CGAP MICROFINANCE GATEWAY

Q & A

Microfinance: Revolution or Footnote? Microfinance Over the Next 10 Years

In this Gateway webinar, we explored important questions about the future of microfinance with our invited speakers Ira Lieberman, Chairman and CEO of LIPAM International and Paul DiLeo, Founder and President of Grassroots Capital Management Corp.

With only one hour for the webinar, and a very engaged audience, there were several questions that the speakers were unable to answer during the time allotted. We followed up with Ira and Paul after the webinar to get their responses to some of these questions.

The answers below have not been edited by Microfinance Gateway and are presented in full as submitted by the speakers.

MICROFINANCE'S PATH

What is your take on the transformation of MFIs into for profit companies and banks? Is that the "natural" next step?

As MFIs grow and engage in more diverse and complex product offerings, they may see advantages to converting into for-profit, shareholder companies. One advantage is that depending on the regulatory framework in their country, a for-profit form may enable an institution to offer certain products or operate at a scale not available to non-profit or non-shareholder entities. However, most jurisdictions do have non-profit forms, like credit unions, that can offer most or all of the products and services that MFIs typically offer.

A second advantage is that for-profit forms are generally viewed as facilitating access to more sources of funding, in particular equity, that enables MFIs to scale up. This is not universally the case and indeed, several of the largest MFIs in the world continue to operate successfully as non-profits. But generally, there has been a trend for many MFIs to convert to a for-profit form, and for new MFIs to be launched as for-profits, and the bulk of formal microfinance services are now provided by for-profit companies.

What is your view on the type of investors that may be entering and potentially distorting expectations, weighing too heavily on the financial return side of the equilibrium? They have more money than any donor... How can the industry work with these funds to help balance their impact and avoid distortions?

In engaging with new investors, it is essential that MFI founders and managers are clear about what business they are in. If their business is providing those financial products and services and serving those clients that can maximize returns for shareholders, they can comfortably engage with certain investors. If their business is assembling financial and other resources that they can use to improve the circumstances and prospects of poor families and communities, they can engage with different investors. It is to no one's benefit to pretend that these are the same business.

That is not to say that the profit-oriented business doesn't provide benefit to its customers, or that the socially-oriented business will not be profitable. Rather it is just stating the obvious: investors have a right and a responsibility to understand what they are investing in, and managers have a responsibility to do their best to deliver the financial or social outcomes they aspire to. Some impact investors express interest in achieving high social impact and high financial returns, that seems for the most part to be inconsistent with social investing. It is important for the board and management to understand investors' expectations.

IMPACT

What can be said about the social impact of microfinance? Are there differences in impact/reach when it comes to MFIs servicing entrepreneurs (business needs) versus people (personal needs)?

Assessments on the social impact of microfinance have seesawed back and forth over the past eight to nine years since the exuberance following the Nobel Prize attracted the professional debunkers. Over the same period the understanding of the complex financial lives of poor households has also become much deeper and more sophisticated. Our succinct summary of the current state of the discussion is that microfinance products and services can help poor clients better manage their finances and risks and can increase incomes both directly and indirectly but won't always do either for everyone.

The likelihood of clients being offered products that help rather than harm is probably increased if the MFI prioritizes client benefit. MFIs traditionally have targeted clients for whom the household and at least some income-producing activity are inseparable, but over the years the industry has moved away from the assumption that the main source of benefit to clients was lending to support income-producing businesses and acknowledged the value of income smoothing and financing for "non-productive" activities, like health services or school fees.

The blogs of CGAP and the Financial Access Initiative at NYU are good sources for the latest research on impact. What is clear is that by itself microfinance cannot alleviate poverty. This was over-promising by some practitioners who promoted microfinance initially. In her book, The Microfinance Revolution, Marguerite Robinson spells that out clearly. Also, safe savings, not generally addressed by those who have measured social impact, may be as important for clients as loans. This is demonstrated in Africa where MFIs who mobilize savings usually have many more savings accounts than loan accounts.

What is your view of how impact data can be used in the microfinance sector to attract more impact investors? Who is leading this?

MFI management and anchor investors are the best candidates to take the lead educating investors about what outcome and impact data are available and relevant to their organization. While there continues to be a lot of moaning and groaning about the lack of data, there is actually more than enough to help investors determine if a target company aligns with their impact objectives, ranging from GIIRS reports to SPI4 and SMART Assessments to the MFIs' own board reports. So there is not much excuse at this point for anyone to claim ignorance about the impact posture of any specific MFI.

INNOVATION

Can emerging digital platforms help MFIs reach smallholder farmers? Any cautionary notes? What other innovations are needed to extend financial services out of the easy to reach regions to remote regions? What models work best?

A lot of work has been underway in recent years to address the particular needs of smallholders, much of it led by and available from CGAP. Digital financial services (DFS) can offer one part of the answer by reducing costs to service remote and widely dispersed clients both with financial products and information to enhance productivity and enable better marketing of products. But these potential benefits come with some caveats: connectivity may not be adequate, and there is some research that suggests that different types of clients – older, rural, women – may be less apt to use DFS for some of their needs. So introduction of such tools must be done carefully to avoid inadvertently excluding exactly those populations that are being targeted. In addition, smallholders need a lot of other supports, in particular better sharing of risk and return with others in their value chains, if they are to be able to incorporate more productive and climate smart techniques.

It seems much of the discussion is on digital delivery channels, how about digital transformation of internal systems? How to incorporate Digital Financial Services when it seems that adding another system/application to already outdated Core Banking Systems just adds to the inefficiencies?

I think that we should distinguish between digital financial services (DFS) and fintech. DFS provides primarily external services such as efficient payment systems or ways to save or borrow through agent networks allowing greater rural or remote outreach. This is all highly beneficial, the high touch of microfinance and the low touch of DFS, if implemented well. Fintech creates algorithms to assist the underwriting process and to improve credit knowledge of the client. These proprietary platforms are expensive to develop and maintain and therefore, suit MFIs with scale. If not, regional MFIs may want to coordinate their efforts to implement these platforms or else joint venture with fintech providers.

Would you agree or disagree with this statement: The Microfinance success in reaching scale while carving their place in the formal financial sector has at the same time limited the ability to innovate given more bureaucratic process and tighter regulation that comes with this success. Therefore, the challenge to keep growing among the underserved and excluded is in its ability to be more agile by understanding clients they don't currently serve and radically innovating process and products leveraging on digital technology.

While there may be some constraints on innovation that accompany tighter regulation, particularly regarding non-financial services, we think these are outweighed by the greater resources that larger organizations can mobilize directly and through partnerships. The greater challenge is to ensure that innovation in pro-poor products and services can continue at adequate scale if MFIs feel compelled to cater to the more profit-oriented segment of their shareholder base.

GOVERNANCE

Over-borrowing happens due to irresponsible lending by multiple competing microfinance lenders operating in an area. Are there any governance-related approaches to address this?

In a double bottom line entity like most MFIs, Boards have the ultimate responsibility to ensure the viability of the institution, and its ongoing commitment to its social mission. This means that Boards must ensure that management has adequate processes and incentives in place to avoid over-lending, and that the Board and management are actively engaged in building industry-wide codes of conduct to avoid destructive practices and call out bad actors.

Were women's issues/gender specifically addressed in your workshop? Both in terms of end-client needs and governance?

No, it was not our intent to ignore this issue but we believe that microfinance generally serves women well and for the most part does not discriminate against women. Also, there are or have been many CEOs or managing directors of MFIs who are women and also of large network groups such as Accion International, Women's World Banking, Pro Mujer, Finca and Pamiga as examples.

PRODUCT DEVELOPMENT

With so much happening around the inclusive finance space in terms of research, there are not many MFIs that have a dedicated product development and research function. What role can DFIs and investors play in promoting this unit internally in MFIs?

This is a very good thought and a good suggestion for the future of MFIs. This is particularly true for market and demand research if MFIs seek to diversify their product lines. Boards should encourage such activity particularly to reduce risks associated with new product development and implementation.

Group lending and savings: any insights into what is currently happening with the group lending model across the sector? How about savings? Is there a need for an NGO savings group approach to incorporate the extreme poor before they move into mainstream MFIs?

While we are not experts, there are many informal or NGO led savings groups around the world; in the aggregate they probably still dwarf the retail deposit base of all formal MFIs. Many of these incorporate a lending function as well. And of course in many countries there are very active credit union industries that are primarily savings driven. There are also "graduation" programs that prepare very poor clients to take constructive advantage of financial services.