinance Associations will face the challenge of remaining relevant and useful by increasingly powerful providers.
- Credit bureaus so far have focussed on the interests of the providers. The information accumulated there will increasingly be used for consumer protection.
- Increased need for consultancy in the organizational and governance challenges facing mature companies.
- Global initiatives to spread tools and technology.
- Increased competition in the rating market with social rating becomes a standard tool.

MF Associations have increasingly powerful members

In a lot of countries the creation of MF associations has shown its positive effects, for example in achieving adequate legislation or in obtaining government support when faced with problems like no payment movements. In an increasingly competitive market, joining forces will become even more important for "stand alone" MFIs. They can get better deals from technology providers or take joint initiatives to integrate into the international payments network or to obtain specialized training. Regional networks can achieve even more, in particular when they bring together smaller countries. At the same time MF associations might loose negotiating power, partly because regulated MFIs and banks might not remain as members. And partly because they will not offer the high quality services needed by the more specialized and modern providers.

Credit bureaus will continue to be important mechanisms for adequate lending and for support to an institutions risk management. The wealth of information they contain about financial service users will also be put to a wider use. In particular the bureaus can play a role in consumer protection. "Red lights" will appear when an individual or a company is acquiring debt beyond capacity.

In the past MFIs contracted consultants and trainers to improve their systems and capacity to lend, to develop products, to train people in typically (micro) finance type of issues. As they grow, they will face the planning, organizational and governance challenges of a growing industry. As a result they will increasingly be clients for specialized consultancy and training services and for professional support in issues such as strategic planning, managing growth processes, financial engineering and organizational improvements.

Smaller and “stand alone” MFIs will not have the capacity to keep up with the technological developments. They will be eager to get access to technology and might be “clients” of global or regional initiatives who offer them access to modernization. The spreading of technological infrastructure (internet, mobile phones) can also be seen as a “support” infrastructure for the spreading of financial services.

The established Rating agencies will continue to thrive although the competition from mainstream banking raters like Moodys and Fitch will increase. All of the raters will increasingly offer the service of social rating.

3.3 The supply

Trends

- Further blending of different types of providers.
- Decrease in market segmentation.
- The coverage in big market like Mexico, Brazil and China will increase and they are being discovered by big providers.
- In mature markets, market development led by innovative providers who close the quality gap.
- Sustained growth of product offer, with increasing technology contents in the products.
- Increasing competition brings price and other advantages to the client but also threat of “over-lending”.
- MFIs facing the organizational and governance challenges of a growing industry.
- Cross border financial services on the increase.
- More and more specialized and niche products.

In the past twenty years the focus of MFIs, microfinance networks, funders, development projects and donors has been on developing the supply capacity. Good practices were about improving the efficiency of the business, about how to charge cost covering interest rates, about risk management and developing new products. Parallel to that the donors drew up guidelines about what to do, where to help, what to demand from the MFIs (see the pink book).

Providers have thrived and this has led to impressive progress in closing the “quantitative gap”, the gap between those demanding financial services and those having access to them. In countries like Bangladesh and Nicaragua, more than 40% of families have access to micro lending. In other countries outreach is still very low. The very disparate coverage between early (like Bolivia and Bangladesh) and late starters (like Brazil, Nigeria, China) will be reduced as these often big markets are being further discovered by big providers.

Clients will determine the supply

A major and newer challenge is closing the quality gap: the difference between the services offered and the services best suited to the clients’ needs. In the years to come, there will be a continued effort to also cover that gap. Getting a US\$ 100 dollar loan as part of a group with a fixed term and a pre-defined pattern of growth of the amount is not what you call a client tailored loan. So although a poor woman might be a credit client in the statistics, the service not necessarily covers her needs. The trend is that clients learn about their needs and gradually are able to express them better. As a matter of fact in the access to a MFI the clients tends to “discover” her real need, and can express it directly to the loan officer or indirectly by walking away, driving up drop-out rates. For both providers and clients there is a continued learning process and in their interaction the basis is laid for product diversification.

New providers enter the scene

Parallel to product diversification, the role of “non traditional” microfinance providers will continue to increase. Inspired by the profitability of the MF market and putting in practice the belief that the poor are an interesting market, the presence of banks as providers of microfinance will continue to increase. They will integrate microfinance into their mainstream commercial retail lending. The presence of other providers will also increase: supermarket chains, insurance companies and others have discovered the market of the poor and apply different strategies of “downscaling”. At the same time MFIs have embarked on upscaling, partly to diversify risks, partly to keep clients that grew with them. These processes tend to blur the borders between types of clients and will lead to de-segmentation. Nobody will have the “monopoly” on microfinance and the term might eventually disappear. If the average size of the financial transaction is a standard to define micro finance, then Western Union is one of the biggest MF institutions of the world.

Increased competition will oblige providers to apply the product development and marketing strategies of a mature industry. There will be more and more specialized and niche products. Some of these will be inspired by a development view, for example credit products supporting the introduction of alternative energy sources. One of the key reasons for MFIs to pursue the status of regulated institution is that it allows them to offer more services. Not only savings but foreign exchange transaction, remittances, payment of utility bills.

Facing this reality of continued innovation, MFIs need to invest, need better trained people who do not offer a standard product but look into the financial need and eventually total financial management and portfolio of the client. The loan officer will increasingly become a financial products advisor.

3.4 The demand

Trends

- Increased attention for the demand side of the market.
- Financial education.
- Empowering the financial products consumer.
- Governments to protect the consumer, even imposing “smoking is dangerous” labels.
- To further deepen outreach: initiatives and NGOs bringing “the non attractive demand” to the market

As the supply side has become stronger and stronger, the focus is shifting to the demand side. Against increasingly big and professionalized financial institutions, the average client is weak, ill prepared and dependent. There is a trend to “change sides”, to focus more on the client.

The “unbalance” between a professional and often aggressive supply and an unprepared and atomized demand will be tackled in a number of ways:

- Long term: better basic education that creates skills for understanding, having a critical attitude and even better knowledge of basic mathematics to understand interest rates.
- Medium term: customer protection, creation of associations of financial products consumers.
- Short term: media campaigns and publication comparing conditions of financial products.

Consumer protection is everywhere. Soft drink bottles show in detail the ingredients. And tobacco companies are obliged to put health warnings on their cartons. In that same line it will become very normal for a MF provider to detail the characteristics of the product. And eventually put a warning in big letters on the loan contract “If the servicing of this loan is absorbing more than 20% of your disposable income, do not sign”.

Towards this new challenge, there is an opportunity for external or donor supported lines of intervention: