Challenges to Microfinance Commercialization

Summary of “Challenges to Microfinance Commercialization” Conference
Convened at The World Bank June 4-6, 2001
by
MicroFinance Network
and
ACCION International

Edited by
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2002
MicroFinance Network

The MicroFinance Network, established in 1993, is a global association of leading microfinance practitioners. Network members are committed to improving the lives of low-income people through the provision of credit, savings and other financial services. The Network believes this sector should be served by sustainable microfinance institutions. The MicroFinance Network is a vehicle for accomplished institutions to provide each other with technical assistance and to learn from each others’ experience.

No. of Institutions: 23 MFIs and 2 support institutions in 18 countries

Regulated: ACCION International, USA; ACLEDA Bank, Cambodia; Banco ADEMI, Dominican Republic; Banco del Desarrollo, Chile; BancoSol, FFP, Bolivia; BRI Unit Desa, Indonesia; Caja los Andes FFP, Bolivia; Calmeadow, Canada; Centenary Rural Development Bank, Uganda; Citi Savings and Loans, Ghana; Compartamos, Mexico; Confia, Nicaragua; Cooperativa Emprender, Colombia; FINAMERICA, Colombia; Kafo Jiginew, Mali; K-Rep, Kenya; MiBanco, Peru; PRODEM FFP, Bolivia

NGOs: ABA, Egypt; ASA, Bangladesh; BRAC Bank, Bangladesh; FINCA, Kyrgyzstan; Fundusz Mikro, Poland; PRIDE, Tanzania; TSPI, Philippines

Total Loan Portfolio: US$ 1.38 Billion

Total No. Borrowers: 7,375,165

Steering Committee: Nabil El Shami, ABA; Maria Otero, ACCION; Md. Shafiqual Choudhury, ASA; Martin Connell, Calmeadow; Carlos Labarte, Compartamos

ACCIÓN International

ACCIÓN International is a non-profit that has been fighting poverty through microlending for the past 29 years. ACCIÓN’s mission is to give people tools they need to work their way out of poverty. By providing small or “micro” loans and business training to poor women and men who start their own businesses, ACCIÓN’s microcredit affiliates help people work their own way up the economic ladder, with dignity and pride. ACCIÓN seeks to bring this opportunity to as many of the world’s 3 million poor as possible by developing microcredit institutions that are financially self-sustaining and together capable of reaching millions of people.

No. of Institutions in ACCIÓN Network: 18 MFIs in 13 countries

Regulated: Fundación Emprender, Argentina; BancoSol, Bolivia; Cooperativa Emprender, Colombia; FINAMERICA, Colombia; Banco Solidario, Ecuador; FINSOL, Honduras; Compartamos, Mexico; Génesis Empresarial, Guatemala; MultiCredit Bank, Panama; Mibanco, Peru; BanGente, Venezuela

NGOs: CEAPE Nacional, Brazil; Fundación Mario Santo Domingo, Colombia; Fundación Ecuatoriana de Desarrollo, Ecuador; FUNDAP, Guatemala; ADMIC, Mexico; FAMA, Nicaragua; Fundación Paraguaya, Paraguay

Total Loan Portfolio: US$320 Million

Total No. Borrowers: 500,000

ACCIÓN partner organizations: CREDIFE (Banco del Pichincha), Ecuador; FUSAL El Salvador; SOGEBANK (SogeSol); Haiti; PADME, Benin; Tchuma, Mozambique; Nkwe Enterprise Finance, South Africa; Kingdom Financial Holdings, Zimbabwe
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ACRONYMS AND DEFINITIONS

ACCION        Closed-end, limited liability company - invests directly in regulated/transforming MFIs
GATEWAY
FUND
ACP           Acción Comunitaria del Perú, Communal Action of Peru
AFCAP         The Microfinance Capacity Building Programme in Africa
AFRICAP       Equity microfinance investment fund for African MFIs
ATM           Automatic Teller Machine
BKD           Badan Kredit Desa, Rural Credit Board
BRI           Bank Rakyat Indonesia
BPR           Bank Perkreditan Rakyat, Rural Bank
CAF           Cooperación Andina de Fomento
CAMEL         Capital Adequacy, Asset Quality, Management, Earnings, and Liquidity Management
CD            Certificate of Deposit
CEO           Chief Executive Officer
CGAP          Consultative Group to Assist the Poorest
DAI           Development Alternatives, Incorporated
ESOP          Employee Stock Ownership Plan
FINCA         Foundation for International Community Assistance
FFP           Fondo Financiero Privado, Private Financial Fund
GTZ           Deutsche Gesellschaft für Technische Zusammenarbeit (GTZ) GmbH
IDB           Inter-American Development Bank
IFC           International Finance Corporation
IPC           Internationale Projekt Consult
K-REP         Kenya Rural Enterprise Program
KSM           Kelompok Swadaya Masyarakat, Self-Help Groups
KUD           Kredit Unit Desa, Village Unit Cooperatives
LACIF         Latin American Challenge Investment Fund
LDKP          Lembaga Dana Kredit Pedesaan, Village Fund and Credit Institutions
LPD           Lembaga Perkreditan Desa, Credit Fund Institution
LSM           Lembaga Swadaya Masyarakat, Non-Governmental Organizations
MF            Microfinance
MFI           Microfinance Institution
MFN           MicroFinance Network
MIF           Multilateral Investment Fund
MIS           Management Information System
NGO           Non-Governmental Organization
PROFUND       ProFund Internacional - for-profit investment fund
ROSCA         Rotating Savings and Credit Associations
PRA           Participatory Rapid Appraisal
SEWA          Self-Employed Women’s Association
SKS           Swayam Krishi Sangam, Self-help Society - Grameen Bank replication project
SOGEBANK      Société Generale Haitienne de Banque
SOGESOL       Société Generale de Solidarite
USAID         United States Agency for International Development
$             Refers to US$ if not otherwise specified
ACKNOWLEDGEMENTS

The MicroFinance Network developed this publication as a follow-up to the “Commercialization of Microfinance” conference, held in Washington, D.C. June 4-6, 2001. The conference was jointly organized by the MicroFinance Network and ACCION International and was attended by over 230 individuals coming from microfinance institutions, donor agencies, regional and national microfinance network organizations, non-governmental organizations, independent consultants and microfinance practitioners. The MicroFinance Network hopes that through the publication of these proceedings, those involved in the complex development of the microfinance industry may gain valuable insight from the exchange of experience and knowledge of the presenters as well as the participants. The conference organizers wish to thank the World Bank’s Consultative Group to Assist the Poorest (CGAP), USAID’s Microenterprise Best Practices (MBP) project and Development Alternatives, Inc., the UK’s Department for International Development (DFID) and the Inter-American Development Bank (IDB) for their generous financial support of the conference.

The conference organizers would additionally like to thank the plenary session speakers who made the conference successful by sharing their individual experiences and personal insight regarding the commercialization of microfinance, as well as consideration of the myriad of challenges that microfinance players face from every angle.

Equally significant in making the conference run smoothly, were the discussion leaders, facilitators and note takers of working group sessions. The conference organizers wish to thank them for their valuable contribution in bringing ideas together and documenting them in an understandable way so that the proceedings could be presented in this publication. A special thanks goes to the discussion leaders and facilitators for their key role in fostering information exchange and discussion.

Finally, the conference organizers would like to express their appreciation for all those who participated in the conference, by challenging presenters with thoughtful questions and by sharing their own experiences. These participants are listed in Appendix B.

The authors would like to additionally thank Beth Rhyne and Gavin McGillivray for taking the time to review this document and provide valuable comments on the final draft.

In conclusion, we would like to thank the staff members of the MicroFinance Network and ACCION for their contribution and their support of the conference and the product of the proceedings, this publication.
IN MEMORIAM

Dirk van Hook, who died suddenly in Uganda in May, 2001, was to have been a speaker at this conference, represented the Centenary Bank in the Microfinance Network. He was an active member of the MicroFinance Network, and dedicated time and effort to its various initiatives with enthusiasm and support. Dirk worked for many years in microfinance, becoming one of the more knowledgeable people in Africa and Asia. His death is a loss to all and he will be greatly missed.

This conference report is published in his memory.
PREFACE

The MicroFinance Network and ACCION International, are pleased to present the conference summary of the proceedings of the 2001 Commercialization of Microfinance conference held in Washington, D.C. from June 4-6, 2001 at the World Bank “Challenges to Microfinance Commercialization.” This conference was designed to engage participants in an active exchange on the complex issue of commercialization of microfinance – its usefulness, its challenges, its promise and its limitations.

In order to set the framework for this publication, it is most useful to consider one question: Why commercialization of microfinance?

Commercialization is the application of commercial principles to the deployment of financial services to the poor. It responds to some of the bottlenecks that microfinance encountered in its earlier stages of development.

It opens the way to greater access to funds, moving the source of capital for microfinance from the domain of donors to that of the capital markets.

It allows for increased outreach through additional funding, enabling microfinance institutions to fulfill their mission – expressed as reaching the poor, or providing access to financial services to those left out of the banking system.

Commercialized microfinance institutions become part of the financial systems in their countries, enabling them to capture deposits and to become integrated into the system of financial intermediation.

Clearly, the changes brought on by commercialization are fundamental and complex: fundamental because they change entirely the framework for microfinance; complex because they bring with them enormous and varied challenges to microfinance institutions, challenges that will continue to evolve as the face of commercialization also evolves in each country.

From the perspective of MicroFinance Network and ACCION International, commercialization and its challenges have become extremely important considerations for microfinance. Commercialization is the only path through which microfinance can become a permanent part of the finance and development landscape. Permanence is the key word in this strong assertion. Sustainability has been attained; profitability has also been demonstrated as possible. Permanence – the long-term existence of financial services for the poor – is the shared objective. Commercialization provides that possibility.

In this context, it is useful to highlight the models most commonly used to commercialize microfinance:

1. Transformation of non-profit entities into formalized, regulated financial institutions:

This is a prevailing model, applied in all regions of the world. This model started with BancoSol in 1992, and many other NGOs have followed this path, converting into financial companies, banks, or specialized financial entities. Indeed, the MFN originated among institutions sharing a common interest in transformation. ACCION International has assisted several affiliates to use this model for transformation into banks and finance
companies in the last seven years: Finamérica in Colombia; Mibanco in Peru, Finsol in Honduras, and Compartamos in Mexico. Other well-known institutions outside Latin America that have used this model are K-Rep in Kenya, CARD Bank in the Philippines, and BRAC in Bangladesh. There have been a variety of capital structure and shareholding models used in this model. In most the NGO has maintained a strong ownership presence in the new entity while bringing in a variety of new investment opportunities.

While this model has demonstrated considerable success in expanding microfinance’s outreach to the poor by greatly increasing the institution’s access to capital, by increasing significantly the level of professionalism of microfinance institutions, and by placing them under the oversight of the country’s regulatory and supervisory entity, it has several shortcomings that have not been resolved adequately:

- **Costs of transformation**: The process of transforming an institution is costly and time consuming, usually requiring between $300,000 - $400,000 and about three years or more to complete.

- **Challenging regulatory requirements**: In most countries, the transformation process is burdened by the political and bureaucratic demands of registering a new commercial banking institution.

- **Ability to mobilize savings of the poor**: While most of the transformed institutions that are legally able to have introduced savings products, the level of savings mobilization has remained low.

- **Limited number of candidates**: This model is applicable only when an NGO has developed the professionalism and financial viability necessary to make the leap into formalization. The number of qualified NGOs that have not already transformed is very small, and it is unlikely that many additional NGOs will evolve.

Because this model is the most common today, two of the plenary speakers addressed the institutional experience of transformation.

2. **Creation of commercial microfinance institution:**

This second model bypasses the non-profit stage, and establishes a commercial microfinance institution from the beginning. The capital structure and commercial objectives are defined as part of the creation of the entity. Bangente in Venezuela, ACCION’s affiliate, was created this way by its founding shareholders - a local bank, a local NGO and ACCION. This is also the model that IPC is using in creating “micro-banks” in Eastern Europe. Because of the greater efficiency of this model, it is increasingly becoming the model of choice for new initiatives. A variation on this model is the purchase of an established finance company license, which is then specialized in microfinance. This model is much newer than the previous one, and the few recent examples are not enough of a critical mass to assess its strengths and weaknesses.

This model also includes small commercial banks that want to expand their market to microfinance. An example is Banco Solidario in Ecuador, which used support from ACCION to gradually convert into a bank specialized in microfinance. Today, the bank is concentrating on this niche of the market (although it also serves other higher income markets), and is growing its microenterprise portfolio and product lines.

3. **Involvement of large traditional banks in microfinance:**

Banks have used a variety of approaches to enter the microfinance market. The most promising is the creation of a subsidiary by a large commercial bank, a model that ACCION has used with two large commercial banks, Sogebank in Haiti and Banco Pichincha in Ecuador. This approach has led to the creation of Sogesol/Haiti and Credife/Ecuador,
subsidiaries that are specialized in microfinance. ACCION is a shareholder in both of these initiatives. The programs are evolving well, but are too new to yield significant complete findings. Nevertheless, the process of structuring these efforts has already demonstrated significant advantages over other approaches. These include shorter start-up time, more capital available, effective use of technical assistance, capacity to make very small loans, and, when there is a “champion” inside the bank, a smooth relationship among shareholders.

A variation of this model is the creation of a type of subsidiary or specialized division by a large development bank, most notably accomplished by Indonesia’s BRI with its BRI Unit Desa system. Banco do Nordeste in Brazil, which launched its Crediamigo program with technical assistance from ACCION in 1998, is also demonstrating promising results.

4. Merger between a commercial bank and a microfinance institution:

This model involves an established microfinance NGO and incorporates it into the commercial operations of an existing small commercial bank or finance company. CONFIE in Nicaragua is an example of this model, as is ACCION’s affiliate in Guatemala, Genesis, now Bancasol/Genesis.

The conference and this publication do not advocate any one model for advancing towards commercialization. All models are being played out right now, and much is being learned about the many common challenges that they face, as well as the promise and limitation specific to each model.

Understanding commercialization is also applicable to NGOs that choose not to transform into commercial entities. While their reasons to remain outside the commercial sector may be persuasive, nevertheless commercialization creates a context in which they must operate. This new context means that achieving a commercially viable level of operations becomes necessary for all microfinance institutions, and forces NGOs to define their comparative advantage as they compete with commercial institutions.

If one notes that commercialization is inevitably necessary for microfinance to prevail beyond our professional lifetimes, it is also important to recognize that its evolution brings with it added challenges that those working in the microfinance industry are just learning to address. Among these, the most difficult is the introduction of competition. While competition benefits the consumer, it creates considerable challenges for microfinance institutions. It is no longer enough to operate profitably in a setting in which one’s outreach can increase at a rapid pace. The institution must now shift to focus on retaining its share of the market, and on providing the most competitive products possible in as efficient a way as possible. Additionally, competition is coming from outside microfinance – as has been the case with consumer lending in several countries. Microfinance is no longer isolated and operating in a sheltered setting.

Regardless of the stage of commercialization in each country, the process forces microfinance institutions to address some of the key topics. The following four seem to be the most important:

- **Regulatory and supervisory environment**: The advances in retailing microfinance, caused by institutional and methodological improvements in the last decade, have far outstripped the developments of the regulatory and supervisory entities and their ability to provide effective oversight to microfinance. Shortcomings in this area are and will be among the most challenging bottlenecks that microfinance faces.

- **Products**: When access to credit was the rallying cry of the pioneer microfinance institutions, customer satisfaction was not a top concern - nor should it have been. The challenge was to create a lending product and demonstrate that it could reach
large numbers while ensuring repayment. Today, development of new products that respond to the varied financial needs of the poor is an essential component of any growing microfinance institution.

- **Lower Costs**: The original focus on sustainability, one of the pillars of microfinance, has now evolved to become efficient sustainability. The race for lowering costs in microfinance is on, not only because it is the only way institutions will remain competitive, but because bringing down the cost of financial intermediation for the poor is an important objective.

- **Governance**: The characteristics of microfinance have created ownership structures and investor profiles that are very different from what one finds in the private sector, bringing with them difficult challenges. The industry is still in the transition period in which true commercial investors, with very few significant exceptions, wait in the wings, maintaining a “wait and see” attitude.

**A highlight of some areas of consideration from the conference:**

Not everyone greets commercialization with open arms. Even those who are most in favor of it are uncomfortable with some of its possible ramifications for the field. That is why the conference is titled “Challenges to Commercialization.” In fact commercialization, in reality, is less predictable that it was when one looked at it from afar. For example:

Transformation has been harder for many institutions to achieve - the process has been very long and draining, too few institutions are genuinely profitable, ownership issues, as mentioned above, are difficult to sort out.

Downscaling has not been taken up as rapidly as expected. While banks have become involved, the barriers to entry, most of which have to do with knowledge about microfinance lending technologies and openness to entering a market that appears so risky from afar, continue to prevail.

Worry about reaching the poor is probably the topic that most often makes people hesitant about commercialization. We do not yet know whether commercialization will drive microfinance up-market or down-market. There are arguments on both sides: the competitive search for new markets presses down market, while demands for profitability provide pressure to move up. What is clear is that the introduction of commercial principles adds an element that challenges the values that motivate microfinance. The marriage between mission and profitability is not an easy one, and has yet to be resolved.

As a field, microfinance is developing by leaps and bounds, encountering this new stage of change with varying degrees of preparation and competence. The challenges are as difficult as in an early stage, but the stakes are much higher. There are no donors to bail out a commercial institution, only regulators to intervene.

In conclusion, the conference offered a time especially for practitioners to gather their ideas and reflect on their work. The presenters and participants are the ones who have to solve the day-to-day problems and who literally lose sleep as they move their institutions forward. The conference and this publication provide the opportunity to gather thoughts, exchange ideas, reflect on all these things and strengthen both the resolve and the ability to make financial services available to the millions of poor working people in our countries.

Maria Otero
President & CEO, ACCION International
Chair, Steering Committee, MicroFinance Network
INTRODUCTION

The “Challenges to Microfinance Commercialization,” held June 4-6, 2001 in Washington, D.C., convened by the MicroFinance Network and ACCION International, brought together over 230 leading microfinance practitioners to discuss issues critical to the microfinance industry today. The conference was held at The World Bank. A plenary session opened the conference, followed by an afternoon and morning of working group sessions. Another plenary session closed the conference. Simultaneous interpretation in Spanish and French was available for the plenary sessions and a limited number of working group sessions.

Demand for this conference was extremely high. Conference organizers extended participation from 150 to 230 in the face of many requests. Through this conference summary, MFN and ACCION hope to reach the even broader audience of those who wished to but could not attend.

Overview of the Conference

Microfinance practitioners from both the non-profit and commercial spheres face new challenges as they operate in increasingly commercial and competitive environments.

More and more non-profits are acknowledging the importance of commercial operations to their long-term financial sustainability. However, the process of transforming from a non-governmental organization to a regulated financial entity has proven complex, involving not only financial, but also operational, structural, and cultural changes within the transforming institutions. This conference provided practitioners the opportunity to discuss common limitations and pitfalls encountered on the road to commercialization, and together explore proven approaches to overcoming them.

Competition represents a current or future challenge for all microfinance institutions, whether for-profit or non-profit, well established or only recently founded. As more and different types of players enter the microfinance market, such as consumer lenders and mainstream banks, traditional microfinance providers must come up with new ways of leveraging their experience and competitive advantage. The conference discussions sought not only to benefit MFIs currently facing these challenges in mature markets, but also those that wish to develop strategies for dealing with competition as their own markets mature in the future.

Emphasizing the perspective of practitioners, this conference convened experts from around the globe, representing leading microfinance institutions, such as BancoSol (Bolivia), K-Rep Bank (Kenya), Mibanco (Peru), BRI (Indonesia) and BRAC (Bangladesh). In addition, the conference gained from some of the insights from those who were involved in shaping the commercialization movement, including Maria Otero and Elisabeth Rhyne and Carlos Castello (ACCION International), Jacques Trigo (Superintendency of Bolivia), and Martin Connell (Calmeadow).

In addition to plenary sessions addressing the overall challenges involved in commercialization, the conference provided each participant an opportunity to examine related issues of his or her own choice in twenty different intensive working sessions.
PLENARY SESSIONS

The plenary sessions, held on the morning of the first day and the evening of the second day, were led by Maria Otero (ACCIION International), Elizabeth Littlefield (CGAP), Kimanthi Mutua (K-Rep Bank), Martin Connell (Calmeadow), Gavin McGillivray (DFID), Jacques Trigo (ACCIION International, and former Bolivian Superintendent of Banks), David Wright (Independent Consultant), Elisabeth Rhyne (ACCIION International), and Nabil El Shami (Alexandria Business Association). Topics of discussion included “Why Consider Commercialization?,” “The Role of Donors in Promoting Microfinance Commercialization,” “The Regulator’s Perspective on Microfinance Commercialization,” “The Challenges of Commercialization for Microfinance Institutions: A Practitioner’s Perspective,” and “Implications of Competition for Microfinance.” In the closing session, participants had the opportunity to ask questions of Rhyne and Wright, who summarized major conference findings at the beginning of the closing session.

The following are brief summaries of the plenary presentations.

The Role of Donors in Promoting Microfinance Commercialization

Gavin McGillivray, Enterprise Development Department
UK Department for International Development (DFID)

Thanks in good part to the work of ACCION International and Calmeadow, represented by Maria Otero and Martin Connell, and the work of others present at the conference, there is now a largely uncontested consensus that commercialization is the most appropriate strategy for the microfinance sector. The question is not whether, but how. The bulk of donor support to date in this area has focused on the transformation of microfinance NGOs into commercially viable financial institutions. This approach has received a great amount of attention, and has produced many significant successes such as BancoSol (Bolivia), ADEMI (Dominican Republic), BRAC (Bangladesh), and Centenary Rural Development Bank (Uganda). But is this enough? Is the success fast enough?

Worldwide, there are a handful of indisputably commercial MFIs, and there are perhaps 25 million microfinance beneficiaries. Will enough MFIs “make the grade” and become commercial in order to make a significant impact on those 25 million, and on the hundreds of millions of potential microfinance clients? Twenty-five million sounds like a lot of beneficiaries, but it is almost negligible when compared to the 200 to 400 million estimated potential microfinance clients.

The microfinance movement may be vulnerable. It has been the “flavor-of-the-month” for donors for quite a few years. But donor fashions move on. Remember Integrated Rural Development projects or the Basic Needs approach? Unless the microfinance movement starts to show vastly greater impact on a sustainable basis, donors and other supporters may well lose interest.

Coming new to the microfinance sector, one’s impression is that we all talk to each other a great deal – but not much outside the sector. The microfinance movement too seldom talks to the people who are involved in and really know about commercial finance: banks, leasing
corporations, insurance institutions, mortgage houses, and accounting firms. It is there that, potentially, lie the scale of capital, the management expertise, the technology, and the systems that could transform microfinance and make the massive impact on poverty that the sector is seeking. We need to pay more attention to what can be done to stimulate banks and other commercial financial institutions to direct more resources to providing financial services to the poor.

How can this be accomplished? Donors must first concentrate on “public good” themes such as ratings, credit bureaus, best practices, R&D, innovation, regulation and supervision - areas where banks are unlikely to invest, because they cannot capture the benefits. Donors need to concentrate on correcting the factors that deter banks, including crowding out by grants and subsidized funding to MFIs from donors.

Some more specific ways in which donors might encourage commercial finance participation in the microfinance sector:

- Training: Support human resource development and set microfinance industry human resource standards (e.g. AFCAP).
- Standards: Support development of best practices and microfinance industry standards (e.g. CGAP and ACCION manuals, and ratings systems).
- Research and Development: Support innovation and project testing (e.g. new financial products and services, new technologies, new ways of working, systems of regulation and supervision).
- Enabling Environment: Facilitate development of appropriate banking and financial laws and regulations, advocate the end of bad practices by government, banks, and commercial players, and help remove dead wood, or bring it back to life (e.g. doing something about state-owned banks and agricultural development banks).

The industry also needs to do some handholding to help banks and others appreciate the opportunities in microfinance. This can be done by helping banks and other financial institutions learn about the market through direct experience, through wider information dissemination and by learning from others involved in microfinance. Opportunities for banks can be made more clear when MFIs can demonstrate the rates of return achievable by investing in microfinance, for example: as through ProFund, IMI, and AfriCap.

There needs to be a higher investment in sharing the message – in disseminating news and information about the successes in microfinance. Furthermore, it is important to invite more bankers to events such as the “Challenge to Commercialization of Microfinance” conference, and include them in circulation lists, listen to them, and learn from them.

Finally, donors need to know when to let go of success stories. They need to stop working with MFIs where the job has been well done. They should free up resources and actually show the world that MFIs can walk on their own two feet. This effort should be coordinated, but, at the end of the day, the need is to let go.

The Regulators’ Perspective on Microfinance Commercialization

Jacques Trigo, Former Superintendent of Banks, Bolivia and Senior Fellow for Policy, ACCION International

Jacques Trigo is currently Minister of Finance in Bolivia
Why is a government interested in promoting the transformation of microfinance institutions into regulated entities?

The primary objective behind transformation is to generate employment and income for a population with scarce resources by expanding the reach of credit and financial services available to small producers, micro-employers, peasants, artisans and merchant retailers. This expansion encompasses the geographical coverage to regions and sectors (especially rural) that do not have access to financial services and responds to the unmet demand for financial services among women.

In order to meet these objectives, newly emerging regulated MFIs must take advantage of credit technology developed by NGOs. Another means towards achieving specific objectives is to enlarge the sources of financing for NGOs. This can be facilitated through participation of risk capital as a part of a vision towards profitability and self-sustainability in the long-term. Once the institution has become a regulated entity, it can engage in deposit taking from the public and can draw the trust of potential advisors.

Why are supervisory entities reluctant to formalize microfinance institutions (NGOs)?

- **Risk**: There is a perception of high risk associated with the formalization process because of the informality of business activity among many existing NGO MFIs, such as and the absence of traditional financial information.
- **Knowledge**: In addition, there exists a certain level of ignorance about the business of microfinance and particularly about its credit technologies. High levels of interest rates charged by NGOs are politically unacceptable to many potential supervisory authorities.
- **Rigidity of Existing Norms**: Many supervisors have established norms that are nearly impossible to change. One of the most serious problems is the inability to adapt microfinance NGOs to the legal framework because the laws and norms, in some cases, are contradictory and confusing.
- **Supervisory Capacity**: Many institutions lack the appropriate staff to carry out ongoing supervision of MFI operations.
- **Total Size of Assets**: Non-bank entities, whether they are cooperatives, financial funds, or others, represent a very small percentage of the total assets of the system (5-10%), while regulators turn their attention to the larger mainstream institutions.
- **Problems with Banking Sectors**: The banking system in many countries faces problems of solvency and financial authorities are focused on solving this critical issue first.

What problems do supervisors encounter when they grant an operating license to a microfinance NGO?

Feasibility studies often lack the necessary technical, financial and economic base. One of the biggest problems is the lack of technology for mobilizing deposits and managing the treasury. Poorly developed information systems don’t fulfill the requirements of the supervisor. In addition, transforming NGOs present unconventional governing structures. For example, owners of capital often don’t permit sustained growth and face considerable losses. In some cases supervisors may encounter the rejection of potential shareholders or executives of an MFI due to moral hazard or questionable ethic. There may also be a question as to the professional competence necessary to manage the business.
Despite its broad success as a NGO microcredit provider run on commercial principles, ABA provides a useful example of how a limiting regulatory framework can create considerable roadblocks for an MFI looking to access funds, achieve greater outreach, or transform as an institution.

History

Alexandria Business Association (ABA) started its operations in 1983 as the Economic Committee for Businessmen under the auspices of the Alexandria Chamber of Commerce. At the time, the objectives of the committee were to support the private sector as well as to represent this vital economic sector on behalf of the government of Egypt. The committee formed the Alexandria Business Association (ABA) in March 1988. ABA was registered as a private, non-governmental organization with the Egyptian Ministry of Social Affairs. Shortly after its registration, ABA signed a seven-year cooperative agreement with USAID under the umbrella of the Small and Medium Micro Enterprise Development Project (SMED). The objective of the project was to provide access to credit and eventually non-financial services to small and micro enterprises in the province of Alexandria. ABA launched the SMED project in January 1990 and within two years it was able to reach operational self-sufficiency. In 1994, the expanding volume of operations enabled ABA to achieve world-class operating cost ratio and in 1997, ABA had geographically expanded its activity to an additional governate named “Kafr El-Sheikh.”

Financial Structure

Because of its private sector orientation, ABA has demonstrated its commitment to commercialization in constructing the SME project’s financial structure. Since the beginning of its operations, ABA has retained its donated loan fund as a USD collateral deposit at the bank with the accrued interest capitalized on the deposit. Against this USD deposit, the bank offered ABA an overdraft credit facility in the Egyptian Pound equivalent to the deposit. Ultimately, the benefit from this arrangement is that ABA will not suffer any operational disruptions in the absence of donor assistance. The solid credit history that ABA maintains with the banks has led the latter to increase the credit facility over the collateral deposit, leveraging the loan capital kept at the bank(s) associated with ABA.

Internal Systems

Beyond a loan officer’s base salary of around $40 per month, ABA has adopted a private-sector salary scheme for its loan officers, which uses a sophisticated incentive system that is applied to officers as well as administrative staff. The system encourages staff to be self-motivated to seek new clients, maintain high numbers of active clients, and minimize portfolio at risk rates.

ABA has achieved remarkable improvement in streamlining its paper work. A new loan takes approximately one week to be disbursed and repeat loans are disbursed within two to three days (excluding Fridays). With this increased efficiency, ABA is able to offer its services now through 12 branches, staffed by experienced loan officers with solid performance records. Each branch is treated as a stand-alone cost/profit center and the top management encourages healthy competition between its branches and branch managers.
Services Offered

ABA has a tradition of conveying a unified and clear message to its first-time clients. During its first meeting with clients, ABA stresses that it is interested in a long-lasting relationship with its clients (not beneficiaries) and the only condition for continuous access to credit is to pay installments on time. This meeting promotes a sense of importance and respect to clients from ABA and pinpoints the “zero tolerance” policy concerning delinquent borrowers.

ABA has a clear and standard “step-loan”, or gradual increase, policy for its clients with a “no-exception” approach that has assisted ABA in promoting a sense of fair treatment among its clients. In addition, with a predefined calendar for loan disbursement dates (twice per month) ABA is able to harmonize efforts towards meeting specific disbursement dates and assisting clients in planning for their credit needs throughout the year.

ABA has designed its provision of non-financial services to clients on a “cost recovery” basis. Moreover, ABA is proud to declare that its non-financial service component is recovering all its associated costs and is even achieving surplus within the last three years.

Finally, ABA has capitalized on its in-house accumulated technical experience and is now extending its training and technical assistance services to microfinance institutions (MFIs) in the region. In addition, ABA offers specialized training courses in all aspects of microfinance best practices through its dedicated training facilities. This TA and training component is also adding to the profits of the organizations, which are reinvested in lending activities.

Current Performance Statistics

As of 2000, ABA has disbursed 170,058 loans amounting to $125.52 million to 59,866 borrowers. Of these borrowers, 24,523 are active clients with an outstanding portfolio of $14.70 million. ABA is now operating through 14 fully decentralized branches in Alexandria and Kafr El-Sheikh. Each loan officer in ABA handles an average of 153 clients with an average portfolio of $91,875 while maintaining a 1.53% portfolio at risk rate. Finally, ABA has reached full financial coverage and achieved 47% surplus that it reinvests in the loan portfolio.

Transforming into a Regulated, Commercial Financial Institution - (Potentials & Limitations)

Regular banking (financial) institutions rarely serve the small and micro enterprise sector due to high transaction costs, lack of knowledge about this sector, the types of collateral and reporting requirements imposed on the banks by the Central Bank, the in-house services mechanism adopted by banks, and the traditional hesitance to lend to small and micro entrepreneurs who are perceived as “high-risk” borrowers. At the same time, because of its change towards a private sector approach to microlending, ABA is not facing the classical types of problems typically faced by non-governmental organizations. Its long-standing history in Alexandria and outstanding record of performance are witness to its success. Considering the current size of operations, ABA is now disbursing monthly more than $2.2 million through its 14 branches. Despite its broad success, ABA’s growth is now constrained well below both market demand and ABA’s delivery capacity due to financial and legal limitations.

On the financial side, ABA can only increase its outreach with the amount that banks allow to provide as leverage over ABA’s deposits, in addition to its reprogrammed surplus. If ABA were regulated as a formal financial institution, one of the primary sources of funding would be its potential clients’ voluntary savings accounts (from small and micro
entrepreneurs). In this regard, most of the research conducted has proved that most poor people need to have reliable, safe, and easy to access places to save money. Finally, the current banking laws of Egypt do not recognize microfinance credit providers as bodies that could be regulated as banks.

From the legal perspective, ABA is considered a non-governmental and not-for-profit organization. It cannot access or deal with private sector investors or market-based initiatives. It cannot leverage its capital through investments in equity or debt. The Ministry of Social Affairs in Egypt has implemented regulations and requirements that have to be strictly followed by ABA as a NGO. Many of those requirements place heavy bureaucratic burdens that negatively affect the operations of ABA, even though microfinance is an activity that needs an alert management, a strong information system, and a quick and informed decision-making process.

**Initiatives Undertaken by ABA**

Recently, the government of Egypt has recognized the vital role small and micro enterprises are playing in the economy. Chaired by the Prime Minister, a committee named “Popular Credit” has been formed from prominent figures, concerned ministers, and major active players in the microfinance sector in Egypt. The objectives of this committee are to discuss and outline major interventions needed to enhance the sector performance of the economy.

Since ABA is selected as a member in this committee, it has provided the committee members with its views in the form of a concept paper. In summary, the paper calls for enacting a specific law to regulate microcredit operations and service institutions as part of the government’s national policy.

Apart from its participation in the committee, ABA believes that the future of the microfinance industry lies in the ability of successful NGOs to transform into regulated financial institutions with adequate asset structures and indicators that generate public trust. The closest model to this institution is a bank form. However, some of the Central Bank of Egypt’s requirements to start a bank are not appropriate for the microfinance “bank.” Some of these requirements include capital requirements, obligatory reserves at the Central Bank, and individual reporting by client to the Central Bank. Nevertheless, ABA believes that with continued efforts and commitment and with appropriate lobbying strategies among its national and international partners, the microfinance institution “bank” could be formed in the near future.

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**THE CHALLENGES OF COMMERCIALIZATION FOR MICROFINANCE INSTITUTIONS: THE EXPERIENCE OF K-REP BANK**

*Kimanthi Mutua, General Manager, K-Rep Bank, Kenya*

K-Rep Bank, the first and only commercial bank focused on serving the poor in Kenya, grew out of an experiment that involved direct and retail lending to community-based enterprises along with wholesale lending to other non governmental organizations. With time and experience, the direct lending practices of then K-Rep Group developed into a solid microfinance institution. Based on this growth, the Group determined that there existed potential to expand and deepen outreach to low-income clients on a commercially viable basis. Based on the considerations of the limitations that K-Rep faced as an NGO, the Group decided to establish a microfinance bank. The transformation process took three years to complete. During this time, the bank encountered a number of problems.
One key problem concerning transformation was finding a way to adapt the payment system. How does the bank continue to interact with the client after transformation? The institution had to change how accounts were maintained. This required dismantling the existing system.

The creation a new regulated commercial institution also required that K-Rep provide its customers the option of savings. If they opted to utilize savings services, the Bank had to also produce savings reports.

The bank also had to address the development of a new corporate culture and other staff issues during the transformation. K-Rep had to hire some people from the banking sector to run certain specialized functions. As a result, tension surfaced among the existing staff, creating unproductive behavior. It took time for the new working culture to fully develop.

Another difficulty encountered during the transformation process was the time spent monitoring data migration into new banking software. Due to standard bank hours, employees had to be able to close accounts by 5 p.m. Management had to focus its attention on data migration, instead of on other important issues. There was also concern expressed by regulators of the bank regarding the amount of time necessary for overseeing data migration, which also led to a sharp cost increase.

Another challenge faced during the transformation process was the issue of governance. The Bank needed to find out how the transforming institution could draw the support of all the members of the Board. Those involved found that it was important also to get a balance of members. The result is that all shareholders are institutional members and under the employee stock ownership plan (ESOP) employees own 10% of the stock.

A final area of concern was that of regulation. Management continued to be concerned about data migration and the high cost structure still after six months of operation as a microfinance bank. Subsequently, K-Rep was reviewed by bank examiners. The result of the examination was the application of certain regulations that required a more disciplined staff.

In conclusion, transformation may not be an easy process, but, in the end, there is more to gain from transformation than to lose. Through the sharing of experiences some of the pain of the transformation process should be reduced. Despite this, institutions should also be careful not to fall into a particular trend. Don’t transform because it is in fashion to do so. Make sure that it is right for each particular institution.

IMPLICATIONS OF COMPETITION FOR MICROFINANCE

Elisabeth Rhyne, Senior Vice President for Research and Development Policy, ACCION International

Until the late 1990’s, most microfinance institutions (MFIs) did not have to worry about competition. They enjoyed near monopolies, as only a few, mostly small service providers sought to reach a huge untapped market. The idea of competing for clients was so far from the mindset of early MFIs that when two of them operated in the same city, they often reached gentlemen’s agreements to divide the market geographically. MFIs frequently shared valuable technical learning with each other. This period of low competition was essential for the development of microfinance. It allowed microfinance institutions the freedom to focus single-mindedly on making the breakthroughs in methodology and management necessary to reach scale and sustainability. These breakthroughs have now brought microfinance to the threshold of competition.

- The rapid increase in competition is coming from three sources:
• Expansion of the self-identified MFIs
• Entry of new commercial players into microfinance
• Emergence of related businesses, primarily consumer lending, that overlap with the client base of traditional microfinance

In a competitive environment, microfinance institutions must shift their thinking to respond to different challenges:

**Figure 1: Concerns of Microfinance Institutions before and during Competition**

<table>
<thead>
<tr>
<th>Pre-Competitive Stage</th>
<th>Competitive Stage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Objective: to reach more people and to become financially viable</td>
<td>Objective: to retain or increase market share, while remaining profitable</td>
</tr>
<tr>
<td>Internal focus: developing the institution’s internal capabilities</td>
<td>Internal issues remain important, but external focus is added: understanding the external environment and incorporating that understanding into business strategy</td>
</tr>
<tr>
<td>Driving motivation: access to funding</td>
<td>Driving motivation: attracting the customer</td>
</tr>
<tr>
<td>High growth projections possible</td>
<td>Low growth likely</td>
</tr>
<tr>
<td>Little need to take the behavior of other players into account</td>
<td>Must study the behavior of the clients, prospective clients, and competitors</td>
</tr>
<tr>
<td>Client demand taken as given</td>
<td>Client demand can evaporate quickly if competitor provides better service</td>
</tr>
<tr>
<td>Low risk, predictable future: institution has high degree of control over outcomes</td>
<td>Rapid change, high uncertainty; lower control over outcomes</td>
</tr>
</tbody>
</table>

**Determining Competitive Strategies**

Recognizing the need for an additional layer of analysis in the strategic decision making of MFIs facing competition, the following diagram reflects a deceptively simple recurrent process.

**Figure 2: Competitive Strategies**

1. Analyze the market and client preferences
2. Analyze comparative advantages in light of competitors
3. Select and implement strategy
4. Monitor outcome and competitor response
Client Behavior: What We Know about Client Preferences in Microfinance

The first and central lesson about competition in microfinance is that it changes the basic relationship between the service and the client because clients have more choices of service providers.

Challenges to standard microenterprise credit

Customers seek good service quality and loan terms including fast loan disbursement, convenient locations, simple processes, and a welcoming, non-intimidating experience. Price sensitivity in competitive markets may be driving down the price of microloans, an important challenge when considering the preference of clients for individual over group loans when both are offered in a directly competitive situation. This challenge has led to significant shifts toward individual lending throughout Latin America.

New products for existing customers

Competition and financial needs of clients lead to development of new products, which, if well designed, have the potential to improve the value of financial services available to clients, especially savings services, which lag far behind credit in the microfinance field.

New markets for microfinance institutions

Competitive financial markets tend to saturate certain markets while leaving others largely untouched. As competition becomes stronger, MFIs can move either upmarket or down, and there is evidence of both. Sustainable methodologies are beginning to emerge for low end markets, and the probability is high that the frontier will move during the next few years.

On the upmarket side, some MFIs are trying out small business lending and consumer lending to the salaried sector, where competition already exists and where providers with longer experience exist. The extent of compatibility between microenterprise lending, small business lending, and consumer credit remains to be seen over the next few years.

Tools for understanding markets

Considerations of quality service, new products and new clients call for MFIs to engage in thoughtful market analysis. In competitive situations, MFIs need to know more about clients than they did in a simpler setting; preferences of clients, opinions about various institutions and services, and financial and economic behavior. They need more information about the numbers of potential clients of various types. Although market research is a well-developed profession in general, the application of market research techniques to microfinance is in its infancy. AIMS and MicroSave Africa are making important contributions here. The next few years should see some important new developments in this area that will leave MFIs better equipped to carry out and use market research.

Analysis of Comparative advantage: Dimensions of Competition among Microfinance Institutions

The process of identifying a competitive strategy that will bring lasting insulation from the relentless pressures of competition has been written about by many business gurus. Yet the tools they describe seem at bottom to consist of gut intuition coupled without a deep understanding of the situation. The process requires an institution to identify and understand its own areas of competitive advantage, considering carefully the competitive
threats that could erode advantages and develop strategies to renew existing advantages or create new ones. Competitive strategy is an art.

Any given organization may employ a combination of the following strategies at any one time or over time:

**First mover advantage:**

The first firm to spot and exploit a new market opportunity or technological innovation can receive high returns after it recoups its initial investment costs. However, if the new market opportunity is attractive, other firms will follow, so firms expect this advantage to be temporary. The value of moving first depends on the size and nature of the costs of entry.

**Barriers to Entry:**

If the firms select products and markets that are difficult to enter, they will find competitive pressures reduced. Some barriers to entry are intrinsic to the industry, while some barriers are created by law. In the financial services arena, once the initial barriers have been passed, there are fewer barriers to offering new products and in new product delivery serving new markets. This entry structure would imply that in a financial circle, first mover advantages would be short-lived.

**Barriers to Exit:**

Firms can reduce competitive pressure if they find ways to make it harder for customers to switch providers. Financial institutions often do this by linking products.

**Market Niche:**

Another strategy often employed is to identify a protected corner of the market in which competition is less intense or in which a firm can develop a specific competitive advantage. Niche strategies can be effective, but are subject to the same forces that erode other forms of advantage, with the added limitation of smaller market size.

**Sustained competitive advantage:**

Beyond these specific strategies is a wide range of attributes that firms develop which give them an advantage in competition with others. In microfinance we see competitive advantage in areas such as funding costs, knowledge of markets, technologies, reputation, infrastructure, legal status, and others. The most effective advantages are those that (a) are difficult for others to duplicate and (b) equip a firm to change as the industry changes.

**Comparative Advantages by Institutional Status:**

In general, the competitive strategies used by one category of institution are similar because comparative advantages are strongly linked to institutional type, history, and corporate culture. Each type of institution involved in microfinance uses its institutional status to provide it with distinct advantages over others, and where status alone is insufficient, institutions attempt to develop specific competencies.

Among the strongest institutional advantages are those associated with commercial banking and particularly with large, well-established banks. Large commercial banks have a number of characteristics that make it hard for other institutions to compete with them:

- Public perception of safety: The public perceives large, historic banks, often backed by the state, as safe places to keep money.
Challenges to Microfinance Commercialization

- Lower cost of funds: Banks with a tradition of savings and mobilization attract funds from depositors of all sizes. These funds are traditionally more stable and cheaper than the funds raised by smaller, specialized banks issuing certificates of deposit.

- Locational advantage through existing infrastructure: Big, established banks typically have large branch office networks that make it easier to bring banking services close to clients.

- Ability to spread fixed costs: Commercial banks involved in a range of banking businesses may be able to spread some of their overhead costs widely, reducing the overheads charged to microfinance.

Licensed MFIs, like EDPYMEs in Peru or FFPs in Bolivia, have access to sources of funds through capital markets and restricted lines of credit that are more plentiful and faster to obtain than their NGO cousins, but still not as cheap as those available to big banks.

Competitive strategies for NGOs seem to revolve around market niche. NGOs can retain greater access to subsidies if they can convince donors they serve a portion of the market that the commercial institutions will not serve.

Cooperatives have developed and maintain clear advantages for savings mobilization, through three main strategies: (1) they emphasize that as member-owned organizations, deposits in them are deposits in something the clients have a long run stake and say in; (2) they have cultivated an image as the place to save over a long period of time (3) they link savings and access to credit, by making loan eligibility and size a function of amount saved and offering products, like housing loans, that are only available to people who have saved a significant amount. With these linked products, cooperatives have created both an incentive to save and a barrier to exit.

Common to the microfinance industry as a whole is competition to provide better products and a better experience for clients, combining the elements mentioned earlier on client preferences: faster turnaround, larger loans, new products, especially packaged together, individual lending, products aimed at different market segments, better treatment of clients, use of automation to increase efficiency and outreach.

**The Dynamics of Overlending: An Intrinsic Problem of Competitive Lending**

In some countries where competition for microfinance clients has become fiercest, notably Bolivia and Bangladesh and to some extent Uganda, evidence is emerging of a dangerous tendency: clients borrow more than they can handle and delinquency rises throughout the microfinance market. This tendency occurs because under competition lenders face strong pressure to make larger loans or multiple loans in order to keep clients from moving to a competitor. Regulatory responses coupled with the growing experience base of micro lenders and their clients may be sufficient to keep over-lending from becoming a crisis in most countries. However, the underlying incentives will continue to exert an influence. It is likely that the days of very low delinquency across microfinance institutions will disappear as competition increases.

In conclusion, MFIs must devote time and energy to understanding how competition changes their situation. They must study the market and the competitors. This requires development of tools and internal processes that can help MFIs access the choices available. MFIs must beware of the pitfalls of increased competition including the fact that unhealthy lending is intrinsic in this new environment and that any effective strategy will be temporary.
SUMMARY OF WORKING GROUP SESSIONS

This section provides an abstract of the presentations. A fuller discussion follows in the rest of the document.

PART I: TRANSFORMATION AND EXPANSION OF MICROFINANCE INSTITUTIONS

Preparing for NGO Transformation
Carlos Danel, Compartamos (Mexico) and Carlos Castello, ACCION International (USA)
Through the use of examples, this session discussed how an NGO can plan for transformation, convince board members, develop and sell the vision, and identify potential investors. Participants had a chance to talk about the pros and cons of various institutional transformation options and capital structures.

Managing NGO Transformation
Pedro Jimenez, BancoADEMI (Dominican Republic) and Pilar Ramirez, FIE FFP (Bolivia)
This session discussed various approaches to implementing structural, financial and operational changes, managing cultural transformation and employee morale, and explaining the transformation to clients. Participants had a chance to learn from two practitioners who have gone through the NGO transformation process.

On-going Commercial Ownership and Governance Issues
Alex Silva, ProFund (Costa Rica) and Martin Connell, Calmeadow (Canada)
This session addressed on-going ownership and governance issues of commercial MFIs, such as how to prepare for ownership/board transitions, revise statutes and bylaws, conduct board performance appraisals and prepare for board renewal. It also covered the board role in overseeing mergers and acquisitions and how to transition out international and NGO/public shareholders.

Reaching Down
Monica Hernandez, BancoSolidario (Ecuador) and Pierre Marie Boisson, Sogesol (Haiti)
This session was intended for traditional financial institutions or others that are exploring expansion into microfinance markets. The facilitators addressed how microfinance is different from traditional commercial lending and explored common elements of and impediments to success. Participants learned various approaches to setting up a microfinance division, including best practices in creating a branch network and field officers to conduct microfinance operations.
PART II: GOVERNANCE, REGULATION, AND SUPERVISION

Regulatory Supervision

Imam Sukarno, Bank Indonesia (Indonesia) and Manuel Montoya, Mibanco (Peru)

This session was for regulated MFIs to learn about how to improve relationships with regulators, adhere to regulations, prepare for and pass inspection, and work with rating agencies. The facilitators encouraged practitioners to share their concerns and preconceptions of what regulators are looking for and to discuss approaches for addressing those concerns with their regulatory officials.

Applying Commercial Principles to an NGO or Credit Union

Witold Szwajkowski, Fundusz Mikro (Poland) and David Richardson, WOCCU (USA)

This session discussed approaches to introducing commercial objectives to a socially oriented institution, the importance of building board buy-in to a commercial approach, managing image and outside perception, and improving efficiency. The participants had the chance to explore a wide range of commercial principles to determine which to apply given their individual MFI's mission and environmental limitations.

Transitioning to Commercial Ownership and Governance

Rosalind Copisarow Rebuilding Society Network (UK) and Gabriel Schor, Frontier Finance International (USA)

This session focused on initial issues related to governance and ownership in NGO transformation. The discussion addressed how to accomplish the right mix of board member backgrounds, to prepare a transformation plan and to see the MFI through its implementation, and highlighted potential issues and opportunities (e.g. role of the former NGO, client and employee representation on the board).

ESOPs and other Advanced Ownership and Governance Issues

Kimanthi Mutua, K-Rep Bank (Kenya) and Michael Chu, ACCION International (USA)

This session discussed the ownership and governance issues relevant to regulated financial institutions. The discussion also covered the use of ESOPs to motivate employees, how to improve the effectiveness of board members and committees, and the role of NGOs or public investor in the ownership mix.

PART III: KEEPING UP WITH THE COMPETITION

Automating Microfinance

Vikram Akula, SKS (India) and Carlos Membreño, ACCION International (Nicaragua)

In this session, practitioners shared how they have used new technologies to improve their efficiency and remain competitive. In particular, participants learned about the use of smart cards, debit cards and ATMs in facilitating financial transactions in MFIs, as well as the use of credit scoring and personal digital assistants to automate credit decisions.

Building Customer Loyalty

Craig Churchill, International Labor Organization (ILO) (Switzerland)

1 Michael Chu is currently fund manager of Pegasus Venture fund and a member of ACCION International’s Board of Directors.
This session helped MFIs understand the full costs of client desertion and discussed ways to reduce desertion by building customer loyalty. The participants learned how to measure and monitor customer satisfaction and desertion, using a variety of client information collection tools, such as surveys and focus groups. The facilitator discussed the costs and benefits of collecting client input on existing and potential products or services, and explained how to develop long-term relationships with loyal customers by responding to client needs.

**Surviving Competition**

*Kurt Koenigsfest, BancoSol (Bolivia) and Alvaro Retamales, Banco del Desarrollo (Chile)*

Based on their experiences in Bolivia and Chile, the facilitators described the extremely competitive environments in which they operate and the strategies they have employed to help them survive competition from the formal financial sector, including the entrance of consumer lenders. They then guided participants through a discussion of how to identify a market niche and protect the MFI through effective risk management (liquidity and interest rate risk management).

**Market Segmentation**

*Inez Murray, Women’s World Banking (USA) and Monica Brand, ACCION International (USA)*

This session presented market research techniques for segmenting the market of an MFI in order to better tailor services and marketing efforts to different groups within the market. The tools were described as was their translation in actions.

**PART IV: NEW PRODUCTS AND SERVICES**

**Mobilizing Savings**

*Graham Wright, MicroSave-Africa (Kenya) and Marguerite Robinson, Professor Emeritus, Harvard Institute of International Development (USA)*

This session explained the difference between forced and voluntary savings and discussed the positives and negatives of savings mobilization. The facilitators presented approaches to conducting market research and new product development for a variety of savings products, including passbook savings and certificates of deposit. They discussed what is involved in developing the infrastructure for savings, setting interest rates, and marketing savings products.

**New Product Development**

*Warren Brown, ACCION International (USA)*

By identifying opportunities for new markets and expanded markets, MFIs can increase their outreach and improve their profitability. This session presented examples from the field of MFIs that have successfully developed new products to expand their markets. It also discussed product failures and how the MFI can minimize the costs of new product development and implementation by using product costing and pilot testing methods. Participants were encouraged to share their experiences in new product development and to describe the processes they used to develop and market a new product.

**Role of MFIs in Rural and Agricultural Lending**

*Carlos Labarthe, Compartamos (Mexico) and Juan Buchenau, Frontier Finance International (USA)*
In trying to expand their outreach, many MFIs are turning to rural and agricultural markets. Some practitioners question whether this can be done in a sustainable manner, i.e. through full cost-recovery and the use of market interest rates. In this session, two commercial MFIs explored this question by analyzing their risk management techniques for rural markets they successfully serve.

**Accessing Capital Markets**

Stefan Harpe, AfriCap Fund (Canada) and Thomas Miller, Multi-Lateral Investment Fund, Inter-American Development Bank (USA)

This session was intended for any MFI interested in expanding their sources of funds. It discussed how MFIs can determine an appropriate capital structure and choose between debt and equity financing. The facilitators presented a variety of alternative financing instruments, including the use of subsidized funds, bonds, and common and preferred stock. Participants learned what types of performance ratios and levels various investors review, with an emphasis on the importance of efficiency indicators.

**PART V: EFFECTIVE RISK MANAGEMENT**

**Client Risk Management**

Monique Cohen, USAID (USA) and Michael McCord, Micro-Save (Kenya)

This session addressed how MFIs can address the needs of high-risk clients and help them remain economically active, thereby protecting the institution's financial viability. It discussed the tools that MFIs could use to assess their clients' vulnerability to risk and how these vulnerabilities translate into their demand for financial services. It addressed potential ways in which MFIs could effectively intervene to respond to these clients' needs, either through new product development or through strategic linkages with other partners for complementary services.

**Participating in Credit Bureaus**

Liza Valenzuela, USAID and Jacques Trigo, ACCION International (Bolivia)

This session discussed the myriad ways in which MFIs share client information to reduce risk of lending to bad borrowers and to limit client indebtedness. Participants explored the pros and cons of the ways in which MFIs share client information, including black lists, public credit bureaus, and private credit and information bureaus.

**Managing through Crisis or Disaster**

Wayan Alit Antara, BRI (Indonesia) and Francisco Madrid (Honduras)

This session discussed methods used by MFIs to minimize losses in times of financial crisis and natural disaster. The facilitators shared their experiences in surviving a hurricane in Honduras and economic recession in Indonesia. Participants were encouraged to share their experiences and ideas for managing effectively through uncontrollable external difficulties.

**Liquidity and Interest Rate Risk Management**

Sylvia Wisniwski, Bankakademie (Germany)

This session discussed liquidity management and interest rate management techniques used by MFIs to reduce risk of financial loss. It addressed liquidity planning and interest rate setting in various environments, as well as how to set reserves at an efficient yet adequate level to protect the MFI in the event of unforeseen losses or changes.
PART I: TRANSFORMATION AND EXPANSION OF MICROFINANCE INSTITUTIONS

PREPARING FOR NGO TRANSFORMATION
Carlos Castello, ACCION International, USA
Carlos Danel, Financiera Compartamos, Mexico

Overview

Over the past decade, ACCION has helped more than 10 institutions create or transform into formal financial institutions. Five of these institutions began as non-governmental organizations, BancoSol in 1992, Finamerica in 1994, Mibanco in 1998, Compartamos in 2000 and FINSOL in Honduras in 2000. The Gateway Fund invested in the first four of these institutions. In addition, ACCION assisted the merger of non-governmental organizations to create new formal financial institutions, as was the case for Bancasol and Genesis in Guatemala, who merged in 2001, and Bangente in Venezuela in 1997. Finally, ACCION helped create microfinance subsidiaries in two commercial banks, SogeSol (SogeBank) in Haiti and Credife (Banco de Pichincha) in Ecuador.

The following discussion will focus, however, on non-governmental organization (NGO) transformation. The primary driving forces behind the transformation of many microfinance NGOs into formal financial institutions are management’s institutional vision and the funding constraints of NGOs, which cannot access capital markets and can seldom mobilize savings. These two forces form important synergies that drive transformation, providing greater access to funds, which in turn enables the institution to reach more low-income customers. Other motives for transformation include competitive pressures, the need to offer more customer services (such as savings accounts) to existing customers, the desire to expand the branch network to deepen market penetration, and the desire to access or establish market niches that require additional services an NGO cannot provide.

There are several critical areas to consider when deciding to transform, ranging from exogenous issues such as regulation and supervision to endogenous issues such as changes in corporate culture. These issues can be broken down into five categories:

- Regulation and supervision
- Ownership and governance
- Leadership
- Human resources
- Operations

The following section explores the important role that each of these issues play, as they pertain to the transformation process. The second section details the transformation of one NGO, Financiera Compartamos, formerly the NGO Asociación Compartamos.
Preparing for NGO Transformation: Critical Issues

1. Regulation and supervision.

How the new institution will be regulated is of paramount importance. Depending on the country’s regulatory structure, the institution can be required to fulfill a range of expectations. It is very important for the MFI to establish a dialogue with regulatory authorities in order to facilitate a reciprocal process of education and negotiation. In some countries, regulators are unfriendly to microfinance. In one country, Guatemala, MFIs are forming a network, in part, to assist in negotiating with authorities.

There are times when an NGO has already established certain self-imposed regulations that may be more stringent than existing requirements. Some regulatory requirements, to which MFIs must comply, are straightforward, including banking laws such as interest rate ceilings, capital adequacy ratios and risk management requirements, as well as guarantee and provisioning requirements.

Other regulatory issues are not so straightforward. For instance, many superintendencies of banks require that the institution have detailed policy and procedures manuals, including a human resources manual and a credit manual. Development and production of such manuals is costly and time-consuming. Also, the regulated institution must adapt its management information system (MIS) so that it can generate more frequent reports over real time reports. This is a major undertaking and most institutions encounter difficulties in carrying out this project. There are instances where regulations are so simple that major changes are unnecessary. But at other times, balances must be closed daily, and few institutions are prepared for that at the time of transformation.

Institutions should budget double or triple the anticipated expenses in time, opportunity costs, and resources. When adapting the MIS, it is necessary to establish a portfolio classification system that tracks aging and historical provisioning related to various types of guarantees, and tracks write-offs. Because transformation is often a long process, it is best to start the MIS and portfolio classification system at least two years before anticipated transformation.

Meeting regulatory requirements is costly not only in the short run, but the institution must also conduct yearly internal and external audits, often pay for legal assistance, and update manuals and systems according to changes both within the institution and in the country’s banking sector as a whole. Another unanticipated cost will undoubtedly be management’s inability to fully focus on the business itself during the first year after transformation, due to the amount of attention to details required by the transformation process.

2. Ownership and governance.

Ownership and governance issues require careful analysis by the board. Each NGO will encounter various possibilities, constraints, and desired outcomes dependent on its own structure and the regulatory environment in which it operates. The following paragraphs discuss some of these variables.

The visionaries that begin as non-governmental microfinance institutions have often invested a lot of personal time, energy, commitment, and resources to a cause in which they deeply believe. These founders often do not want to give up control of the institution or diverge from their original vision. Thus, they often want to keep a majority stake and may resist change. Management will be faced with the following choices:

- Design a balanced ownership and governance structure to meet both social and profit objectives.
• Allow the NGO to keep control, because its founders worked hard and do not want other people to come in and threaten the original mission.

• Move slowly to build consensus, and allow pure private investors to eventually come in and participate in the decision-making process.

If the institution decides to incorporate private investors in the ownership mix, management and the board must consider why private sector investors are desirable, and consider the types of private sector investors who will be allowed to take stakes in the organization, including individuals who already sit on the institution’s board. Also, the board will have to decide whether the NGO will receive a premium for its initial work done to develop the institution.

The role of foreign investors is another issue that management and the board must consider. Multilateral funds (which may or may not be familiar with microfinance), specialized investment funds, and technical assistance providers are some examples of foreign investors. For example, technical assistance providers may create a conflict of interest if allowed to sit on the board.

3. Leadership of the new microfinance institution.

Depending on the qualifications and characteristics of the NGO’s management, the new institution may require new internal management. At the very least, it is likely that former NGO management will have to be trained to provide proper guidance and direction to the new regulated institution. In extreme cases, the board must decide who will be the new executives, managers, and board members. Issues to consider when choosing leadership include the following:

• Whether to retain NGO executives or attract individuals from the private sector banking.

• How to train new employees at the executive and board levels so that they can better understand the theory and practice of microfinance.

• How compensation levels and schemes change when higher-paid bankers are hired; NGO employees may feel they need more compensation because the MFI is now a bank.

• How to manage legal liabilities for board members; in some countries, for board members of banks, the law can take possession of personal assets in cases of fraud and cases of mismanagement.

4. Human resources.

Loan officers, tellers, data entry personnel, and other staff members will all be affected by the transformation. Staff will have to be transferred to the new institution, and this could be a good time to conduct an overall staff “clean-up” (i.e. require all staff to resign, and select individuals to be re-hired).

Once the staff of the new institution is confirmed, management must maintain clear and structured communication with the staff regarding the transformation. Most importantly, it is the job of management to maintain or update the organizational culture. One common threat to an MFI’s organizational culture is “bankers’ syndrome,” where employees distance themselves from the customers once the MFI is formalized. Management must assert that although the new institution is regulated, its intent is still to serve the working poor, and this requires different banking methods than regular commercial banks. It is very important for new hires, especially those from the formal banking sector, to receive this message in order to be integrated into the MFI’s organizational culture.
5. Operational issues.

In terms of operations, a transformation can create new possibilities for the institution, many of which can improve processes and procedures. Transformation can open windows for reengineering of internal systems, portfolio clean-up, new product development, and expansion of physical infrastructure.

- **Reengineering**: The institutional changes required by transformation create the opportunity to revisit the credit process and eliminate inefficiencies that were created during the institution’s growth. Streamlining systems often translates into savings for the institution, since it usually reduces the time employees dedicate to particular processes.

- **Portfolio clean-up**: As the institution transforms, it may be possible for it to leave the problem or the non-performing sections of its portfolio with the founding NGO. However, since dividing the portfolio can also allow the new MFI to present its portfolio as better than it actually is, it is best to have customers close out their accounts with the NGO and re-open them with the new institution.

- **New product development**: As microfinance service delivery moves more and more toward superior customer service, new product development will allow the new MFI to compete with other regulated institutions. If management decides to introduce new products during transformation, the new microfinance institution can open up “new and improved.”

- **Physical infrastructure**: Transformation creates the opportunity to expand the branch network, for example, through the addition of new buildings. With the availability of funds from capital markets, the new institution can broaden its outreach to meet the demand of a growing number of microfinance customers.

**Transformation Case Study: Compartamos, Mexico**

Financiera Compartamos recently completed its transformation process and is now a regulated financial institution. At the time of transformation (December, 2000), Compartamos was serving 64,141 clients with working capital loans averaging $155 outstanding per client. It had a portfolio at risk greater than 30 days of 0.58 percent, and it worked through a network of 35 branches and 380 staff. At the time, Compartamos had a return on equity of 31 percent.

It took Compartamos two years to obtain the license to become a finance company. Throughout that time, Compartamos kept operating as an NGO and prepared for transformation by working out the major issues and building capacity for the new corporate form. Compartamos transformed to meet the changing demands of the institution. In the eyes of management, this transformation was part of the normal evolution of the institution.

**Motivation for Transformation**

The main driver of Compartamos’ transformation was its institutional vision: Compartamos is committed to scale and permanence. Therefore, transformation was not accompanied by any major ideological shifts; instead, transformation helped Compartamos stay true to its vision. For Compartamos, transformation was a means to an end, but not the end in itself. The institution transformed because it had reached a certain level of development and, in order to continue fulfilling its mission, it had to move to the next level.

The need for larger funds was the other major driver behind the transformation. One of the major constraints on Compartamos, as an NGO, was the lack of access to the capital markets. It could only fund itself through scarce outside donations and from the surplus from its own operations. As a finance company, Compartamos now has full access to
commercial loans and in mid 2002, it will be able to issue commercial paper. By accessing commercial funds, the institution can reach more customers. The customer was at the heart of the decision to transform.

**Ownership Structure/ Governance**

The amount of control given to the founding NGO can shape the future of the organization. For Compartamos, its shareholders and the authorities, it was crucial that the NGO remain a major player in the organization, but not to hold the majority of shares in the finance company. The NGO realized that its role would change as the institution transformed and as new leaders entered. The NGO Compartamos now holds one third of the entire stake.

Private investors were brought in to hold more stock than the NGO in order to provide an ownership sense, and to provide governance to promote prudent financial performance. They also provided a familiar face to the capital markets, as real stakeholders that suffer or gain with Financiera Compartamos’ results.

Compartamos’ private investors are young Mexican entrepreneurs with a special social sensibility, who understand the financial services business, have knowledge of the local markets, and expect a financial return on their investment. Combined, the private investors hold one third of the stake of Financiera Compartamos.

For Compartamos, the inclusion of institutional foreign and specialized investors reflects an effort to provide local shareholders and local markets with institutions that have knowledge of the business in the region, and that provide governance and experience. They too hold one third of the stake in the institution. These foreign investors are highly respected institutions that have experience inside and outside of Mexico, and that can bring credibility for capital lenders such as Profund, ACCION.

The Board of Compartamos aims to reflect the multi-skilled nature of the capital composition, and includes external members for good governance.

**Leadership of New MFI**

Compartamos strongly believed that if it was to transform into a regulated financial institution, as part of the natural evolution of the institution, then the performance of the NGO should imitate the operation of a regulated institution well before it actually became one. Thus, the NGO’s executives were better able to understand the needs of the formal institution ahead of time. And, because of this, Compartamos chose not to change leadership at the executive level once transformation formally occurred.

To complement the abilities of management, Compartamos trained staff and adopted practical accounting and management information systems. And, while retaining its original executives facilitated the transformation process, it still had to invest in recruiting people knowledgeable of the banking sector, and to train its staff to be able to perform as a regulated entity.

**Human Resources**

In transferring staff, Compartamos found that it was crucial to maintain transparency and communication throughout the transformation process. A special effort was made to ensure that no speculation or rumors would take over (for example, that those without a college degree would be fired, or those with a college degree would see a huge salary increase), and that management kept all staff very informed of each step in the transformation.
Regulation

Since it does not mobilize savings, Financiera Compartamos is now regulated as a non-bank financial institution. In general, regulation and supervision in Mexico is not as stringent as Compartamos’ internal policies, so Compartamos was unaffected by provisioning or guarantee laws.

The adaptation of management information systems was one of the only major areas of adaptation and development for the finance company. The existing MIS had to be upgraded for operational reasons, and therefore management seized the opportunity to make it comply with banking regulation.

When mobilizing capital for equity, Compartamos found an excess supply of capital and calculated an optimal capitalization ratio that could provide shareholders an attractive return on their investment.

Operational Issues

Operational issues were very much present throughout the process of transformation, but were not directly related to transformation as much as they were the natural process of evolution of the operation. One key lesson is that through the transformation process, the institution experiences a great deal of change and re-direction. Operational issues that are too ambitious can complicate the overall change process.

Transformation in Africa versus Latin America

Latin America has seen more MFI transformations than Africa, but there are a number of MFIs in Africa that are now poised for transformation. While many of the same principles apply, there are differences as well. In Latin America, the transformation from NGO to regulated financial institutions was driven in large part by strong boards of directors composed of leading business people who understood the advantages of becoming a regulated entity, who were potential investors and many of whom were already involved in the banking industry. Therefore, this evolution was very natural once the other “prerequisite conditions” of transformation were in place.

In Africa, the situation is different. The leading NGOs that are considering transformation more likely to be management-driven with little input from their respective boards. Board members may have limited business or banking exposure at a senior level. In addition, few are in a position to make any substantial investment in the equity of the newly transformed entities. As a result, board members are in a weak position to drive the transformation process in conjunction with their executive staff. The transformation process in Africa is sometimes driven more by regulatory constraints and by the perceived imperative to capture savings than by a lack of access to funds.

The NGOs’ executive staff may be understandably reluctant to go through a process that could require them to respond to much stronger boards and investors and be scrutinized by market forces.

MANAGING NGO TRANSFORMATION

Pedro Jiménez, Banco ADEMI, Dominican Republic
Pilar Ramírez, FIE, Bolivia

After transformation has occurred, management must guide the evolution of the new MFI. Banco ADEMI (Dominican Republic) and Financiera FIE (Bolivia) both discovered that human capital is the most important resource in guiding this evolution. Each institution...
groomed, trained, and supported its board and management teams in order to manage the process of transformation.

**Experience of Banco ADEMI**

The non-governmental organization ADEMI transformed into a regulated institution because ADEMI had grown too large to be unregulated. At the time, competitors were saying that ADEMI seemed to be lending too much money, and management feared that if the banking superintendent came to review the institution, ADEMI’s reputation would be damaged. Other reasons for transformation were to create a liability structure for the institution, and also to mobilize savings.

Prior to transformation, ADEMI had operated as an NGO for 15 years, and reached more than 60,000 clients cumulatively, lending approximately $3 million each month and a built-up equity of about $18 million. The NGO had clear institutional objectives, with a target group of microenterprises that work in the informal sector. ADEMI’s aims were (1) to democratize credit in the Dominican Republic, (2) to contribute to income improvement of the local population, and (3) to generate jobs. ADEMI’s fourth objective, defined in early 1983, was self-sustainability. Embedded in these aims was the goal of graduating clients to the formal sector, and later it made sense to graduate the institution to the formal sector. As ADEMI evolved into a regulated institution, its institutional objectives would not change.

In 1997, one year before applying for a bank license, management examined ADEMI’s performance to determine its readiness. Taking the experiences of others into account, the board developed a business plan, an internal auditing process, and other measures to facilitate transformation. Since top management of ADEMI had all graduated from college and had risen through the ranks from loan officer, they were kept on as management staff. After applying for the bank license, management used the four-month waiting period to train staff to comply with banking standards. ADEMI also hired a university professor and someone from the superintendency to oversee the process and the beginning stages of the regulated institution.

ADEMI slowly and methodically transformed. During the first year, Banco ADEMI operated from only one branch, while the NGO operated the other 27 branches. In the second year, the bank operated 11 branches, while the NGO operated the remaining 21 branches. In this time, the portfolio increased from $33 to $50 million (at end of 2000). In 2001, Banco ADEMI is aiming for a 20 percent portfolio increase. Banco ADEMI’s average loan size is about $3000, although some customers borrow much larger amounts. Some of those who have $30,000 loans today are those who had $200 loans 15 years ago, which is a testament to Banco ADEMI’s goal of growing with its customer. Now that the institution is more efficient, Banco ADEMI is lowering interest rates, which also helps to retain customers.

Strong human capital was the most important factor in the success of the transformation. At Banco ADEMI, staff own 20 percent of the bank, which gives them a stake in its success. The board, too, is another key player in human capital. To facilitate the maturation process of the transformed institution, the board must understand how to run an enterprise, respect monetary authorities, have the ability to guide personnel, and be able to understand the needs and requirements of donors and foreign supporters as well as understand the needs and requirements of microfinance clients.
Figure 3: Banco ADEMI: Statistics 1998-2000
(Monetary Figures in millions of US$)

<table>
<thead>
<tr>
<th></th>
<th>1998</th>
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<tr>
<td>Number of Employees</td>
<td>2291</td>
<td>232</td>
<td>248</td>
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<td>Portfolio</td>
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<td>Average Size of Loans</td>
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<td>3,347</td>
<td>3,163</td>
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<tr>
<td>(Microenterprises)</td>
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<tr>
<td>Number of Clients</td>
<td>9,855</td>
<td>13,918</td>
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<td>Total Amount Lent</td>
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<td>Number of Loans/Year</td>
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<td>Equity Capital</td>
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<tr>
<td>Net Income</td>
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<td>$4.3</td>
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<tr>
<td>ROE</td>
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<td>Solvency Ratio</td>
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<td>18.0%</td>
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<td>Risk Ratio2</td>
<td>1.44%</td>
<td>1.17%</td>
<td>1.01%</td>
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1 Includes 101 Credit Officers and 60 Administrative Staff of ADEMI (58 payroll of the Bank).
Beginning 1999 the entire staff are employed by the Bank.
2 According to auditing reports of the Bank Superintendence.

The Experience of FFP FIE, Bolivia

After operating as an NGO for 12 years, the non-governmental organization FIE began the process of transformation into a formal financial institution. The reasons for change were various, but most stemmed from the increasingly competitive and saturated microfinance market in Bolivia during the late 1990s. The specific reasons for transformation were (1) increased access to funds, (2) ability to mobilize savings, (3) increased credibility in the eyes of investors, and (3) to keep up with the competition, since the trend for microfinance institutions in Bolivia was to become part of the formal financial system.

For microfinance institutions in Bolivia to transform into regulated institutions they first become a private financial fund, or FFP (Fondo Financiero Privado). An FFP is a financial institution that can be established once certain requirements have been met, as set out in Bolivian law. To comply with the requirements an MFI must have a minimum capital amount of $800,000, possess a professional staff with demonstrated experience in micro savings and lending activities, and abide by the Law on Banks and Financial Entities of 1993, which defines non-bank financial entities and private financial funds.

In the case of FIE, the NGO became one of the shareholders of the new for-profit company, and the same managers of the NGO became managers of the new company. Management adopted the tenet that managing transformation meant managing human capital. As much as the institution was changing, the individuals who ran the institution had to change as well. The primary change was that management shifted from a group that voluntarily came together to start a non-profit organization into a group of shareholders and owners who risk capital and expect a return. In one way the group changed from one that was working within a civil code that gave the legal status to the NGO into one that adopted the standards and norms of the commercial code. The key motivation of this difficult process was the promise of having access to new funds and the ability to offer savings to loan clients.

The shareholders of FFP FIE are primarily individuals who are willing to risk their own capital. They know that the institution serves the low-income sector of the population, which can expose the institution to additional risk. Reconciling the social and profit sides of the FFP has been the most difficult challenge of managing the transformation process.
Private shareholders must be willing to accept that this business works with the very poor, and their involvement must be based on something more than just expectations for a financial return.

Of course, depending on the structure of the market, NGOs can survive without transforming into a regulated institution. In fact, many NGOs claim to do a better job of reaching the poor because they are able to get soft loans from various lenders. However, the drawback of remaining an NGO is that outreach is curtailed. In the case of FIE, the institution had to either become regulated or stay very small. For countries that lack the infrastructure to create regulated institutions, there are alternatives such as cooperatives and credit unions.

In the event of transformation, there may be the issue of deciding what to do with existing subsidies. It is very important that a clear plan is developed from the beginning of the process. The institution should have an arrangement with the donor. And, if the subsidy is used as equity in new company, the institution must ensure that the necessary paperwork, agreements, etc. are in place, keeping in mind that the subsidies may also be taxpayer funds.

ON-GOING COMMERCIAL OWNERSHIP AND GOVERNANCE ISSUES

Martin Connell, Calmeadow, Canada
Alex Silva, Profund, Costa Rica

The board and management survey conducted by the MicroFinance Network in 1998 of nearly 30 institutions revealed that the prevailing issues in governance, including both the functions and motivations to serve, were very similar between for-profit and not-for-profit MFIs. In both cases, there was a high level of awareness of fiduciary responsibility, management oversight, and the need to ensure the right managing director was in place.

Change and Growth in the Microfinance Market

As the newly transformed institution grows and matures, it will encounter many issues and challenges that it never would have faced as a non-profit institution. Before transformation, management must consider the institution’s ability to negotiate through these on-going issues. Regulated institutions will inevitably be challenged to (1) reduce prices and costs through greater efficiency, (2) make management changes, (3) merge, be acquired, and acquire, (4) accept changes in control in return for more capital, and (5) accept the possibility of mission drift, and be prepared to cope with it.

In the last few years, there has been a rapid growth in the microfinance sector. While that growth has been occurring in most regions of the world, it is perhaps in Latin America that the greatest changes have taken place, especially in the competitive environment and in access to capital markets. The extent of this change is providing some of the most dynamic challenges and opportunities to the sector, and for that reason, this presentation is focused on that region.

In Latin America, total microfinance loan portfolios of both regulated and unregulated institutions now exceed $877,527,000.1 Some of the characteristics or issues emerging from this period of rapid growth in Latin America are:

- Intense competition in certain markets, like Bolivia.

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1 CGAP Occasional Paper No.5, Table 1: Institutions engaged in microfinance in Latin America (1999) - Portfolio outstanding for regulated institutions = US $648,564,701 and unregulated institutions = US $228,962,203
• Rapid growth in investment, with current levels in equity more than $100 million, debt more than $150 million, and deposits more than $300 million.²

• The emergence of commercial banks that own MFI units, often with an NGO partner (Sogebank of Haiti, Banco del Caribe of Venezuela) and those that operate as pure players (Visión of Paraguay, Banco de Credito of Peru, and Banco Pichincha of Ecuador.)

• More intense supervision, scrutiny and in some cases, competition from governments.

• This change in environment brings with it a change in how MFIs in the region must operate, even in the present; plan their futures, address capital markets access and govern themselves. Some of these changes include the following:

• Improving operating efficiencies in order to reduce costs.

• Deposit taking, inter-bank lending and debt financing, which have become key components of micro lending portfolios, leading to tighter internal controls and board oversight.

• Equity, which has replaced grants, and which means that new owners expect profits, dividends, and a reasonable exit opportunity.

• Control of the institution, in that both the shareholders and the board could be forced to change.

• Management accountability, which will increase dramatically, with attendant rigorous performance reviews and willingness to address management change.

Competition, especially from the private sector, will continue to increase. Given the commercial banks’ comparative advantage in systems, back office, and treasury, their ability to impact pricing is strong. They can also lure microfinance staff with more competitive salaries, which in turn makes it necessary for MFIs to offer better incentives to avoid high staff turnover by effectively countering the competition. And, as competition grows and microfinance becomes more visible, governments will inevitably increase their scrutiny and intervention.

Despite these challenges, competition and commercialization help microfinance to better serve its target clientele by encouraging better pricing schemes, greater stability of financial institutions, and new products. However, along with these benefits come the many responsibilities associated with managing a formal financial institution.

Shareholders and the Board

The board will feel the impact of transition very strongly, as members will have to shift from a “cheerleading” role to one of fiduciary oversight. In this capacity, the board must maintain an objective distance from management in order to give performance evaluations and put the right management team in place. The board must also have the knowledge and expertise to take part in strategic planning and to give oversight approval in many issues that involve a legal risk, including mergers, acquisitions, change in capital, payment of dividends, and allocation of resources by management.

Many of the new responsibilities of the board include making difficult decisions, and board members must be prepared to do so. If either the board members or the management of the NGO do not have the correct skills to manage a commercial institution, they will have to be replaced or thoroughly trained, since the performance of the organization is critical for a formal financial institution. Under-skilled management must adapt or be replaced.

² CAF.
Management must deepen its talent pool to meet the growing and more complex needs of the institution.

Many institutions have found that having a single strong shareholder is more efficient than having many weaker shareholders, because it is easier to make decisions. However, the balance between objectives is lost in such an arrangement, because having a diverse ownership structure means that differing shareholder interests can balance commercial interests with visionary objectives like impact on poverty.

**Role of the NGO**

If the original NGO remains in existence, it cannot allow its subsidies to flow to the commercial organization. One example of what happens when an NGO plays such a role is the CorpoSol/FinanSol crisis, where the NGO CorpoSol served to hide bad assets of the commercial institution, which eventually folded under the pressure of its poorly performing portfolio. Furthermore, if the commercial entity operates with any amount of soft money, it loses its power to provide a demonstration effect to traditional banks.

One situation that is yet to be seen in microfinance is a large bank buying out an NGO. However, large commercial banks are not likely to become poverty lenders. They may perceive a niche market opportunity in microfinance, and they will be effective in serving that population. However, they will not serve the poorest of the poor. It is important to note, though, that few of the MFIs operating in Latin America are currently serving the poorest of the poor as their only market, or at all. If a commercial bank did buy out an NGO, it is possible that the bank might be better able service the market and at a lower cost.

**ACCESSING CAPITAL MARKETS**

*Stefan Harpe*, AfriCap Fund and Calmeadow, Canada  
*Tomás Miller*, Multilateral Investment Fund, Inter-American Development Bank USA

This session examined how MFIs access capital markets from the perspective of Calmeadow and the experience of the Multilateral Investment Fund, a fund of the Inter-American Development Bank.

It is important for MFIs to decide what the appropriate capital structure is regarding the optimal balance between equity, debts, and grants. This question is not only a financial one; the structure depends on the ultimate objective of the MFI, and those objectives will determine how its balance sheet will look. To determine the balance of its capital structure, the MFI must weigh the objectives of the shareholders versus the objectives of the institution. Maximizing profit, social impact, or the short-term value of the institution is a decision that the board must make by examining the institution’s vision, mission, and financial necessities. Leverage and capital structure are preconditions that debt and equity investors look at when considering investment in an MFI.

Microfinance institutions often find that the commercial “pot of gold” is an elusive one. Factors that contribute to the difficulty of accessing commercial funds are various, but mostly stem from the following factors:

- Microfinance is a relatively new industry, and the process of paving the road toward accessing capital markets is taking longer than originally believed.
- The sector is transitioning from donor funding to commercial capital.
Many microfinance institutions struggle to reconcile their objectives of development and profit; the lack of clarity can get in the way of the preconditions necessary for borrowing on the capital markets.

Socio-cultural factors in each region affect the evolution of microfinance; in some regions, there is a lack of trust in microfinance as a credible industry.

The Search for Capital

There are political ramifications of empowering poor people through credit, such as shifts in balance of economic and social power within communities. In order for microfinance institutions to access commercial capital (i.e. to expand community outreach and influence), the microfinance sector must develop a political strategy for building coalitions, lobbying, and forcing change within countries and communities. Changing banking laws requires a concerted effort and a well-thought strategy.

It is a misconception that leading MFIs do not have trouble accessing capital. While it is true that leading MFIs have an easier time finding funds than less-established ones, the real issue is that the type of money MFIs can access may not come with appropriate oversight, governance, and a commercial perspective. Leading MFIs are stuck between a donor-funded phase and a commercial-funded phase, and donors are often not willing to fund profitable, successful institutions. For these large MFIs, grants are not sufficient, but commercial sources will not lend funds in large enough amounts to present a long-term solution to funding needs. To bridge this gap, a more nuanced approach by donors is necessary. Donors may be in the best position to develop new instruments, like specialized investment funds. More conventional development banks are needed to intervene in this transition. Easing the transition in this way will help facilitate the creation of more demonstration models in microfinance.

Access to capital markets not only means access to private equity, but also access to debt. Borrowing money to on-lend, coupled with regulatory reform to give depositors confidence, can widen product range and funding to institutions. Many MFIs are overcapitalized, and in order to generate attractive returns on equity, and continued access to capital markets, MFIs must adopt an appropriate debt-equity ratio and an appropriate capital structure with a certain amount of equity. Once these structures are in place, a larger amount of debt provides leverage, and is lent out with a sufficient margin to generate an attractive return on equity (ROE). These activities require a more sophisticated funding strategy, and they require regulated status, as well as a number of other institutional capacities. All these requirements are a key part of the development of the microfinance sector.

The notion of leverage and expansion through access to commercial capital beyond donor funding has been recognized in the field for some time. Since local banks cannot make available funds that are consistently large enough, and since regulated status gives access to both private equity investors and debt for leverage, the microfinance industry will stagnate if it does not become largely regulated. Commercial viability requires that financial institutions lend out borrowed funds at a multiple of their equity base – in other words, that they leverage their equity.

Optimal Capital Structure

There are several theories regarding appropriate capital structure in the corporate world, but these theories do not always apply to microfinance; MFIs do not always want to maximize profits, sometimes they want to maximize social benefits. Furthermore, there are some market assumptions that do not always apply in developing countries, because of local market structures. Often, these markets lack debt, and liquidity costs are very high. Furthermore, it is normal that in developing countries, public sector policies cut out private
sector initiatives or at least crowd them out. One interesting theory that accurately describes the process that microfinance follows is the pecking order theory.

Microfinance institutions typically begin their funding with grants, seed capital, retained earnings, and soft loans. When these sources no longer meet their capital needs, MFIs look to commercial loans, which have specific characteristics. Often, commercial lenders enforce certain controls, such as limits to arrears and quotas for outreach. Such contracts have clauses to protect the creditor, the lender, or the bank against gapping or interest rate movements. In Latin America, lenders reaching to MFIs have this conditioned money. Profund, LACIF, ACCION’s Gateway, CAF, MIF, and IFC all have such conditions, and demand more information, which is a move toward commercialization. However, because of these conditions, ultimately MFIs prefer internal finance, which comes with no strings attached. But, if an MFI does determine the need for external funds, it often will first risk security. Microfinance institutions will typically start with debt, next moving to hybrid or convertible debt, and quasi-debt, and finally equity. The more types of financing that are available to microfinance institutions, the more discipline they will have vis-à-vis capital markets, in turn facilitating more money to flow into these institutions.

**Liability Side Strategy**

For the field to continue moving forward, microfinance must shift its focus from developing the assets side of the balance sheet, namely portfolio growth, quality of the portfolio, and revenue generating assets, to the liabilities side of the sheet.¹

The risk capital that investors put into an institution, in terms of common shares, is the capital that regulators look at when they determine how much leverage they will permit. This standard is according to the Basle convention on banking standards, currently established at 1:12 for banks. The conventional wisdom places this figure at 1:6 or 1:7 for MFIs, but this is not based on analysis.

There is a variety of funding sources available to an institution that can develop its liabilities in a way that matches each instrument with the particular investor profile and risk profile. The safest investment is in a deposit; the riskiest investment is in a common share, and in between there are many options, which can be priced to match the profile of a particular investor. An unsecured subordinated debt would have a certain interest rate; a debt, secured by hard assets has a lower interest risk, and therefore a lower cost. Corporate finance theory outlines how to develop a range of funding options at different prices to generate an overall cost of capital, which is managed with an eye to generating a sufficient return on that capital to reward the investors.

With that scheme in mind, MFIs must develop a funding strategy that maximizes their ability to generate an appropriate amount of debt, an appropriate amount of equity, and a return on those classes of securities to ensure continued access to capital markets. This is not a static picture, but a dynamic one that evolves over time. In many regions of the world, markets are so underdeveloped that capital markets are neither deep nor sophisticated enough to deal with anything else other than a loan or equity. As we see in developed capital markets, there is a whole range of instruments, from preferred shares, to subordinated debt, to collateralized debt, which all provide different funding options as they seek to fund different parts of the asset side. For example, it would be inappropriate to fund a loan portfolio with equity. It is funded with borrowed money, consisting of either deposits or subordinated debt. Using the wrong funding instruments reduces the potential profitability of an institution, especially if it is overcapitalized and lending out its equity.

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¹ Liabilities include (1) deposits, which come with protection or insurance, (2) debt, (3) subordinated debt, (4) equity, (5) preferred shares, (6) common shares, and (7) retained earnings.
More demonstration models of successful commercial microfinance institutions will eventually convince skeptics, stimulate regulatory reform, entice commercial banks to be players in the field, and attract private investors. The microfinance industry requires a multi-faceted strategy to open commercial windows and address funding constraints.

**Practical suggestions**

To prepare the microfinance market to accept new types of investors, on both the debt side and the equity side, microfinance institutions could develop the following initiatives:

- **Develop a business plan.** This plan should be a constantly evolving framework including a strategic planning capacity, such as a two-day retreat, or the nomination of an individual who is responsible for anticipating upcoming issues. The substance of the plan should include a capital budget, a plan for expansion and how it is linked with operating budgets, as well as a hiring scheme. Appropriate management capacity and systems will complement the business plan.

- **Nurture an institutional culture.** The institutional culture is of intangible but unmistakable value. A healthy institutional culture is not overly linked to donors, but is firmly rooted in local culture, managed by locals, and provides economic benefits to the country. The institutional culture is well perceived by customers, and it may affect customer loyalty and the institution’s ability and desire to offer appropriate services. Institutional culture shapes the way the local community perceives the MFI.

- **Develop linkages.** Bringing local business leaders and bankers on board will help them to learn about the microfinance industry, and in turn, incite them to support the goals of the MFI. An advisory committee dedicated to institutional development can further help strengthen the individual institution as well as the industry as a whole.

- **Create a strategic vision and appropriate governance structure.** This intangible asset contributes to the institution’s development by assuring employees that there are appropriate structures in place for management accountability. When the whole organization is aware of its roles and responsibilities, the institution will be stronger. A demonstrated commitment to viability will further enhance employees’ trust in the institution.

- **Develop appropriate benchmarks and comparisons with the banking sector.** Comparisons of financial performance will help the organization to orient itself among major players in finance. Indicators to consider include (1) profitability (return on assets and equity), (2) debt to equity ratio, (3) operating efficiency, (4) growth potential, (5) outreach, (6) portfolio quality, and (7) balance sheet leverage. It may be helpful to refer to benchmarking publications, such as the *MicroBanking Bulletin* or *MicroRate* for industry benchmarks.

- **Aim for an optimal capital structure.** An MFI that seeks an optimal capital structure should seek more debt versus risk tolerance, leverage its equity base for a risk-adjusted return to investors, and balance sources of funding with a capital budget plan for growth. At the same time, the MFI must meet regulatory and industry standards.

The overall goal for the industry is for the range of investors to expand. The field will move from funding sources of development banks to institutional investors to individuals. In Latin America, the MFIs have done better than commercial banks in terms of growth, profitability, and quality of the portfolio. A parting question is this: Although the results have been positive, why is the private sector still putting less money into microfinance?
REACHING DOWN

Pierre-Marie Boisson, SogeSol, Haiti
Mónica Hernandez, Banco Solidario Ecuatoriano, Ecuador

The practice of “reaching down” to small borrowers by commercial banks is one way for the microfinance market to achieve greater scale. Commercial banks, however, are often wary of reaching down because they perceive the small scale sector as being too risky and too expensive. They may also feel blocked by socioeconomic barriers that perhaps only traditional microfinance institutions can overcome. But these beliefs are usually unfounded. Some compelling reasons to enter the microfinance market include opportunities for portfolio diversification, desire for a new public image, the profitable and successful experience of microenterprise banks elsewhere, available funds, rediscount lines, technical assistance from donors, and financial liberalization, among others. In order for commercial banks to enter microfinance, the banks’ owners, other decision-makers, and technical and financial partners must learn what they have to gain from the sector.

Reaching down can be accomplished in two ways: (1) by existing commercial banks that open a microfinance subsidiary, affiliate, or arm, or (2) by creating a new commercial institution that lends exclusively to the microfinance market. Sogesol, located in Haiti, is an example of a bank that opened a microfinance affiliate; Banco Solidario, located in Ecuador, is an example of a commercial bank created to operate in the microfinance market.

A closer look at the key aspects of commercial banking versus microfinance banking provides a useful perspective of the issues involved in reaching down to the microfinance sector. The main difference between commercial and microfinance banking is in the mission. Figure 4 examines other differences between traditional commercial lending and microfinance. Figure 5 examines how different types of banks within the field of microfinance compare, focusing on aspects of their mission, structure and operations.

Figure 4: Commercial Banking versus Microfinance

<table>
<thead>
<tr>
<th></th>
<th>Traditional Commercial Lending</th>
<th>Microfinance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mission</td>
<td>To provide clients with financial services and products with favorable returns to shareholders.</td>
<td>To provide financial products and services to a low-income population that does not have access to conventional commercial lending, with favorable returns to shareholders.</td>
</tr>
<tr>
<td>Services</td>
<td>Strictly financial components.</td>
<td>Both financial and social components.</td>
</tr>
<tr>
<td>Clientele</td>
<td>Favors larger-scale, well-off, literate clientele who can satisfy stringent loan conditions. Banking culture not ready to lend to low-income clientele, but will accept their savings.</td>
<td>Savings and credit facilities for lower-income households and small-scale enterprises in urban areas and small farmers in rural areas. Banking culture ready to serve low-income clientele with few opportunities.</td>
</tr>
<tr>
<td>Administration</td>
<td>Complex administrative procedures often incapable of understanding needs of poor small savers.</td>
<td>Simple procedures that are easily understood and adapted to target population.</td>
</tr>
<tr>
<td>Premise</td>
<td>Economy’s surplus transferred as financial services to upper-income population.</td>
<td>Economy’s surplus transferred to low-income population with no access to traditional commercial lending.</td>
</tr>
<tr>
<td></td>
<td>Traditional Commercial Lending</td>
<td>Microfinance</td>
</tr>
<tr>
<td>------------------------</td>
<td>------------------------------------------------------------------------------------------------</td>
<td>------------------------------------------------------------------------------</td>
</tr>
<tr>
<td><strong>Savings</strong></td>
<td>Does not mobilize small-scale deposits or rural savings.</td>
<td>Mobilizes savings from low-income urban households and rural savings.</td>
</tr>
<tr>
<td><strong>Selectivity</strong></td>
<td>Selective regarding clientele; avoids clients who make small deposits; if does mobilize small savings, usually does not give small loans to same people.</td>
<td>Accepts small amounts of regular savings. Financial technology adapted for small sums.</td>
</tr>
<tr>
<td><strong>Loan Application Procedures</strong></td>
<td>Complex loan application procedures, based on clients’ income and assets.</td>
<td>Simple, non-bureaucratic access to credit, based on client’s character and capacity to pay.</td>
</tr>
<tr>
<td><strong>Loan Processing</strong></td>
<td>Complex processing of loan requests; loan delivery is not prompt.</td>
<td>Prompt approval and minimum delay in disbursement.</td>
</tr>
<tr>
<td><strong>Collateral Requirements</strong></td>
<td>Collateral requirements: deposits or savings accounts in a commercial bank, or property, which can be mortgaged.</td>
<td>Collateral requirements: according to local conditions and borrowers' capacities to repay a loan.</td>
</tr>
<tr>
<td><strong>Costs versus Risks</strong></td>
<td>Lower operational costs and risk; however, not attainable for low-income clients and small-scale enterprises.</td>
<td>High operational costs and higher risks reflected in interest rate charged; however, more accessible.</td>
</tr>
<tr>
<td><strong>Repayment Rates</strong></td>
<td>Repayment rates are lower.</td>
<td>Very high repayment rates due to lending methodologies.</td>
</tr>
<tr>
<td><strong>Customer Support</strong></td>
<td>Little or no support to clients.</td>
<td>Strong interaction and monitoring of clients. Quick actions in case of defaults.</td>
</tr>
<tr>
<td><strong>Costs</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- <strong>Financial</strong></td>
<td>Lower than microfinance.</td>
<td>Higher than traditional lending.</td>
</tr>
<tr>
<td>- <strong>Accessibility</strong></td>
<td>Complex; very difficult or sometimes impossible for microentrepreneurs to access.</td>
<td>Assistance to microentrepreneurs in whole process; simple access to loans.</td>
</tr>
<tr>
<td>- <strong>Opportunity</strong></td>
<td>Loan delivery not prompt enough for businesses with high capital rotation.</td>
<td>Prompt loan delivery; meets needs for microenterprises with high capital rotation.</td>
</tr>
<tr>
<td><strong>Accessibility to Microentrepreneurs</strong></td>
<td>Microentrepreneurs are afraid to approach a traditional commercial lending facility: low self-esteem and self-confidence.</td>
<td>Microentrepreneurs feel comfortable approaching microfinance institutions: their confidence and self-esteem increases. In return, clients are faithful and feel responsible towards the organization.</td>
</tr>
</tbody>
</table>
### Figure 5: Comparative Analysis of Different Types of Commercial Banks in Microfinance

<table>
<thead>
<tr>
<th>Mission, Commitment and Bank Culture</th>
<th>Microfinance Division (e.g. Banco Agrícola Comercial, El Salvador; Banco del Pacífico, Ecuador)</th>
<th>Independent Structure (NGOs/ others) (e.g. Sogesol, Haiti; Banco del Desarrollo, Chile (Bandesarrollo); Banco del Pichincha, Ecuador (Credifé))</th>
<th>Regulated Organizations Created for Microfinance</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>• Institutional mission not focused on microenterprise sector or social investment. Difficult for staff to understand microfinance structure. Only small portion of portfolio in microfinance. Microfinance as a means to diversify portfolio; bank culture prioritizes large accounts, may resist microfinance culture.</td>
<td>• Institutional mission of independent structure focused on microenterprise sector. Institution creates an independent structure to target microenterprise sector; less interference with conventional bank culture.</td>
<td>• Institutional mission focused on microenterprise sector. Committed to microfinance as a for-profit business; bank culture prioritizes making profit. Majority of portfolio in MF; may or may not have microfinance methodologies.</td>
</tr>
<tr>
<td>Administrative and Organizational Structure</td>
<td>• Bank creates a division to handle microfinance operations; dependent on large bank structure. Needs to be adapted to handle large numbers of small transactions.</td>
<td>• Bank creates an independent structure (NGO, foundation, others) for microfinance services; semi-independent on large bank structure, and dependent on its financial resources. Adapted or created to handle microfinance transactions.</td>
<td>• Largely specialized in micro and small loans since inception. Structured to provide microfinance services. May open other lines of credit to better-off clients. Created to handle large amounts of small transactions.</td>
</tr>
<tr>
<td>Capital Structure</td>
<td>• Shareholders interested in bank’s profitability. Established internal controls and administrative accounting systems. However, methodology differs from typical microlending methodologies; needs to be adapted. Usually offers services through different windows.</td>
<td>• Shareholders interested in financial and social profitability. Products and processes created or adapted to the different target population.</td>
<td>• Shareholders interested in financial profitability. Products and processes created for the different microfinance culture. Microentrepreneurs attached to other products besides credit, to strengthen microenterprise.</td>
</tr>
<tr>
<td>Products and Methodology Human Resources</td>
<td>• Difficult to involve staff in a different microfinance culture. Salary structures for MF officers differ from normal conventional banking salary structures.</td>
<td>• May adapt specific salary structures for independent structure. Easier to recruit and retain staff outside large institution.</td>
<td>• Strong incentive systems to motivate productivity. Specialized staff hired. Importance of training and retraining staff.</td>
</tr>
<tr>
<td>Cost-effectiveness</td>
<td>• Existent physical infrastructure from which to expand and reach out to MF clients. Large transactions may help to subsidize high costs of microfinance services, until they become profitable.</td>
<td>• The creation of an independent structure is likely to be more costly initially. Initial cross-subsidization of the independent structure (from banking institution) created for provision of MF services.</td>
<td>• Extra costs incurred in programs or activities created solely for clients’ benefit, with a social purpose and thinking in long-term investments (e.g. retaining clients). Importance given to find innovative strategies to reduce costs.</td>
</tr>
</tbody>
</table>

**For Profit only**

- **Solución, Financiera de Crédito del Perú**

**With social mission**

- **Banco Solidario, Ecuador**

- **Banco Solidaario, Ecuador**
Banco Solidario

Banco Solidario was created in May 1995 with an initial investment of $700,000 from pure private investors, and is the first microfinance bank born with 100 percent private funds. It is a regulated microfinance institution created, with technical assistance from ACCION International, to provide financial services with a social mission to the microenterprise sector. The majority of its portfolio is in microfinance, but the bank offers other lines of credit to clients with higher income levels. Forty percent of its capital structure comes from foreign investment, with shareholders interested in both financial and social profitability. Banco Solidario has a strong focus on serving client needs: products and processes are adapted to the particular social, environmental, and economic context and their client. The bank prides itself on its ability to remain flexible.

Banco Solidario found private money from several Ecuadorian companies that believed in the idea of microfinance. Once the bank offices were established, and lending had begun, ACCION, Cooperación Andina de Fomento (CAF), and the Inter-American Development Bank invested funds to become shareholders. These institutions would not give money to ideas, so the bank first had to risk its own money before being able to access funds from these larger lenders.

The bank’s mission states that it is committed to benefiting the industry as a whole; its aim is to go beyond serving its own purposes. Banco Solidario is the founder of Red Financiera Rural (Rural Financial Network) and Foro de la Microempresa (Microenterprise Forum), both of which seek to strengthen the Ecuadorian microfinance industry.

Banco Solidario creates new products in response to emerging needs of microentrepreneurs. Recent developments are loans for migrants and rural microfinance loans. The development of successful innovative microfinance technology including use of the palm pilot is now being transferred to MFIs in other countries.

Staff is trained to closely identify with the institution’s mission. Each member of the bank’s team, from senior officers and shareholders to the lowest ranked staff, is asked to embrace the bank’s commitment to microfinance. Meanwhile, it is the job of finance specialists to find balance between financial and social goals. Banco Solidario recruits specialized staff to manage its microfinance programs, and it has found that loan officers with no experience in conventional banking can best understand the principles and mission of the organization.

Despite a severe financial crisis in Ecuador from 1998 to 2000, Banco Solidario’s results have been positive as of April, 2001:

- Gross Profit: $461,200
- Technical Equity: $9,329,560
- Technical Equity (%): 17.6% (higher than required by law)
- Average loan size: Solidarity = $200, individual = $450, with collateral = $800
Porfolio: 68.83% portfolio diversified between microenterprise, low-income housing, and small enterprise (87.19% of total number of clients) (Microfinance portfolio of $17.9 million at Sept. 30, 2001)

Number of microfinance clients: Increase from 14,266 (Sept. 30, 2000) to 23,271 (Sept. 30, 2001)

To get around a loan ceiling of 18 percent, BancoSolidario cleared with the banking authorities the ability to charge assessment fees related to the loan, resulting in rates of 32 to 42 percent. One notable problem in Ecuador is the frequent change of the government. This places a higher burden on the microfinance industry, which must re-educate new officials often.

SogeSol

In 1998, SogeBank created SogeSol, a major affiliated company dedicated to microcredit. Currently, with 24 percent share of banking system assets (27 percent for the group) and over 30 percent of the small savers market, SogeBank is by far Haiti’s lead commercial bank and has been for the last fifteen years, a true success story in the otherwise depressed Haitian economy.

Haiti’s Economy and Banking System

Haiti is the Western hemisphere’s poorest country, with a per capita gross domestic product (GDP) of $566, life expectancy of 54 years, infant mortality at a rate of 71 per thousand, adult literacy at 51 percent, and a rural impoverished people making up 80 percent of the population. The population at large is very young (the median age is 20), mostly self-employed, and rapidly urbanizing. The unemployment rate is at 17 percent, and of those who are employed, 75 percent are self-employed (3 million people). There are an estimated 1.6 million microenterprises in Haiti.

The urban population makes up 35 percent of the country and is growing two and a half times more rapidly than the population of other areas; this growth adds great pressure for more jobs. Forty-nine percent of Haiti’s GDP is in the service sector, mostly in the informal sector. Private and public transfers increasingly drive the economy.

There are 12 banks in Haiti: two foreign, two state-owned, and eight local private commercial banks. The total assets of these banks are $1.1 billion, or 25 percent of the Haitian GDP. The combined loan portfolio is $420 million, or 10 percent of the Haitian GDP. The banks hold 730,000 accounts, and 88 percent of these are savings accounts with an average balance $634. These are microsavers, and they hold 40 percent of the value of the entire banking system. In this scenario, the poor are lending to the rich. Forty percent of those savers (250,000 people) are bankable microenterprises, i.e. they are making profits from their business activities, they have identifiable needs, and they are not receiving loans from their banks.

The reason that there are so many bankable enterprises that are not being served is because Haiti experienced a high level of financial repression until 1995. This recession stopped the banking sector from reaching down. De-regulation in 1995 lowered the reserve requirement from 48 percent to 26, lifted the 22 percent interest rate ceiling, and licensed five new banks, inducing fierce competition in the banking sector. Competition led to branch network expansion, aggressive marketing, a change of bank culture, and a search for new clients and new businesses.
As of 1995, the microfinance sector in Haiti has been able to grow at unprecedented rates. The current characteristics of this sector are:

- Rapid growth
- High interest rates
- Industry fragmentation
- Lack of scale
- Below market potential

Figure 6 describes the structure of the Haitian microfinance industry as of September 2000. The sector serves about 62,000 microentrepreneurs. The annual growth for the sector was about 12 percent per year over 12 years.

**Figure 6: Structure of Haiti’s Microfinance Sector, September 2000**

<table>
<thead>
<tr>
<th>Type</th>
<th>Number</th>
<th>Portfolio (millions)</th>
<th>Average Loan Size</th>
<th>Number of Loans</th>
<th>Loans per Institution</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cooperatives</td>
<td>72</td>
<td>$13.6</td>
<td>$720</td>
<td>18,743</td>
<td>260</td>
</tr>
<tr>
<td>Village Banks</td>
<td>14</td>
<td>$1.6</td>
<td>$92</td>
<td>17,316</td>
<td>1,237</td>
</tr>
<tr>
<td>Solidarity Groups and Mutuals</td>
<td>10</td>
<td>$1.0</td>
<td>$60</td>
<td>16,448</td>
<td>1,645</td>
</tr>
<tr>
<td>NGOs and Other Similar Orgs.</td>
<td>14</td>
<td>$2.8</td>
<td>$480</td>
<td>5,763</td>
<td>412</td>
</tr>
<tr>
<td>Banks</td>
<td>1</td>
<td>$3.4</td>
<td>$1,000</td>
<td>3,382</td>
<td>3,382</td>
</tr>
<tr>
<td>Total</td>
<td>111</td>
<td>$22.3</td>
<td>$360 (average)</td>
<td>61,562</td>
<td>555 (average)</td>
</tr>
</tbody>
</table>

**The SogeBank Group**

SogeBank is Haiti’s largest bank, capitalized at $300 million, and with a 27 percent share of the banking sector. The SogeBank group has five affiliates and one foundation. It has a credit card product that holds 53 percent of the market and was the first and only ATM provider in Haiti. In addition, it has the largest telecommunications network in the country. In 1998, it acquired Haiti’s fifth largest bank.

**Culture**

SogeBank thrives on a mix of traditional bank conservatism and a healthy amount of entrepreneurship. It is the leader in the small savers’ market, with over 30 percent market share (in deposit value) and 39 percent of the market share in clients (250,000 accounts). SogeBank practices strong internal control, and maximizes internal capacity. Its success rests on its positive image, strong governance, and a 15-year history of profits and high dividends.

**The SogeSol Concept**

Management recognized the opportunities for microfinance that banking liberalization had created. The comparative advantage over NGOs and cooperatives in the microfinance sector seemed obvious: banks already had scale, the capacity to handle a large transaction volume. The challenge for the bank was to adapt a methodology that was quite different from traditional lending. SogeBank decided to accept the challenge because it already was a leader in the savers’ market, because competition threatened to take away customers, and because it perceived microfinance as profitable. It formed a separate affiliate, SogeSol, because microfinance required different motivators (social in addition to business), a different institutional culture, and new investments. Some of the key success factors were strong technical assistance and knowledgeable and effective human resources.
Building Partnerships

SogeBank, entering a field that was risky and new to Haiti, needed to build sustainable partnerships to gain specialized know-how and training, as well as resources, to enter into formative stages for the new microfinance institution. SogeBank approached the Inter-American Development Bank (IDB) and Profund in 1998, and subsequently formed a partnership with the IDB for technical and other assistance. But the real tool that the IDB provided was an entrance into the network of microfinance practitioners. In July 1999, SogeBank completed a business plan with the help of Development Alternatives, Incorporated (DAI), and in January 2000, it partnered with ACCION International, which assigned two technical advisors who resided in Port au Prince during 2000 and 2001 to assist SogeSol to start and launch its microfinance program.

Building the Organization

Before distinguishing institutional structure, target clientele, or human resources needs, SogeSol created its mission statement:

- **Mission:** To promote Haitian entrepreneurship by adapting the traditional ways of banking to respond to the need of microentrepreneurs. Sogesol will focus on client satisfaction, while always aiming to achieve the levels of efficiency and profitability required to ensure the continuity of its services.

- **Objective:** To reach thirty thousand clients, 13 branches (8-9 outside of capital city), $20 million portfolio, and 4 percent return on assets within five years.

With the mission and objectives in mind, Sogesol created itself as a loan service company for Sogebank; all assets and liabilities belonged to the bank. Sogesol was responsible for relationship-building. Sogebank was paid with a variable fee that reflected the credit risk of Sogesol’s loan portfolio. The branch network was separate from, but adjacent to that of Sogebank, and the two institutions would share equipment. This arrangement allowed Sogebank to reduce the cost of each branch from $100 thousand to $50 thousand. However, the two institutions would have distinct boards, management, and staff. The reasons for this structure include (1) staff motivation and morale, (2) efficiency, and (3) a need to conform to the regulatory framework.

**Human resources**

Sogesol hired three experienced loan officers from Sogebank, and then hired additional loan officers who had two-year degrees in accounting, business, or marketing. Sogebank next developed a training and monitoring module, as well as a staff compensation scheme.

**Clients, products, and methodology**

Sogesol’s customers were 21-55 years of age with at least one year in his or her current business and location. Loan amounts were based on a character assessment and detailed business evaluation; loan amounts grew with successful repayments, and the 3.5 percent monthly interest rate, with a flat fee, was eventually reduced. Sogesol made individual working capital and small equipment loans, from $100 to $3000, with a three to 12 month maturity and non-traditional collateral. Loan officers were instructed to form close ties with customers to reinforce repayment. Both the client and the loan officers were penalized in cases of delinquency.

**Results**

During the first ten months of operation, Sogesol created 2 branches and hired 40 staff members (including 25 loan officers). The first branched achieved a ratio of 100 clients per loan officer after eight months. The two branches serviced 1420 clients, with a portfolio of $410,000 (average $275 per client). Arrears greater than 30 days amounted to 1.8 percent.
Now Sogesol attracts 400 new clients per month. By September 2001, it plans to have built an additional branch, and to service 3,500 clients in total. And by September 2002, it plans to have created 6 branches, servicing 8,500 clients, with a $500 average balance and a $3.4 million portfolio.

Lessons Learned

In order for a bank to reach down into the microfinance sector, it must have a strategic fit. Since Sogebank already offered deposit services to the microfinance sector, it was easy for it to expand its services. The bank must have unconditional support from its board and top management; without this commitment, it will be impossible to take on the initiative. Another crucial factor is the need for a clear vision and a strong plan in order to convince the board, partners, and staff of the value of the new initiative. Staff must be able and willing to face the challenges of establishing a new function within the institution.
PART II: GOVERNANCE, REGULATION, AND SUPERVISION

REGULATORY SUPERVISION

Imam Sukarno, Bank Indonesia (Indonesia)
Manuel Montoya, Mibanco (Peru)

Regulated MFIs must learn how to maintain positive relationships with regulators, adhere to regulations, prepare for and pass inspection, and work with rating agencies. The three key concerns of becoming a regulated institution are (1) sufficient amounts of equity, (2) preparedness for the high costs of regulation, and (3) the ability to manage information, such as balance sheets, collateral calculations, and loan provisions, which all require an efficient management information system. Peru and Indonesia are two countries that have highly developed regulatory systems for microfinance.

The Case of Mibanco, Peru

Mibanco transformed from the non-governmental organization Acción Comunitaria del Perú (ACP) in 1998, after ACP, a financial intermediary, had managed various projects related to community development for thirty years. In the early 1980s, ACP developed its first strategic plan directly related to microenterprise development.

In May 1998, ACP became the majority shareholder and operative manager of a new venture called Mibanco (Banco de la Microempresa S.A.), Peru’s first for-profit, fully-regulated commercial bank dedicated to microenterprise. Mibanco’s initial $16 million in capital came entirely from the private sector. Sixty percent came from ACP’s client base and loan portfolio. Other investors included ProFund, the ACCION Gateway Fund, Banco Wiese Sudameris, and Banco de Crédito del Perú. In November 1999, the Corporación Andina de Fomento became a shareholder of Mibanco. The non-profit ACP continues to offer non-financial social services.

The formal division between micro and commercial banks in Peru is characterized by micro banks extending credits of less than $20,000 and commercial banks lending $20,001 and more. As a regulated financial institution, Mibanco is now subject to taxes on net income (the NGO was tax-exempt), loan provisioning requirements, reserve requirements, and reporting requirements. Like other institutions, it faces a capital requirement of $8 million. The MIS must track personnel, staff, and all funds. Furthermore, Mibanco must undergo a thorough annual external audit, at the bank’s expense. This audit focuses on an analysis of the loan portfolio as well as a review of procedures and regulations. In addition to the yearly external audit, all regulated financial institutions must have an internal audit department. In the case of Mibanco, the internal audit department reports directly to the board.

4 Some information for this section is derived from Campion and White (1999).
Beyond the annual auditing visits, Mibanco must present 103 reports monthly to the superintendent, either by disk or via the Internet. The following list is an overview of the reports required by the superintendent:

- Daily report on interest charged
- Semi-monthly report on reserve position
- Monthly financial statement
- Monthly report on effective equity level and risk-weighted assets
- Monthly report on principal debtors
- Trimester report classifying debt quality to establish credit rating
- Annual report

The information from these reports is made available to the general public.

In addition to annual audits and superintendent reports, Mibanco is obligated to contract, at its own expense, other institutions to supervise specific aspects of its operations. This includes the evaluation and classification of risk. Mibanco also undertakes special market research when it plans to open a branch in a new location in order to evaluate business prospects in that area. While the organization has at times found it difficult to classify loans and manage the many different requirements for information that must be documented for each loan, it is felt that the costs associated with such supervision is minimal when compared to the aggregate value derived from close regulation.

Before entering into the phases of transformation, the NGO microfinance institution must consider the supervisory requirements and weigh them against the benefits of becoming a regulated institution. In some cases, an NGO would be better off remaining unregulated, because the benefits may not outweigh the costs. Mibanco became regulated for the following reasons:

1. In Peru, an NGO cannot leverage its capital in the same way a bank can. Mibanco can leverage up to 11 times its capital.
2. Bank status allows access to capital markets, as long as the bank demonstrates efficiency, a strong loan portfolio, and a strong history in delivering financial services.
3. Regulators give the institution enhanced credibility.
4. Only a regulated bank can capture deposits from the public.

Under the current organizational structure, the shareholders and the board of Mibanco are personally responsible should the bank face a crisis. Their personal property is at stake, and they could face incarceration if the problems are serious enough. Despite the inherent risks that accompany bank status, Mibanco recognized the financial benefits of having access to capital markets, incentive enough to accept the increased responsibilities.

Figure 7 shows the incremental growth of Mibanco’s portfolio and lending profile.

**Figure 7: Program Growth**

<table>
<thead>
<tr>
<th>Year</th>
<th>Active Portfolio</th>
<th>Amount Disbursed</th>
<th>New Clients</th>
<th>Active Clients</th>
<th>Average Loan Balance</th>
<th>Percentage of Women Clients</th>
</tr>
</thead>
<tbody>
<tr>
<td>1994</td>
<td>$2,281,094</td>
<td>$15,375,336</td>
<td>6,518</td>
<td>9,023</td>
<td>$376</td>
<td>58%</td>
</tr>
<tr>
<td>1995</td>
<td>$6,707,755</td>
<td>$39,358,665</td>
<td>15,150</td>
<td>19,120</td>
<td>$485</td>
<td>57%</td>
</tr>
</tbody>
</table>
### Challenges to Microfinance Commercialization

<table>
<thead>
<tr>
<th>Year</th>
<th>Active Portfolio</th>
<th>Amount Disbursed</th>
<th>New Clients</th>
<th>Active Clients</th>
<th>Average Loan Balance</th>
<th>Percentage of Women Clients</th>
</tr>
</thead>
<tbody>
<tr>
<td>1996</td>
<td>$9,673,051</td>
<td>$58,788,658</td>
<td>17,500</td>
<td>26,225</td>
<td>$527</td>
<td>59%</td>
</tr>
<tr>
<td>1997</td>
<td>$12,456,976</td>
<td>$62,358,787</td>
<td>18,253</td>
<td>31,877</td>
<td>$530</td>
<td>61%</td>
</tr>
<tr>
<td>1998</td>
<td>$12,137,442</td>
<td>$59,942,102*</td>
<td>19,189*</td>
<td>33,858</td>
<td>$526</td>
<td>62%</td>
</tr>
<tr>
<td>1999</td>
<td>$19,273,855</td>
<td>$58,130,077</td>
<td>19,755</td>
<td>41,344</td>
<td>$528</td>
<td>62%</td>
</tr>
<tr>
<td>2000</td>
<td>$36,925,607</td>
<td>$85,700,610</td>
<td>29,747</td>
<td>58,088</td>
<td>$636</td>
<td>59%</td>
</tr>
</tbody>
</table>

*including ACP

### The Case of Indonesia

#### Background

Microfinance in Indonesia is provided by the formal and informal sectors. The formal sector agents for microfinance include commercial banks (BRI Unit Desa), the rural banks (BPR), savings and credit cooperatives (Koperasi Simpan Pinjam/Kosipa), village credit boards (Badan Kredit Desa/BKDs), village fund and credit institutions (Lembaga Dana Kredit Pedesaan/LDKPs), and village unit cooperatives (Kredit Unit Desa/KUDs). The informal sector agents include various sorts of non-governmental organizations (Lembaga Swadaya Masyarakat/LSMs) and self help groups (Kelompok Swadaya Masyarakat/KSMs), moneylenders, local sources of trade and consumer credit, and mutual credit arrangements, like rotating savings and credit associations (ROSCAs).

Microfinance institutions in Indonesia have experienced a number of difficulties. The low quality of human resources has made it hard for institutions to find experienced staff. Bad corporate governance has threatened the stability of the institutions and insufficient infrastructure has impeded the growth of microfinance institutions. As of September 2000, approximately 35 percent of rural banks (BPRs) had unsound conditions; 260 of these were certain to be closed and liquidated.

Another significant problem has been the lack of legal framework for some MFIs, such as village fund and credit institutions (LDKPs). With technical and financial assistance from international institutions, Bank Indonesia has been initiating efforts to restructure the rural banking industry, setting up a legal framework for informal MFIs, building up infrastructure for MFIs, and undertaking training and courses with certification for the staff of rural banks.

#### Regulation of MFIs

The following Figure 8 describes the current legal and regulatory framework for MFIs in Indonesia.

### Figure 8: Legal and Regulatory Framework of Indonesian Microfinance Institutions

<table>
<thead>
<tr>
<th>Type of MFIs</th>
<th>The Law</th>
<th>Regulator and Supervisor</th>
<th>Regulation</th>
</tr>
</thead>
<tbody>
<tr>
<td>BKD</td>
<td>The Banking Act No.10 of 1998</td>
<td>BRI for and on behalf Bank Indonesia</td>
<td>Asset quality, area of operations.</td>
</tr>
<tr>
<td>BPR</td>
<td>The Banking Act No.10 of 1998</td>
<td>Bank Indonesia</td>
<td>Licensing and management, capital adequacy ratio, legal lending limit, provision for bad debt.</td>
</tr>
<tr>
<td>BRI – Unit</td>
<td>The Banking Act No.10 of 1998</td>
<td>BRI and BI for BRI as a whole</td>
<td></td>
</tr>
<tr>
<td>Cooperatives;</td>
<td>The Cooperatives Act</td>
<td>State Ministry of</td>
<td>Licensing, management, capital.</td>
</tr>
<tr>
<td>Type of MFIs</td>
<td>The Law</td>
<td>Regulator and Supervisor</td>
<td>Regulation</td>
</tr>
<tr>
<td>-------------</td>
<td>---------</td>
<td>--------------------------</td>
<td>------------</td>
</tr>
<tr>
<td>Loan and Saving Unit</td>
<td>No.25 of 1992/ Government Decree No.9 of 1995</td>
<td>Cooperatives and Small Medium Enterprises</td>
<td>-</td>
</tr>
<tr>
<td>LDKP</td>
<td>-</td>
<td>Regional Government/ Regional Development Bank (BPD)</td>
<td>-</td>
</tr>
<tr>
<td>NGO</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>ROSCA</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
</tbody>
</table>

The above table shows that village fund and credit institutions (LDKPs) are only regulated by the regional government and do not have any legal status, even though they collect funds from the public. According to the law, every party that collects funds from the public must get a license from Bank Indonesia. Due to the funding of domestic micro-financial markets by international financial markets, there is an urgent need for the proper legal and regulatory frameworks for MFIs.

One additional justification for granting MFIs legal status is the fact that MFIs weathered the 1998 financial crisis much better than the commercial banks. Such a legal status might encourage the government to place MFIs as a priority program. This would, in turn, allow the MFIs to expand their outreach and increase their financial resources through mobilization of deposits and commercial loans.

Currently in Indonesia, the same organization that supervises commercial banks also supervises MFIs. However, the supervisory body experiences high costs with MFI supervision, and is often constrained by a lack of a specialized understanding of the needs of MFIs. Some of the smaller rural banks at present are supervised by BRI, which is in return paid by the Bank Indonesia. However, this is a rather limited arrangement. Two solutions have been proposed to address this issue: (1) a section of the provincial government or a central ministry would handle the supervision, or (2) an association or similar group would handle some self-regulation, perhaps in association with an insurance function. Whatever the final arrangement, the primary burden for rural bank supervision and technical assistance should be born by the networks with which many of them are connected and the supervision institution should set standards and investigate problem cases. In particular, it has been recommended that resources be concentrated in a compliance unit for cases where legal requirements are not being met.

Costs for regulation and supervision can be high. Government funds are limited and banks are unlikely to want to use their own funds for the purpose of regulation and supervision. Rural banks themselves may be asked to bear some of the costs of supervision, but their resources are also quite limited, and any passing of costs to their customers will affect their competitiveness. Given the severe constraints on cost, it is important to determine the minimum set of supervision requirements and procedures consistent with prudent banking. This process may be assisted by a further automation of reporting and off site supervision, with a periodic on-site supervision sufficient to guarantee the processes integrity. Two key issues are as follows:

Appropriate standards for accounting, reporting, and personnel. This can be standardized and automated so that the cost is minimized and utility to banks and supervisors is maximized. A series of studies on actual practice and recommendations for its improvement is nearing completion.
Appropriate standards for loan classification. This is one of the most critical issues and has been considered by several of the groups working on reforming supervision.

The Cases

*BRI – Unit Desa System*

BRI is a major state bank with a profitable “micro-banking” division called BRI Unit. BRI more than meets the common criteria used to measure performance of rural financial institutions, i.e. self-sustainability and outreach. Micro borrowers appear to value their access to BRI’s credit and savings services very highly. They are reluctant to break their banking relationship with the BRI units even if they have to squeeze their consumption to make their loan repayments on time. BRI has been careful to keep the micro credit window open so that those who pay on time are able to borrow again if their enterprise justifies it.

BRI branches supervise BRI Units, and the cost of the supervision is charged to the Unit. The supervising manager is required to visit the Unit once a week to verify their reports. Units have to report daily (trial balances), weekly (liquidity reports), monthly (progress report, balance sheet, income statement), quarterly (personnel report), semi-annually (past performance indicators), and annually (balance sheet and income statement) to the supervising branch, regional and head office.

Bank Indonesia supervises BRI as a whole. It must maintain a certain capital adequacy ratio, adhere to legal lending limits requirements and publish its balance and income statement showing the amount of such loans quarterly both in newspapers and at a location on its premises. In addition, BRI must have officers who meet minimum requirements in education and professional experience. Detailed rules govern bank accounting and how charges and loan arrears are handled and each bank gets a CAMEL rating.

*Credit Fund Institutions (Lembaga Perkreditan Desa/LPDs)*

LPDs, which are owned by the traditional village (desa adat), are one type of LDKP in Bali. These LPDs are designed not only to serve the pure economic goals but also to contribute to maintain the desa adat and its system of associated temples. LPDs rely on savings and deposits rather than credit and grants as their source of refinancing. BPD Bali acts as the banker of the LPDs, absorbing over-liquidity and providing credit when needed. Similar to the other LDKP, LPDs offer saving accounts and deposits at market rates.

Although owned by traditional villages, the government continues to play an important role in LPD development. To fulfill its guidance, supervisory and auditing role, the government has installed a guidance and supervisory body for LPDs at provincial, district and sub-district level. BPD Bali has undertaken technical guidance and supervision by analyzing monthly LPD reports and by carrying out on-site visits. There is no systematic supervision procedure or standard and the supervision conducted depends on the characteristic of its LDKP, the policy and the capability of each provincial government and BPD.

*Rural Banks (Bank Perkreditan Rakyat/BPR)*

There are two types of Rural Banks (BPR), BPR-BKD (Village Credit Board) and BPR-Non BKD. According to the law, all BPR are supervised by Bank Indonesia. Since there are many BKDs, and since they are not mobilizing deposits from public, Bank Indonesia decided that BPR-BKD should be supervised by BRI on behalf of Bank Indonesia. The other rural banks - BPR Non BKD - are supervised directly by Bank Indonesia. At present there is a system of both on-site and off-site inspection, using a modified CAMEL for calculating BPR Rating. They also have to meet certain banking standards such as maintaining the minimum capital adequacy ratio and legal lending limits.
The present system for rural banks is lacking on several grounds. Both the cost and the number of unsound rural banks are excessive. Bank Indonesia is now restructuring the BPR industry and is in the process of reforming the regulations.

Current Regulation and Strategic Planning

Under current regulation, rural banks need to submit several monthly reports, an annual business plan, and annual balance sheet and income statement reports. Bank Indonesia is now undertaking steps to simplify the current report of BPRs in order to give more focused supervision and to better grasp structural problems of particular BPRs.

Bank Indonesia with technical assistance from GTZ has been working on matters such as improving regulation and supervision referring to international standards, working out BPR restructuring by establishing the Deposit Insurance Scheme and Pooling Fund, proceeded by an industry clean up and setting up a legal framework for non-bank MFIs.

The draft legal framework for non-bank MFIs is planned to be finished at end of this year with subsequent proposal to the House of Representatives. The draft defines and presents the characteristics of non-bank MFIs, owners, management, outreach, licensing, minimum capital requirements, supervisory agency and prudential regulation.

Conclusions

Microfinance in Indonesia has a long history that can be traced back to the Dutch colonials, when microfinance services were provided by formal and informal agents such as BRI Unit, BKDs, BPRs, LDKPs, cooperatives, and other informal agencies (NGO, moneylenders, and ROSCA).

The success of BRI-Unit is primarily due to strong networking, maintenance of a good information system, saving products development, innovative and flexible loan terms, close monitoring of loan performance, and good quality, professional human resources.

Microfinance in Indonesia is still facing structural problems that need to be resolved. In this case, Bank Indonesia is undertaking a study to formulate new regulations and supervision for BPR; building up infrastructure for MFIs, especially BPR through consultation and technical assistance, training and education; setting-up a deposit insurance scheme; and providing a legal framework for non-bank MFIs.

Applying Commercial Principles to an NGO or Credit Union

Witold Szwajkowski, Fundusz Mikro, Poland
David Richardson, World Council of Credit Unions, USA

Lessons from the Experiences of World Council of Credit Unions

The typical microfinance institution attains its goals by melding a socially-minded strategy with a business strategy. Whether the two can fit together has been an on-going debate in the field. Many microfinance practitioners have found that, paradoxically, the more commercially-minded the institution becomes, the greater social impact it can achieve. This paradox exists because a commercially-minded institution is focused on the bottom line; when the bottom line grows, the institution can serve more individuals who were traditionally shut out of financial markets.

But, in addition to the argument that commercialization leads to more resources, which leads to greater outreach, it can be argued that commercial principles contribute to social goals in other ways. Even strict financial principles such as solvency and risk
diversification can contribute to social goals, as Error! Reference source not found. Figure 9 suggests.

Figure 9: How Commercial Principles Contribute to Social Goals

<table>
<thead>
<tr>
<th>Commercial Principles</th>
<th>Social Goals</th>
</tr>
</thead>
<tbody>
<tr>
<td>Market Share</td>
<td>Client Outreach</td>
</tr>
<tr>
<td>Profitability</td>
<td>Service Orientation</td>
</tr>
<tr>
<td>Efficiency</td>
<td>Competitive Access</td>
</tr>
<tr>
<td>Solvency</td>
<td>Quality of Products</td>
</tr>
<tr>
<td>Risk Diversification</td>
<td>Quantity of Products</td>
</tr>
<tr>
<td>Transparency and Accountability</td>
<td>Price</td>
</tr>
<tr>
<td>Prudential Standards</td>
<td>Institutional Safety</td>
</tr>
<tr>
<td></td>
<td>Trust</td>
</tr>
</tbody>
</table>

The chart presents the following relationships:

- *Market Share is linked to Client Outreach*: the more outreach, the more market share.
- *Profitability is linked to Proper Pricing*: by setting prices to cover costs, profitability can be attained.
- *Efficiency is linked to Competitive Access*: by being efficient, an MFI can be more highly competitive and provide greater access to more poor people.
- *Solvency is linked to Institutional Safety*: by being solvent, an MFI can be a safe place.
- *Risk Diversification is linked to Quantity of Products*: by diversifying your loan and savings products, you can diversify your risks.
- *Transparency and Accountability is linked to Trust*: by not hiding financial information, an MFI can build trust and confidence in the client-users.
- *Prudential Standards are linked to Institutional Safety*: by adhering to prudential standards, staff can build a safe institution.

Microfinance institutions that embrace commercial principles are often more capable of growing and thriving than their non-commercialized cousins:

- A *traditional MFI* often has only one niche: a *commercial MFI* may have multiple niches, which result in greater market share and risk diversification.
- A *traditional MFI* sometimes has a single product; a *commercial MFI* may have multiple products to diversify risk and increase profitability.
- A *traditional MFI* has the tendency to be less financially disciplined, because of a reliance of donor money and soft funds; a *commercial MFI* must have financial discipline, which in turn gives it solvency.
- A *traditional MFI* is usually financed by donors; a *commercial MFI* can grow through retained earnings and attracting deposits.
- A *traditional MFI* may have a rigid methodology; a *commercial MFI* can explore flexible alternatives, which may lead to greater efficiency.
MicroFinance Network

- A traditional MFI often has little incentive for best practices in governance; a commercial MFI must prove to investors that it is trustworthy, and therefore adopts prudential standards, transparency, and accountability.

Lessons from the Experiences of Fundusz Mikro, Poland

Most commercial principles applied in business can be traced to two fundamental laws: (1) the law of property, i.e. an owner’s rights and duties regarding this property and (2) the necessity of complying with agreements. These two fundamental laws are preconditions for the existence of economic activity, and from these one may trace the eleven commercial principles quoted below. These principles can also be applied to microfinance NGOs that seek to behave commercially to provide high-quality financial services to a large number of microfinance customers.

1. Identify a clear business vision and mission.

The owner of any organization should specify its vision and mission, which give shape to the activities of the institution. In cases where there are many owners or donors, each may have a slightly different goal or other vision, which may cause confusion, making it difficult to properly manage the firm. In these cases, it is up to the board to ensure that a common mission exists and that it is carried out. For NGOs, donors may complicate the situation by using the organization as a tool for fulfilling their own goals. NGOs must be wary of such a situation.

2. Provide an identity to the organization.

If an organization is not yet commercial but aspires to be, the manager, the board and the employees should know exactly where the organization stands on the road toward commercialization. An analysis of the institution’s position should be based on an honest financial analysis that takes into account all costs. If certain aspects of the organization’s operations are to be commercial, while certain others are not, this division should be clear.

3. Cultivate an organizational image.

An organization may be non-commercial (not generating any profit), but customers may perceive its products as fully commercial, especially if they are paying commercial prices for them. This perception reflects on the organization’s image and will shape customer and staff expectations of the organization. It is the duty of the board to foster an image that corresponds with reality and to ensure that both employees and customers understand the non-profit nature of the organization in spite of the commercial character of the product. The firm's mission and vision constitute part of its image.

4. Create a unified policy.

In a commercial organization, relations between the organization and its employees, as well as those between the organization and its customers are the result of concluded agreements, including by-laws and contracts of the organization. Because employees represent the organization to customers, they must uniformly enforce policy. Personnel should be periodically evaluated to ensure they are correctly representing the organization. Various recruitment or training mechanisms may help to achieve this goal.

5. Define an appropriate decision-making process.

Management of a commercial firm requires a process for decision-making. Therefore, there must exist a clearly defined system for undertaking decisions. Before any such discussion of a problem, it must be known how any decision is to be made and who is to have the final
word. The undertaking of a decision by consensus, as a rule, leads to a decision ultimately being made by one person who weighs the opinions of the others.

6. Delegate authority.

This principle is fulfilled if every employee of the organization has the right to delegate authority to a subordinate, but at the same time bears full responsibility for the results of any delegated action. Delegating also means that the person to whom decision-making has been delegated has the right to make errors. Decisions undertaken should not be overturned but should be evaluated.

7. Facilitate the flow of information.

Every superior of an employee is obligated to provide subordinates with necessary information for the fulfillment of work duties, or else point out how or where such information may be obtained. Only an employee's direct superior may specify the employee's tasks and conduct the necessary checks to ensure that these have been accomplished. Thus, it is best if everyone has only one superior. A system should be in place in which every employee has the ability to appeal the decisions of his superior.

8. Conduct research and development projects.

A commercial firm should conduct continuous research of the market in which it operates, and regularly adapt its products to the market's demands. Where the firm is capable of keeping ahead of market expectations, it is best if the firm creates new products and develops a market for them. This is especially true for organizations that operate as non-commercial organizations, and whose operations are based on subsidies. Creating new products may thus repay the “debt” to donors and may be viewed as an investment in research and development.

9. Utilize the organization’s resources.

Commercial organizations operate and specify the achievable goals within the framework of resources available to them. Non-commercial organizations often specify goals whose achievement demands additional resources, often from outside sources (from donors) for the achievement of those goals. It is necessary to monitor resources available on an ongoing basis, including the ability of the organization to raise and repay the loans necessary for the achievement of its goals.

10. Create an organizational culture.

One precondition for development is the free flow of opinions and ideas. Every employee of an organization should have the right (and be encouraged) to express his or her opinion and the person to whom such an opinion is addressed should be trained to listen and consider a wide range of ideas. The person expressing their opinion should also take heed to the reply.

11. Foster positive examples.

The social duty of every commercial organization is to promote positive, socially accepted examples. In the case of microfinance organizations, these may be examples of enterprise, examples of building relations built on the principles of partnership in business, or examples of conducting a specific business and using external financing. Commercial organizations should aim to generate profit, but not at the cost of their desire to promote only positive examples. A balance between mission and money should be maintained.
TRANSITIONING TO COMMERCIAL OWNERSHIP AND GOVERNANCE
Rosalind Copisarow, Street-UK Foundation, United Kingdom
Juan Buchenau, Frontier Finance International, USA

Transitioning to commercial ownership and governance is one element of the process of institutional transformation. This element, however, is significant enough to merit considerable attention, as the ownership and governance of an MFI will doubtless affect the institution’s culture and operational procedures.

The Decision Behind the Transition

Although it is a common perception that transformation is always desirable, this is not always the case. Microfinance NGOs do not always have the capabilities or even the desire to transform. When considering transformation, an NGO should take into account the following issues:

- The impact that transformation will have on the institution’s profitability versus its impact on reaching its target group.
- The ability of NGO board members to run the commercial finance institution. This includes the ability of board members to shift focus from donor dependence to market orientation.
- The burden of additional obligations (disclosure requirements, banking supervision) versus the benefit of easier access to on-lending funds, expanded range of products.
- The average transaction size of loans to clients. An NGO has a freer hand to reach a poorer level; if the institution’s mission is to reach the poorest of the poor, transformation may not be appropriate.
- Product offerings. In many countries, certain products, especially savings, may be off-limits without regulatory status.
- The cost and complexity of additional software, as well as additional staff required for more complicated systems.
- Additional reporting systems required by regulators to maintain transparency.
- Changes in governance structure to establish tighter controls.
- Current access to funding.
- The abilities of current staff to meet the needs of a new, transformed institution.
- Whether the bottom-line goal of the institution is to become profitable, sustainable, or a combination of both.

When trying to decide whether or not to transform, the institution must ensure (1) a proper balance between objectives, institutional structure, and costs, (2) that systems remain simple yet able to get the job done, and (3) that the board and management focus on the institution’s core competencies by aligning goals and legal structure with these competencies.

Governance

The typical ownership structure of a commercial institution created from a non-governmental microfinance institution is the following: the NGO has 30 to 40 percent equity; the private sector, multilaterals, and specialized funds hold 40 percent; and one or more strategic partners hold 20 percent. Most problems that a transformed institution faces
are related to the governance. To avoid problems of this type and to help mitigate conflicts, the institution should make governance a high priority by making sure that the owners have a shared vision. Also, responsibilities of the board should be balanced between executive and non-executive duties. If the board gets too involved in operations, it may face conflict with the management. It is in the board’s strategic best interest to have a “champion of change” who can help build a commercial MFI by securing investors and explaining the idea of a social return. Ideally, board members should possess a mix of skills that meet the needs of the institution.

Ownership

NGO Ownership

As an owner of a transformed MFI, the NGO can help keep the regulated institution focused on the target client group and mission. One way to create this type of structure is to set up an intermediary to participate in the new institution, such as a specialized foundation whose sole objective is to invest in the new commercial institution; the original NGO may then continue its traditional work.

Private Sector, Multilateral, and Specialized Funds Ownership

It can be desirable to have a private sector entity as owner. Strong private sector participation can, in most cases, only be achieved via a majority stake of a single investor or investor groups. However, the institution runs the risk that the majority owner may change the mission of the MFI. There is also a potential conflict of interest if the majority owner comes from the banking sector. And, multilateral institutions may not represent the best solution to beneficial ownership as there is often high rotation of board members. In addition, they may often follow a well-defined exit strategy, but sometimes they focus more on their exit strategy than how to help the institution become profitable. Risks aside, the fact remains that currently the microfinance sector is not yet profitable enough to expect the private sector to be a majority shareholder. At this point, a mix of private and public sector interests is best.

Strategic Partners as Owners

Although strategic partners are often only willing to serve when their influence on the institution is guaranteed (i.e. with a majority stake when combined with one or two other owners), they come with the added benefits of both a positive image and the provision of necessary funds. However, since some strategic partners, such as ACCION International, also give technical assistance, there is a potential for conflict of interest when managers of the fund also manage the technical assistance. In such cases, there must be well-defined rules to govern the process.

Some advice to follow when selecting a partner includes the following:

- Do not idealize your partner, since everyone is learning at the same time.
- Look for partners who are willing to learn and willing to play an active role in the board.
- Make sure that a local partner is not a potential competitor.
EMPLOYEE STOCK OWNERSHIP AND OTHER ADVANCED GOVERNANCE ISSUES
Kimanthi Mutua, K-Rep Bank, Kenya
Michael Chu, Pegasus Venture Capital, USA

Advanced Governance Issues

Governance is one of the most decisive factors in ensuring the effectiveness of any organization. At the heart of good governance lie two key issues. The first is the accountability of management. The second is the prevention of board entrenchment, which affects the accountability of management. It is up to the shareholders to emphasize the importance of entrenchment prevention. The following questions are central to the governance issue, and address the CEO, the board, and management.

Is the CEO the right person for the job?

The five most important criteria that make a good CEO are the following:

1. Vision. A good CEO has a view of the future that is aligned with the organization’s goals. A good CEO has a vision of the future of the industry, and of the role of the institution in the industry.

2. Leadership. Leadership is highly focused on the formation of an excellent management team. Having formed this team, a good leader will extract 110 percent out of it, and will incite the team to tackle the toughest and most fundamental questions facing the institution.

3. Past performance. Has the CEO delivered in the past, and has he or she taken this or other institutions in the directions they needed to go?

4. The future. A good CEO takes steps to positioning the institution in a place that is relevant to the future of the industry.

5. Skills set. Skills needed at the early stage of MFI development are different from those needed at later stages. Some managers have the ability to expand their skill set so that they are better able to change and adapt. In some instances, though, the CEO is incapable of such change.

Is the Chair of the Board the right person for the job?

The same questions as above must be asked of the Chair.

How do board members spend their time?

Outside of the board meeting, board members should spend their time on substantial matters. If the board members spend most of their time on issues that are important, but which are not substantive strategic issues, then there is a lack of good governance. In such cases, e.g. when the board is spending time negotiating the location of the next branch, the board’s activities indicate that accountability of management is probably lacking, or that the board is interfering with management.

Is the board clearly communicating with the CEO?

It is the board’s responsibility to communicate clear direction to the CEO. Without clear communication, accountability is obstructed.
Is the board structured in a way that may help reinforce these ideas?

If the board only meets in a highly structured environment, it is hard to deal with substantive matters. Board meetings, by definition, are incapable of dealing with substantive matters the first time. The first time an issue comes up at a board meeting, it will likely be addressed in a superficial manner, since the sheer number of people on the board will probably prevent in-depth discussion. A board should never make a decision on the day that an issue first emerges. Instead, boards should engineer ways to ensure in-depth discussion over a period of days before concluding any subject.

Is turnover occurring at the rate that it should?

The biggest threat to a high-performing institution is the resistance of the board and CEO turnover. When the CEO or the Chair is only able to give 80 percent of what they have to the institution, the remaining 20 percent is void. At 80 percent, the person should think of leaving their place for someone else. Although it is painful to leave, it is necessary in order for good governance to take place. By moving on, even though a particular manager may not be right for the next stage, this does not diminish the contribution that he or she has provided in the previous stage. It may be emotional to leave, however, the same affection that causes this emotion is the same reason that one should let go once the threshold is crossed.

If this is a transformed institution, what percent ownership does the originating NGO hold?

NGO majority ownership may work on a temporary basis, but it may turn into a dangerous situation as time passes. The cause of danger is that because an NGO does not have an owner, it is often the chair that put the group together that guides the organization. On a shareholding board, if people disagree, they talk to each other. On a non-profit board, members do not have an incentive to stand up and disagree with the chair, so instead they resign. The effect is a lack of dialogue and an avoidance of confrontation, which leads to a powerless board. If this is the board of an NGO that is the majority shareholder of an organization, it will bring its poor governance along to the regulated MFI.

Do the shareholders contribute to the governance of the organization?

Some shareholders may not be ideal in terms of governance because they exert their governance through delegated representatives who have no link with the organization. The effect is a shareholder without stake and without direction. The ideal group of shareholders has a real stake in the institution. Absolute agreement is not necessary so long as there is a real desire to provide a consensus. No one around the table can feel like they have to have 100 percent of their opinion in the consensus. The most important characteristic of board members is their ability to build consensus and compromise.

Employee Stock Ownership

An employee stock ownership plan (ESOP) is one possible element of an organization’s ownership structure. K-Rep Bank instituted an ESOP when it became a formalized institution in 1999. The objectives of the ESOP is to provide employees with increased morale by giving them a real stake in the bank and by discouraging staff turnover, as the stock ownership is revoked if the employee resigns before five years of service.

K-Rep Bank’s ESOP is administered by the Kwa Multipurpose Cooperative Society, which holds 10 percent of all of K-Rep’s holdings. The shares are allocated to employees based on seniority and professional assessments. Kwa does not hold a seat on the board, but allowing it a seat is under review since it would increase the employees’ role in governance. Other shareholders include the International Finance Corporation (IFC), the African
Development Bank, Shorebank, and the Netherlands Development Bank, which holds less than 10 percent ownership and therefore has no seat on the board. K-Rep Group has the largest holding at almost 29 percent.

Staff that have been employed by K-Rep for three years or more are eligible for employee stock ownership. Participation is voluntary, and 90 percent of staff holds stock options. Of the shares that are allotted to each employee, he or she must purchase half, and then the others are free of charge. In addition, some shares are given as bonuses. Payment can take place over a period of time, which is important for less well-off junior staff. However, in cases of payment default, all shares are lost. If an employee leaves the company before completing five years, then he or she loses the free-of-charge shares and can sell the other shares to other employees. K-Rep has allocated 50,000 shares to staff; the balance is being allocated as annual bonuses under a five-year program.

K-Rep has found the ESOP to be a good way to encourage staff commitment to the institution and reward seniority. If the institution does not perform well, then staff feel like they have something tangible at risk. K-Rep’s ESOP has existed for one and a half years, so it is still going through certain early tests and difficulties.
PART III: KEEPING UP WITH THE COMPETITION

AUTOMATING MICROFINANCE

Vikram Akula, Swayam Krishi Sangam, India
Carlos Labarthe, Compartamos, Mexico

Deploying technology to automate microfinance is no longer an option, but a necessity for MFIs. Only with such automation will MFIs be able to meet the challenges of commercialization. For instance, the use of technology can help MFIs overcome the high transactions costs and credit risks that are still a barrier to sustainability and to expanding outreach. In addition, technology can address problems such as weak financial control, poor information management, an inflexible methodology, and numerous other shortcomings.

However, not all technology is appropriate for MFIs. Technologies from the commercial banking sector, for example, are often too costly for microfinance institutions. Other state-of-the-art technologies, such as electronic or wireless banking, require infrastructure that most MFIs simply cannot access.

Microfinance institutions must therefore consider which technologies are appropriate for microfinance, and especially for each individual institution. There are four issues to consider:

1. Identification of the main problems that constrain MFIs that can potentially be addressed by an appropriate use of technology (e.g. high delivery cost, credit risks, scope for fraud and error).
2. Consideration of examples of technologies that are either in use or potentially can be used to bolster microfinance (smart cards, debit cards, personal digital assistants, etc.).
3. Exploration of the infrastructure required for these potential technologies and whether the infrastructure is available to MFIs or can be created.
4. Discussion of the requirements, for either an individual MFI or the MFI sector as a whole, to adopt such a technology. For example, what scale of operations is required to justify an investment in an automated MIS? What common standards would be required for the adoption of automated credit bureaus?

Case Studies

Swayam Krishi Sangam, India

Swayam Krishi Sangam (SKS) is a Grameen Bank replication project in one of the poorest parts of India, the drought-prone Medak District of Andhra Pradesh. SKS is piloting the use of smart cards and hand-held terminals to improve microfinance. A smart card is the size of a credit card and is embedded with a microchip that can hold 800 times the amount of information than that of a regular magnetic-strip card.
Smart cards will lower the high cost of delivering financial services to the poor by replacing manual passbooks and collection sheets with a smart card, or “electronic passbook,” that holds all loan information in the chip. Each group of borrowers keeps a hand-held terminal in the village so they can have a transaction record at their fingertips. The combination of smart cards and hand-held terminals reduces the time of weekly village meetings because loan officers do not have to enter any information by hand, which is a lengthy process. Instead, they download information into their own hand-held computers each morning, insert the borrower’s smart card into the hand-held terminal in the village, and simply update the borrower’s cards with a push of a button to indicate whether they have paid on time or not, and to indicate the particulars of any new loan requests. The information appears on the screen of the hand-held terminal through a specially designed interface that communicates with the chip on the smart card. This system allows field staff to increase the amount of clients he or she serves. With this technology, a staff member can potentially double productivity, and an MFI can thus achieve financial sustainability more quickly, in as little as two thirds of the time typically required.

Smart cards will enable SKS to reduce the scope for error and fraud, because fewer transfers of information take place when using the technology. This reduction is particularly important because microfinance involves a huge number of manual entries of transactions, and each time there is a chance of error or fraud. A typical SKS staff member manually records over 200,000 transactions a year at the village level. Smart cards will solve this problem by having a single data entry point of the electronic passbook that seamlessly links information flow from the village to the branch to the head office and even to donor and lending agencies. To update files of SKS’ main computer, the loan officer simply has to connect the hand-held to a data port and push a single button.

The smart card system will also enhance the ability of management to monitor operations and quickly respond to problems because it provides “real time” portfolio information. As soon as a customer defaults on a loan payment, the branch manager will know about it and be able to take appropriate steps.

Smart cards will enable SKS to offer a wide range of flexible financial services to meet the diverse financial needs of the poor, such as immediate loans for hospitalization or other emergencies. Information about the client can be stored in the chip, making it easier to offer these customized loans with appropriate terms.

**ACCIÓN International (CrediPalm) Case Study:**

During the past 25 years, ACCIÓN International has implemented new tools and methodologies with the main objective of reaching the most clients and positioning its network of affiliates as leaders in their markets. One of ACCIÓN’s latest tools is a software called CrediPalm that has been developed by a team of in-house developers of the Palm Operating System platform. The Palm is a very small computer, about the size of a large calculator that can perform the basic functions such as word processing and calculations.

The project started with an early Palm application as a pilot project at Compartamos, Mexico in 1999. After proven success, ACCIÓN decided to replicate it to other members of its Network of affiliates as CrediPalm software.

CrediPalm is one answer to one of the biggest challenges in microcredit, which is the high cost of operations. Poor people generally do not have collateral or a credit history, often cannot be reached by phone, and frequently live far from the city. All these factors increase loan processing time and therefore cost. Loan officers working in poor urban neighborhoods usually travel by local bus to the potential borrower’s home or shops and take the application with pen and paper. They then re-enter the data into the computer.
Challenges to Microfinance Commercialization

when they get back to the office. By using a Palm unit, loan officers can input their clients’ information at a single point, and later deliver it to the main computer electronically.

Some of the functions of CrediPalm in the lending process are as follows:

- Capture data from clients
- Analysis of clients’ financial information and social and economic conditions
- Credit scoring calculations
- Direct data transfer to the institution’s MIS
- Client financial statement assessment tool
- Loan pre-approval
- Access to clients’ current and historic payment information

The application also performs all the calculations automatically and stores credit policies to make validations as the information is being inputted, allowing the loan officer to reject or accept a client on the spot. For example, if the institution requires a monthly income of $50 for a specific requested loan size, and the loan officer indicates a monthly income less than $50 on the CrediPalm application, the requested loan size will be denied. CrediPalm also has the capacity to carry all the reports loan officers need in the field, eliminating the use of paper.

Some Myths about the Use of Palm Pilots

Simply using the Palm Pilots will increase productivity. Even though the loan officers have a tool that will help them perform their job in less time, the tool requires the institution to launch an effective promotion effort to attract as many clients as it can serve. Without such a marketing plan, Palms will only make life easier for loan officers, but not necessarily enhance productivity.

Palm Pilots make it possible for the MFI to reduce personnel. Palm Pilots eliminate the need of computer operators, but there will always be a need of data auditors to ensure the information’s integrity.

Palm Pilots eliminate fraud. CrediPalm does have a function to record loan officer activity on the machine. This reports gets delivered to the supervisor, but human intellect is still more powerful than machines.

ACCION decided to implement the CrediPalm project based on its proven benefits. The technology lowers operation costs, automates and standardizes the lending process so that all loan officers use the same procedures, is easily implemented, and it is portable and easy to use at a relatively low cost.

Results to Date

Since May 1999, when the first microfinance institution used a Palm Pilot, four others integrated this small and powerful machine into their lending methodologies. One of the added values of the introduction of a Palm application is the opportunity it brings to the institutions to fully review their lending process and redesign or cut useless sub-processes.

ACCION is aiming to reduce the time processing a loan by 30 percent, bringing the opportunity to serve more clients in less time. ACCION is seeking this reduction with the Palm by eliminating the double input of data and taking advantage of the application’s capacity to deliver automatic calculations of financial information such as cash flows, business ledgers, and other data including clients’ payment capacity and financial
indicators. Another form of saving to the institutions is represented by the paperless operation.

**BUILDING CUSTOMER LOYALTY**
*Craig Churchill, International Labor Organization, Switzerland*

A loyal client is a satisfied, repeat client who takes advantage of a variety of the microfinance institution’s services. A loyal client provides market feedback by asking for product enhancements, refers others to the institution, and identifies with the institution, not just his or her loan officer. A loyal client associates her future with the MFI, and is immune to the pull of the competition. The following is a list of the top ten reasons to cultivate customer loyalty in a microfinance institution.

**Top Ten Reasons to Instate a Customer Loyalty Strategy**

10. **New clients are very expensive to acquire.**

The loan application process, training, and group formation, among other methods of orientation, are very costly to the institution. Depending on the methodology of the institution, it can sometimes take two or three months to fully integrate a new customer. The time and human resources expenses associated with acquiring new clients drives up the cost of a new client’s loan.

9. **New clients have the smallest loans, which generate the least income.**

Often, the cost of servicing these small loans is greater than the income generated from it. The risk that accompanies a new borrower makes the cost even higher.

8. **A long-term relationship with the customer makes way for life-long partnerships.**

An institution generally does not break even on a customer until the fourth or fifth loan, even if the customer pays on time during each loan cycle, because the institution must pay off accumulated deficits from previous tiny loans. For this reason, it is worthwhile to generate long-term relationships with customers. Exit interviews can help the institution determine what the client needs as her needs change and her business grows.

7. **Repeat clients with good credit histories produce greater efficiencies and higher loan officer productivity.**

Repeat clients with good credit histories can drive greater efficiencies in productivity. If the loan portfolio consists of a large percentage of repeat borrowers, the institution can streamline the lending process with simplified loan applications, reduced screening requirements, and less frequent repayment periods. Furthermore, a credit officer with large portfolio of repeat clients can handle many more clients, which affects both efficiency and productivity. A long-term, repeat customer who prefers to keep loan sizes small can be more profitable than a first-time large loan because of efficiencies in loan delivery.

6. **Loyal repeat customers should present fewer credit risks.**

In theory, loyal repeat customer should present lower credit risks, since the MFI has been gathering information on that customer over time. Every loan and every repayment generates more information to make an easier credit decision based on both character and the capacity of the business. Unfortunately, not all MFIs work like this. In many cases, institutions use delivery mechanisms that actually get in the way of their abilities to learn about individual customers, especially with some of the group lending methodologies. An
institution that operates at the group level does not allow loan officers to get a sense of the repayment capacity or the character of the individuals in the group, which may lead to repayment problems as loan sizes increase. Also, if an MFI’s policy is to keep giving larger and larger loans, the client will eventually be unable to repay. However, if the methodology is designed properly, loyal repeat customers should be lower credit risks.

5. Loyal customers generate referrals.

Loyal clients are advocates of the institution and tell their friends about it. Generating new referrals and growth is easy with a cadre of loyal advocates. If an entrepreneur learns about an MFI from a friend, he or she automatically has a higher affinity for it than if they were to read it about in the newspaper or another relatively anonymous source. Word-of-mouth marketing also enhances loyalty in the clients who were referred to the institution, since the friend’s like for the institution predisposes the new client to like the institution too. Establishing solid relationships with customers is an important element of creating loyalty. A loan officer’s attendance to life events like weddings is one way to establish this relationship; a commitment on the part of the loan officer to remember all of her customers’ names is another.


Portfolios that consist of high volumes of long-term clients are more stable than those that consist of high volumes of new clients. If a loan officer’s portfolio is half comprised of clients on their first loan and half comprised of repeat clients, portfolio quality may be more in jeopardy, even if repayment is perfect, than if it were comprised of 80 percent repeat clients. Repeat clients create a stabilizing factor in the institutions. If institutions are turning over clients so fast that their portfolios are always consisting of high volumes of new clients, they may have cause to worry. Healthy growth is based on a foundation of loyal, repeat customers.

3. Customer desertion can subsidize the competition.

If new clients leave Institution A before they are profitable, and they use their repayment record to leverage better terms with Institution B, Institution A is in effect subsidizing the competition. Institution A has taught the client how to borrow, has helped him or her develop a credit history, and just when this client has begun to turn a profit, he or she leaves and borrows from another institution. At the same time, when that client leaves, Institution A is foregoing any future money to be made on that client.

2. Customer loyalty breeds staff loyalty.

Many elements of making good credit decisions are based on making mistakes, so a seasoned credit officer tends to have better repayment rates and generate the most revenue for the organization. Staff loyalty is therefore important to institutional development. Although there is no hard evidence of the relationship between customer loyalty and staff loyalty, inherent logic points to a connection. If loan officers are working with clients who like working with them, who pay on time, who are enthusiastic about the institution, then the loan officers’ jobs will be more enjoyable. This enjoyment creates a circle of reinforcement, because loan officers will probably respond positively, which will encourage attachment of customers to the institution. Staff loyalty comes with time, and it is enhanced as the loan officer is on the job. Staff incentives, appropriate pay structures, and staff recognition are other ways to breed staff loyalty.

1. Customer loyalty is a critical element in achieving the social impact of microfinance.

Customer loyalty is critical in order to achieve the social impact of microfinance institutions. A fifty dollar loan will not change the life of a struggling individual, but access to financial services over the long term creates a better chance of success. Customer loyalty
is important to the development of the institution, and by extension it is important to the lives of those whom MFIs serve.

**Surviving Competition**

*Kurt Koenigsfest*, BancoSol, Bolivia  
*Alvaro Retamales*, Banco del Desarrollo, Chile

**Experience of BancoSol**

BancoSol is the leading organization in the micro-finance industry in Bolivia. Since 1992, it has served over 650,000 clients and has become the most successful private commercial initiative with a solid social content. By the end of 1991, BancoSol’s parent NGO, Prodem, had helped to finance more than 45,000 micro-businesses, providing more than $28 million in loans with a default rate close to zero. BancoSol offers financial services to micro-entrepreneurs, individuals and small businesses, with a strong focus on women, who account for 63 percent of BancoSol’s clients and 53 percent of the loan portfolio.

**Evolution of BancoSol’s Loan Products**

BancoSol began operations with a single product, the solidarity loan, based on a common debt structure that mandated that in order for a member of the solidarity group to access a loan, the other members in her group had to maintain a perfect repayment history. However, as the microfinance industry in Bolivia matured and clients became more sophisticated, there was less demand for this product. It occupied more than 91 percent of the gross loan portfolio in 1998, but only 25.7 percent in mid 2001. In these same years, the total solidarity group portfolio shrank from $67.7 million to $18.8 million.

During this time period, other microfinance players entered the market, which forced a change of product offerings. In response, BancoSol launched the individual loan. In 1998, the individual loan accounted for 8.6 percent of the loan portfolio, or $6.4 million, and in mid 2001, it accounted for 53.3 percent, or $38.9 million.

Although BancoSol’s total loan portfolio increased from 1998 to 2001, the default rate also skyrocketed during the same period. While being only two factors among many that created high delinquency rates, the solidarity group default rate climbed from 4.6 to 29.9 percent during these years, and the individual loan default rose from 3.9 percent to 16.5 percent.

At the end of the year 2000, BancoSol was contending with nine other microfinance institutions in the Bolivian market. Although BancoSol had the largest loan portfolio by far, and although overall BancoSol maintained its share of the market over the years, the sheer number of competitors made it easier for BancoSol’s customers to jump to another institution without repaying their loans. Furthermore, BancoSol reduced its interest rate from 42-48 percent in 1996 to 24-38 percent in 2000 (loans taken out in bolivianos were more expensive than those in dollars). However, BancoSol’s interest rate was higher than its competitors’ rates and BancoSol still maintained its market share because of its strategy for moving through the competition crisis.

**BancoSol’s Challenges**

The challenges facing BancoSol were many-fold, and stemmed from a maturing microfinance market and the 1998-1999 Bolivian economic crisis which continues in 2001. The challenges can be broken down into several key topics:
• **Substitution.** All competitors had similar products that were similarly priced.

• **Clients.** Clients were highly concentrated in some key cities and were sensitive to the prices of financial services. Clients experienced a low cost of switching between institutions because there were few exit or entrance barriers for Bolivian MFIs.

• **Rivalry.** Although microfinance customers were maturing and looking for more sophisticated products, the overall number of clients in areas of concentration had not greatly increased. Therefore, MFIs experienced slow demand growth and often competed for the clients that existed in the market.

• **Potential competitors.** There was a high probability that more competitors would enter the Bolivian microfinance market. New entrants faced significant market barriers, like high risk, lower economies of scale, a historically low reaction from competitors, and the important learning curve that takes place before achieving success. However, new entrants also had many opportunities to exploit, including certain consumer lending institutions. Bolivian microentrepreneurs had demonstrated low institutional loyalty and were ready to jump to the next institution if they could find a cheaper price or different product, and regulation in Bolivia was not stringent, i.e. presently, an institution can become a private financial fund, which has lower requirements than that of a bank.

**Strategic Tools used by BancoSol to Manage the Crisis**

BancoSol adopted commercial strategies to cope with the economic and social crisis. Management encouraged portfolio growth, deposits growth, and the development of new products and services to reduce customer desertion. BancoSol realized that the economic and social situation in Bolivia made it more likely for staff to jump institutions as well. In order to retain the staff that they had trained and groomed, management improved salaries and trained staff in specialized areas within the bank.

BancoSol also expanded its product line to include small consumer loans, automobile loans (for entrepreneurs who would offer public transportation), housing improvement loans, revolving lines of credit, pawn loans, and loans designed to finance home installations of public utilities, such as water, electricity and natural gas. On the deposits side, BancoSol now offered savings accounts in local or foreign currency, demand deposits, and time deposits with a monthly interest payment or one at maturity.

Furthermore, the bank increased its geographic coverage and began an aggressive marketing scheme to promote not only the bank itself but its individual products. In this way, BancoSol was able to maintain market share.

Recognizing that products are not always enough to retain customers in a competitive market, BancoSol also began to offer payment services for utilities, taxes, and payrolls; wire transfers and money orders; debit cards, ATMs, and smart cards. Figure 10 summarizes all of BancoSol’s products and services that helped management cope with the crisis.

**Figure 10: Summary of BancoSol’s Products and Services**

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<tr>
<th><strong>Loan Products</strong></th>
<th>Consumer Loan Products</th>
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<td>Utilities</td>
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<td>Line of credit</td>
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<td></td>
<td>Pawn</td>
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</tbody>
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Savings Products

- Savings accounts
- Demand deposits
- Time deposits

Services

- Utilities, tax, and payroll payment
- Wire transfers and money orders
- Debit cards, ATMs, and smart cards

Management also took steps to improve the quality of the portfolio through effective risk management tools, and to implement cost reduction techniques. Some of these techniques include credit analysis post disbursement, lower credit margins, market segmentation to determine appropriate loan sizes, the implementation of credit scoring, and training staff to be more goal-oriented. BancoSol was able to use these techniques through the crisis to produce a better cost efficiency ratio at the end of the crisis than it was able to maintain before the crisis.

Experience of Banco del Desarrollo, Chile

To beat the competition, a microfinance institution must have a specific strategy in place. Even if specific competitors are not yet on the horizon, these days an MFI must be prepared for their eventual arrival. Although strategies for surviving competition vary from environment to environment, all institutions recognize that they must know their competition in order to compete and come out ahead. These institutions also must have intimate knowledge of the financial landscape and the challenges posed by that landscape. The general model for surviving competition suggests that when facing a probable loss of market share due to a competitor’s product, an MFI must offer a similar product, at a lower price, with a greater budget for advertising and promotion, using a greater sales force than its competitors.5

In the past, Banco del Desarrollo has successfully dealt with several large competitors, usually large commercial banks that give consumer and small business loans. When a consumer lender entered the market, Banco del Desarrollo expanded its product loan to offer consumer loans. When a subsidized state-owned bank began to be more competitive, however, the solution was not so easy since Banco del Desarrollo could not match the subsidized funds. Instead, Banco del Desarrollo improved the quality of the service it offered by adding value in the form of service delivery. It trained loan officers to treat their clients with a great deal of respect and kindness. Because clients often suffered certain social disadvantages such as a lack of education, they were often not treated with respect by bankers or loan officers. Banco del Desarrollo decided to change this situation by providing a positive experience for its customers.

Loan officers were also trained to be completely honest in loan assessments. They would candidly inform potential clients of all of the fees and responsibilities involved with the product so that the clients would not have any surprises down the road. In this way, Banco del Desarrollo developed a reputation for honesty and a commitment to its customers, promoting not only customer loyalty but also attracting new customers as the word spread about its positive image. The bank found that, whereas anyone could imitate a financial product, it took real specialization to add value to that product.

Banco del Desarrollo found that in the case of each competitor, it was able to offer something better. When a competitor offered consumer lending, Banco del Desarrollo aggressively sold its loan products to beat the competition. Banco del Desarrollo emphasizes its strengths to go where the competition cannot. The bank also found that design of products was an important factor. If products were properly designed, they could offer them at a lower price than the competition could.

5 Kotler (1999).
Challenges to Microfinance Commercialization

The basis for most of Banco del Desarrollo’s strategy has been a once-a-month focus group session between clients and management. The bank has found these focus groups to be a useful guide towards helping the institution design products and services that customers value. When management gets an idea for a solution to a current problem, it then conducts a survey on a representative client sample to ensure that the focus group’s responses are aligned with the rest of the customer body. By knowing why customers are happy with the institution, and knowing when customers are unhappy, Banco del Desarrollo has been able to sustain its relationships with its clients.

Banco del Desarrollo has found that it must be open to new ideas in dealing with market realities. It has also found that it must be keenly aware of the products and services offered by other institutions. Finally, Banco del Desarrollo found that a competitive institution is one that finds and sustains one advantage over any competitor. In this bank’s case, the advantage is customer care through loan officers who are in tune with the both the social and economic needs of their customers.

MARKET SEGMENTATION

Monica Brand, ACCION International, USA
Inez Murray, Women’s World Banking, USA

Experience of ACCION International

The microfinance market is evolving at a rapid pace. Clients are more sophisticated than ever, competition is increasing, and desertion is a threat. To ensure that its affiliates are able to meet the changing needs of the microfinance market, ACCION started a market intelligence program designed to:

- Deepen the understanding by MFIs of clients’ needs and preferences
- Increase MFIs’ ability to analyze their own strengths and weaknesses vis a vis those of their competition
- Identify tools for market analysis and adapt them for use in microfinance institutions.

The market intelligence program has a quantitative component, focused on survey research (of which the segmentation research has been a large part) and a qualitative component which uses interviews, focus groups and participatory rapid appraisal (PRA) tools. Among the specific topics examined in this program are clients’: uses of loans; preferences regarding financial service characteristics; attitudes about their businesses and future plans; satisfaction with existing services and institutions; reasons for desertion; and perceptions (image) of competing MFIs.

ACCION’s work on client segmentation was premised on the hypothesis that there are various groups within the overall client population who can be distinguished from each other on the basis of verifiable (actionable) characteristics, and who either behave differently from other groups (in terms of repayment, growth, etc.) or who have different attitudes (and hence would respond to different types of marketing or product characteristics). If segments could be easily identified on the basis of readily evident variables, it would be possible to tailor special offers, new products, marketing messages, and product features to enhance the appeal of MFI products to those groups and increase overall client satisfaction. This kind of tailored marketing could be particularly important in highly competitive markets.

In carrying out the market segmentation research, ACCION partnered with market research firms in the US and Argentina whose standard clientele are larger corporate businesses, and
MicroFinance Network

who have advanced knowledge of both statistical methods and psychometric (attitude-based) analysis. Working with these analysts, we identified five ways to group clients:

There are five different ways to segment:

1. **Who buys**: Demographics, experience with credit, purchase behavior, type of business.
2. **Why they buy**: Attitudes and beliefs, such as loyalty to the institution, traditionalism, aggressive go-getter mentality, or tendency to evaluate.
3. **Results of buying**: Benefits such as convenience, growth, accessibility, comfort, security, or understanding.
4. **What they buy**: Product features such as fast approval, loan terms and amounts, guarantee mechanism, and interest rates. Features may differ for borrowers and savers, individuals and solidarity groups.
5. **End use of product**: Commerce, production, service, housing, and consumption.

The test of the usefulness of market segmentation would be whether actionable segments could be identified. In order to be actionable, a segment would need to be readily identifiable (for example through demographic characteristics, past behavior or responses to a few questions about attitudes), and once identified, that segment would have to behave as clients in a significantly different way from the rest of the client base.

The results of the market segmentation exercise, which was carried out in Bolivia with clients of BancoSol, have not yet confirmed the original hypothesis about the usefulness of market segmentation techniques, though they have yielded a great deal of insight into client perceptions.

It did prove possible to group clients into clusters according to their attitudes about their businesses and the future, and these groups were looking for very different things from their microfinance service provider. It was possible to distinguish and name the following groups:

- **Demanding business owners** – looking to move up (not necessarily arrived) and willing to move from one strategy to another; will change microfinance providers if service is not good; values speed and efficiency, will seek the best interest rates.
- **Self-confident entrepreneurs** – oriented toward economic growth; innovators; willing to make longer term investments but also to take calculated risks; looking for good personal treatment and individualized service
- **Cautious and static** – keeps the business in good order, but not looking toward dramatic growth. Values orderly service provision. Borrows for a combination of business and family needs – generally for maintaining the business or solving a particular problem.
- **Humble, passive** – just making it with existing business; not much thought of moving up; wants to be treated with respect; looking for simple services
- **Pessimistic and resigned** – oriented toward the family more than the business, based on a sense of pessimism about the future; wants to protect what the family has, invest in the children’s ability to climb out of poverty; not very demanding of financial service provider; considering dropping out of borrowing

The attitudes expressed in these groupings go a long way toward explaining how socioeconomic position, business skills, recent family and business history, and long run attitudes combine. These attributes determine how and why clients use financial services, and interestingly, they suggest the attributes of those services that different types of clients
value most. For example, the demanding business owner is going to shop around for low
prices and fast loan turnaround, as different from the self-confident entrepreneur who is
looking for a service provider who will be more of a partner in long run growth. It is easy
to imagine how an MFI could adapt its services to respond to each of these groups.

The elusive element in the market segmentation work has been that it has not proved
possible to identify which group an individual belongs to on the basis of easily verifiable
characteristics. None of the readily available demographic indicators, business variables or
past client behavior variables correlates highly with the identified segments. One
possibility, which is currently being tested, is that these groups could be identified by
adding a few attitude-based questions to their loan applications.

Among the lessons from this exercise are the level of professional knowledge needed to
carry out a statistically valid market segmentation study, as well as the large sample size
and resulting database. The resulting costs and level of effort suggest that such a survey
would be appropriate only for larger MFIs facing heavy competition. For most MFIs and in
most situations, the more straightforward qualitative and quantitative tools mentioned above
would be more practical.

**Experience of Women’s World Banking**

Customer segmentation is the most precise method of positioning an institution. Basing a
competitive strategy on an understanding of individual customers is too broad a goal;
basing a competitive strategy on generalizations about the microfinance industry is too
vague a goal. Basing a strategy around clusters of customers about which the institution
can make generalizations is the most efficient and direct way to compete in the market.

Client research is an integral part of defining what the strategic position of an MFI should
be. With this in mind, Women’s World Banking has created a strategic positioning project.
The main activities of the project are an analysis of the microfinance sector and MFI
competitors, surveys to understand the client’s needs, and an analysis of MFI capabilities.
With this analysis, WWB forms a plan of action to best meet the needs of its target
customer.

The analysis of the microfinance sector and MFI competitors asks the following questions:

- How is the microfinance industry changing in particular countries of operation?
- How big is the potential market?
- How saturated is it?
- Who participates in the industry?
- Who are the most important competitors?
- What kinds of products and services do they provide?
- What can the MFI learn from them?

The next step, understanding the clients, explores what clients like and dislike about loan
products and service delivery, how well a particular MFI measures up against competitors
in meeting client needs, what else clients may require to help them meet their financial
needs.

The third step, analyzing MFI capabilities, determines the strengths of an MFI an
organization (i.e. determines its core competencies), defines the necessary capabilities to
best reach and serve clients, and how their costs stack up to those of their competitors.
These three steps are imbedded in a larger, seven-step process that allows an MFI to strategically position itself according to the market segment it is most able to serve. Figure 11 describes this process.

**Figure 11: Strategic Positioning Process**

1. Project Planning
2. Analyze MF Sector and Competitors
3. Understand the Clients
4. Analyze MFI Capabilities
5. Make Choices
6. Develop Action Plan
7. Take Action (Ongoing)
8. Revisit and conduct more analysis on an on-going basis as needed.

In order for this strategic positioning project to lead to important changes for an MFI, it must be designed around the specific needs and contact of an institution. The appropriate timing and resources must be allocated in order to generate high-quality data and analysis. The quality of data and analysis is pertinent because it is on this data that the institution will make choices about which actions to take and which not to take. For the best analysis of the data, the process should be participatory, drawing on the knowledge and expertise of the entire MFI’s staff. Finally, the data and analysis must be followed by a specific plan to take action. This plan should answer the questions of what the MFI can do differently to serve its target customers more effectively. For the plan to really take hold, it must be based on a foundation of commitment and personal responsibility.

Understanding the clients is perhaps the most important element of the strategic positioning initiative. The objectives of Women’s World Banking’s customer research is to understand low-income entrepreneurs’ opinions of the products and services offered to them by either WWB affiliates or other MFIs. To better understand clients, WWB has surveyed both active borrowers and drop-outs of two affiliates in Colombia and one affiliate each in Bangladesh and Uganda. The margin of error was plus or minus four percent. Surveys ask for the following information:

- Demographics.
- Importance of loan and product delivery mechanism attributes.
- Satisfaction or dissatisfaction with loan and product delivery mechanism.
- Reasons for dropping out.
• Comparative satisfaction (how the customer’s satisfaction levels changed if she switched institutions).

• Use of and demand for new products and services.

These attributes change as the particular microfinance market matures. For example, in a new market, segmentation should be based on whether the geographic dispersion is urban, semi-urban, or rural; demographic data such as gender and income, and “firmographic” data such as business age and size. A new market can exist well with a basic product design with no customization. In a growing market, segmentation should be based on the needs of the population, such as product attributes of loan size, term, and repayment frequency; service delivery attributes, such as the guarantee mechanism, requirements, and turnaround time; and customer service. This market requires product refinement and some customization, e.g. by business activity. In a semi-mature market, segmentation should be based on attitudes, such as the degree of risk aversion developed by the target market, as well as brand loyalty, the purchase process, the client’s propensity to switch, and other more advanced issues. In such a market, institutions must concern themselves with new product development and a high level of customization.

The customer surveys will allow the institution to discover the particular needs of its new, growing, or semi-mature market. Once various attributes are pinpointed, the MFI can look for correlation between them. Some attributes are as follows:

• Fast loan approval
• Size of loan
• Interest rate
• Term
• Institution’s reputation
• Loan officer’s ability to give business advice

Following the correlation exercise, the next step is to perform cluster analysis to see which product characteristics are the most important to customers. The key to proper implementation of a market segmentation project is the quality of the MFI’s database. An institution lacking a good database is a poor candidate for market segmentation.
PART IV: NEW PRODUCTS AND SERVICES

MOBILIZING SAVINGS

Marguerite Robinson, USA
Graham Wright, Micro-Save Africa, Kenya

For microfinance institutions, there are two types of savings: voluntary and compulsory. Voluntary savings are a service from which clients can withdraw and (often but not always) on which they receive interest. Compulsory savings is a discipline, or a form of loan guarantee fund, which drives up the effective cost of loans. This following section addresses the benefits of voluntary savings mobilization.

A substantial proportion of client exit from microfinance institutions is driven by the credit-only focus. For example, in Bangladesh clients drop out in order to (1) collect the funds from their compulsory savings account, (2) to access microfinancial services where their savings are available in an emergency, (3) to access enhanced services from other MFIs, i.e. ones that offer a wider range of products.

East African microfinance customers drop out to (1) avoid the pressure of weekly loan repayments, (2) respond to the seasonality of income/expenditure, i.e. in the summer months customers do not have to pay for school supplies for their children, (3) collect the funds from their compulsory savings account.

Microfinance institutions can avoid some client exit by mobilizing savings, which can be conducted profitably on a large scale. Poor people need savings services because of emergencies, opportunities (which are often unexpected), to pay for lifecycle events associated with death or marriage, and to smooth payments of their consumption needs. People do not need loans all of the time, but they do need savings all of the time.

Savings as a Service and a Source Of Funds For Loans

To offer credit services, the microfinance institution selects borrowers that it trusts through business assessments, character assessments, cash flow analysis, or a combination of several tools. In savings mobilization, however, it is the customer who must trust the MFI.

To begin the process of introducing savings services, the MFI must always conduct market research and feasibility analyses. Once these tests are completed, the institution uses the information to design appropriate high-quality services first to its existing customers, and then to new market niches. The institution should publicize its instruments and services in locally appropriate ways.

Compulsory and voluntary savings are usually incompatible. However, some institutions have designed programs where a percentage or a value amount of savings are made available to customers, but once customers are allowed to remove part of their savings, they usually prefer complete voluntary savings mobilization. Quality voluntary savings services will usually mobilize more than locked-in savings.
Savings Products

What is most important is not any particular savings product, but the combination of products available from the MFI, which each saver can customize for his or her particular needs. For large-scale savings mobilization to be viable and to finance substantial portfolios, savings must be mobilized from the public and not from the poor alone. This cross-subsidization is the only way that the poor can be served cost-effectively on a large scale. However, such practice requires special attention to ensure that the products are attractive to all potential savers.

Cost Issues

Contrary to popular opinion, mass savings mobilization need not be an expensive source of capital. Though small savings can be captured at low financial costs, the small size of transactions might disproportionately raise administrative costs. This disadvantage, however, may be compensated by the synergies created through the economies of scope between savings and lending.

Products’ interest rates and fees can also be used to provide:

- Incentives to build up and maintain balances
- Disincentives to withdraw
- Revenue from transactions/ledger fees

Information costs and loan loss provisions are expected to be less when MFIs can draw on the deposit histories of potential borrowers to analyze their capacity to pay and creditworthiness. It is essential that MFIs cost their products to make informed pricing decisions. Costs of new products are difficult to determine in advance, so pilot-tests are needed to estimate cost accurately. Interest rates paid and the charges levied on savings accounts should be carefully structured to encourage savers to maximize deposits and minimize withdrawals.

Some Basic Principles for MFIs in Large-Scale Savings Mobilization

Profitable large-scale savings mobilization is not a matter of adding a few products to a microcredit institution. It changes the institution fundamentally. MFIs should offer only a few carefully designed savings (and other) products. Too many products make branch management too complex and expensive and many products are not necessary for most clients.

- Large-scale savings mobilization should be limited, except in highly unusual cases, to publicly regulated and supervised institutions that are legally permitted to mobilize public savings.
- Microcredit institutions introducing voluntary savings should pay particular attention to the preconditions required and to appropriate sequencing.
- Products are necessary but not sufficient for profitable voluntary savings mobilization from the public, as they are only one element in a much larger set of requirements for the profitable large-scale mobilization of savings.

Management, Organization and Human Resources

High quality, experienced, and committed governance and management are essential. The MFI should stop efforts to raise voluntary savings if these are not available.
Management and staff training and incentives related to each step of the sequencing process are essential. Some managers and staff (especially middle managers) may object to, and in some cases refuse to implement, the necessary broad-based changes. This problem, where it arises, must be carefully and quickly dealt with (usually not easy).

Because mobilizing voluntary savings from the public will change the institution dramatically, organization, internal supervision, liquidity management, and financial intermediation are likely to need to be fundamentally revised.

Who Benefits from MFIs that offer Voluntary Savings Mobilization to the Public?

Clients are the obvious benefactors of the savings services, since it is they who require and demand the service. However, the MFI benefits too, for several reasons. First, clients are likely to be more satisfied and therefore more likely to repay their loans to maintain ongoing access to the package of financial services. Second, savings provides microfinance institutions with an attractive source of capital: locally mobilized voluntary savings is potentially the largest and the most immediately available source of finance for some microcredit institutions. Small voluntary savings can mobilize large amounts of funds that are more stable than other funding sources. Third, the MFI receives additional income from loans made, investment of the new capital, and also from fees charged on savings transactions.

One less obvious benefactor is the national economy: Savings are brought out of the informal into the formal sector and made available for reinvestment.

NEW PRODUCT DEVELOPMENT

Warren Brown, ACCION International, USA

New product development in a commercial context is the process of taking a new financial product, service, or delivery channel from the idea phase to the ready-to-market phase in a manner that creates a high probability of client acceptance and positive returns for the institution.6

The core of the new product is the reason why the customer pays money for the benefit of the product, or the need it fulfills (e.g. liquidity or livelihood funding). The actual product is comprised of the features that characterize what the customer is buying, including how it is designed (terms, rates, eligibility requirements) and the way it is packaged (application package, type of passbook, etc.). The augmented product is how the customer receives the product, including the mode of delivery and servicing, which includes application turnaround time, hours of operation, waiting room facilities, customer service, and product knowledge on the part of loan officers.

The process of new product development

There are five steps in developing a new product:

1. Opportunity identification
2. Analysis and evaluation
3. Prototype design
4. Pilot testing
5. Institutionalizing the product roll-out

**Opportunity Identification**

The flow of information from various sources is filtered into the organization; this filtering process generates new product ideas. Client comments and behavior; internal records, files and reports; competitive entry or changes in strategy, and changes in the overall market, such as regulatory changes are all sources of information that can drive new product development.

However, this information is not spontaneously generated. The MFI must develop the capacity to actively identify, communicate, and pursue market-driven opportunities. Developing such a capacity is three-tiered:

1. **Create active mechanisms for collecting information.**
   - **Clients.** Conduct exit interviews, key user analysis, and periodic one-on-one interviews; put a suggestions box in each branch.
   - **Internal sources.** Create customer-centered databases, redefine regular management reports to reflect customer information.
   - **Competition.** Develop competitor tracking systems, glean from publicly available information (such as credit bureaus).
   - **The overall market.** Track regulatory changes, the macroeconomic environment, and the actions of any potential partner organizations.

2. **Develop an organizational structure and culture that supports the flow of information and ideas.**
   - When information is generated and collected, the mechanisms must be in place for it to reach decision makers in a timely fashion.
   - Mechanisms must be in place for the “field” perspective to filter up to senior management.
   - Staff must feel comfortable making suggestions and sharing new ideas.

3. **Ensure that people and processes are in place to champion the best ideas.**
   - When good ideas reach the “top,” they must be acted upon; if they languish, the earlier efforts were wasteful.
   - There should be a process in place to validate and test new ideas.

**Analysis and Evaluation**

Past experience, customer research, new product ideas, competitive analysis, and external market information, coupled with the evaluation of customer and institutional needs, result in a concept for the new product. This concept includes a description of the core, actual, and augmented product.
Prototype Development

The purpose of the prototype is to test the concept. After a breakeven analysis and an assessment of institutional capacity, the MFI can build the prototype, which will serve as an instrument for pilot testing.

Pilot Testing

Pilot testing is essential for all new products. A limited pilot test will reveal glitches in the product prototype, and it will undoubtedly uncover systems or components associated with the product that need further development. Key parameters to consider in defining the scope of a pilot test include the appropriateness of the testing site, the appropriateness of the target population (adequate size and representation), and the timeline.

There are nine steps to follow in preparing for, executing, and monitoring a pilot test:

1. Convene a pilot test team.
2. Define objectives.
4. Develop the testing protocol and performance indicators.
5. Develop customer marketing materials.
6. Install systems (temporary or otherwise).
7. Train relevant staff.
9. Monitor and evaluate test results.

Institutionalizing the Product

Effective inclusion of the product into the current operations of the MFI relies on effective communication between management and staff regarding the objectives and goals of the new product. After systems and processes glitches have been worked out based on pilot test results, the information from the pilot tests must also be effectively transferred to staff members.

Even in a case where an MFI did its best to minimize surprises and errors, it is quite likely that the new product will cause something to go wrong before it can operate smoothly.

Conclusions

The process of new product development largely determines the quality and success of the products developed. However, a new product is not always the answer to every different customer need. Microfinance institutions should avoid product proliferation, and ensure that the products it does have are efficient and driven by the demand of the market.

Up-front investment in product development increases market potential and reduces the costs of product launch and commercialization. Pilot testing is a crucial element of this up-front investment. But, regardless of the amount of money and resources that an institution invests in a product, without institutional readiness and capacity, the new product will have difficulty finding success.
ROLE OF MFIS IN RURAL AND AGRICULTURAL LENDING

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In many regions, there is a large, untapped rural microfinance market. The situation is very different from country to country, but it is well-known that the Latin American rural microfinance market is largely underserved. This following section will focus on this region.

The traditional rural microenterprise is a family that is living off scant resources. This family relies on diverse sources of income, such as keeping goats and selling the milk, working the land to produce tortillas for sale, and a son or daughter in an urban area who is working in the services sector to generate more income for the family. In rural areas, the division between the microenterprise economy and the family economy is non-existent. Fungibility of money is very important to these individuals.

Characteristics of the rural market differ markedly from characteristics of an urban or semi-urban market. In rural areas, there is a high level of social cohesion, as the people from the community know each other very well. In general, the economic activities are more basic than those in urban areas. For example, there may be less of a service industry, and more of a focus on the economy’s fulfillment of basic needs. Also, rural residents often lack financial information. Furthermore, from the point of view of a financial services provider, clients are highly dispersed. Not only are they at a great distance from one another, but they are also a great distance from the urban market. Often, there is a concentration of one type of economic activity within a region. For example, the community in Oaxaca, Mexico, is specifically known for handicrafts.

The characteristics of rural microfinance products often differ greatly from those of urban products. First, rural microfinance relies almost completely on character lending, since there is nearly always a lack of information regarding the individual’s cash flow. Second, whereas solidarity group lending is waning in urban markets, it is a defining characteristic of rural markets, since collateral is scarce in these communities. Furthermore, since the community is the best judge of the likelihood of repayment by a given individual, a solidarity group is often the best credit committee available. Organizing clients in groups has the further benefit of lowering the cost to the institution.

Lending to agricultural producers has been shown to be feasible. Calpiá in El Salvador and Los Andes in Bolivia both have strong rural lending portfolios. Both receive technical assistance from the Germany-based IPC, so their programs are similar. Calpiá’s rural lending portfolio is $3.2 million; Los Andes’ is $8.1 million. Both have arrears greater than 30 days of about 7.5 percent, about the same as their urban portfolios. These institutions give individual loans and use the projected cash flow as the main tool to assess each household’s diversification strategy. With this information, the institutions design the loans. Collateral depends on the loan size and the characteristics of the client.

The following is a short list of some of the conditions for a successful agricultural lending program:

• An enabling environment.
• Long-term commitment of the owners, the board and the management of the MFI.
• Diversification of risks.
• An efficiency-oriented organization.
• An appropriate cost structure that covers interest rates and tariffs.
• Adequate and appropriate lending technology.
• Close monitoring of production and market conditions.
• Funds for staff development and on-lending.

The geographic dispersion of the enterprises, the quality of the transportation infrastructure in the area, and the complexity of the individual household economies all affect the cost structure of the loans. Although all lending activities are inherently risky, the risks related to agriculture include additional market risks, production risks, and political risks, since lending to these areas will empower those who live in rural areas.
PART V: EFFECTIVE RISK MANAGEMENT

CLIENT RISK MANAGEMENT

Monique Cohen, United States Agency for International Development, USA
Michael J. McCord, MicroSave-Africa, Kenya

“Life for the poor is one big risk.”
— Card Bank Client

Because delivering microfinance services is a business, the proliferation of microfinance products should be demand-led. The most common of a typical microfinance institution products are fixed asset and working capital loans. There are very few products that help people mitigate risk and financial shocks. To attract clients, an MFI must offer products and services that reflect clients’ expressed priorities and needs, and among the most attractive are tools for personal risk management. Development and refinement of such products begins with market research, which leads to concept development, design, costing, pilot testing, and roll-out.

Risks Faced by Typical Microfinance Clients

The lifecycle of the typical microfinance client dictates his or her financial needs. Each generation can be described as beginning with marriage and ending with death, with various significant events in between. These events, especially marriage and death, are the primary drivers of financial needs. Figure 12 describes this lifecycle.

Figure 12: Lifecycle of a Typical Microfinance Client

![Lifecycle of a Typical Microfinance Client](image-url)
For the working poor, each part of the lifecycle is subject to additional risks beyond those faced by individuals with either more reliable income sources or access to benefits that are largely unavailable to the poor, such as health care. Each client of a given MFI is vulnerable to a number of frequent and wide-ranging risks. Illness, death and loss of the household income earner are the most prominent risks; but in poorer areas, accidents, robberies, and other crimes are frequent. In addition, a micro entrepreneur takes risks with her business, and taking a loan makes this enterprise even riskier. People are willing to accept the risks of taking a loan because they value the lump sum of money; little bits of money are available from other sources, but MFIs are their only source of lump sums.

Credit has many benefits, but it carries high risks related to the client’s ability to repay. If the returns on the investment made with the loan are negative, or if the main household earner experiences a shock, then an individual will reduce assets and consumption to repay loans, since defaulting risks the client’s access to financial services in the future. Failure to repay can also lead to a loss of self esteem, confidence, and social assets such as a community network, especially in a group lending scheme.

**Role of MFIs in Protecting Customers Against Everyday Risks**

Microfinance institutions can help their customers face the risks of daily life. Helping customers to manage risk not only benefits the customer, but it also benefits the institution by enabling customers to better handle the ups and downs of their own financial cycles, and in turn repay their loans on time. Microfinance institutions can help clients mitigate risk with adaptive credit or savings products. However, many microfinance clients are working with a peer group loan, so clients build up their resistance to risk by adapting the products in the following ways:

- Using savings products to build up their assets.
- Diversifying their income sources.
- Facilitating a diversified asset portfolio, e.g. investing in housing and education, to protect their assets.
- Using loans to enable better management of the resources at hand, e.g. if a business opportunity presents itself, the client can immediately exploit it.
- Accessing knowledge and improved social networks.

**Strategies for Coping with Financial Shocks**

In 1999, a microfinance client in Bolivia was experiencing progress with her business after taking out a few loans, but with her fourth loan, she experienced a shock. Her son died and her husband fell sick. The consequence was that she had to reduce her inventory and remove her savings from the village bank; as a result, her cash flow declined rapidly. As the crisis waned, she built savings and went back to the village bank and gradually eased herself back to business. She had taken three steps forward and one step back, but access to finance helped her recover faster. Financial shocks such as personal crisis or national economic downturn call for various coping strategies.

For low-income families, the first responses to coping with such events are:

- Modify consumption.
- Search for new sources of employment or send other household members to work.
- Seek personal financial intermediation, i.e. borrow from family or friends.

Secondary coping strategies, which can be extreme and are used as a last resort, include:
Challenges to Microfinance Commercialization

- Sell productive assets.
- Cash in earmarked savings.
- Take emergency loans.
- Borrow from other sources such as a relative or money lender.
- Withdraw children from school.
- Default on loans.

After identifying and assessing likely risks in terms of frequency and severity, a client can manage risk by avoiding risk at all costs, taking steps to reduce risk, sharing risk with informal social networks, or transferring the risk with insurance.

Microfinance Services and Client Risk Management

Microfinance is currently more effective in helping protect against shocks by building up resources than helping clients to cope with shocks after they occur. By using credit and savings to smooth the peaks and troughs of a life vulnerable to risk, microfinance can help people cover some risks. But some institutions are testing a micro insurance product to protect individuals against losing the gains they have made with savings and microcredit.

Principles of Insurance Provision

Insurance provision makes sense for microfinance clients. They are a large group of similar individuals who are exposed to similar risks, there is limited policyholder control over the event (the policyholder cannot create the event), losses are determinable and measurable, and the chance of loss is calculable. Institutions have the capacity to make premiums economically affordable, as long as they limit the insurable events to non-catastrophes. An MFI that offers insurance must first determine which life events are insurable and which are un-insurable. The institution must also conduct market research by conducting a risk profile of the market or market segments through focus groups, a debt profile of individuals through client interviews, a mapping of the client financial landscape (positioning of inflows and outflows of cash), and a wealth ranking of customers to see where people fall in the continuum of poverty and wealth to determine what kinds of insurance the clients might want and need. The MFI must also assess itself and the competition to determine whether the product is feasible.

Risk Management Product Delivery Mechanisms

Any risk management product must reach the poor effectively and efficiently. For this reason, microfinance institutions are well positioned to offer such products, either directly to their customers or through a regulated insurance provider, since they already have an infrastructure for reaching the poor. However, an MFI that offers risk management products must have the capacity for appropriate management, for developing a pricing plan, and for assessing risks. The basic needs of an institution that provides access to insurance are skills, capital, and reinsurance.

There are four models of service delivery of health insurance (though similar models also apply for other types of insurance):

1. **Partner-Agent Model.** In this model, an MFI teams with a regulated insurance agent that offers insurance products to the MFI’s customers. There is no risk to the microfinance institution, and its administrative burden is minimized. The insurer does the back-office servicing work, while the MFI does the front-office delivery work, and the insurer carries the risk. The partner-agent model has some important advantages and disadvantages. The model carries no risk to the microfinance institution, a limited burden on management, and little need for insurance expertise.
The drawback is that the MFI relinquishes premium earnings, which is the price for no administrative burden. Insurers want an efficient delivery mechanism, and for this the partner-agent model works.

2. Community-Based Mutual. This type of insurance is managed by the members of the mutual, who develop the products. The microfinance institution is the entity that services the insurance product, but the members carry the risk, since they are using their own funds.

3. Full-Service Model. In this model, the microfinance institution is the insurer, and, thus, it carries the risk (its portfolio and assets).

4. Provider Model. This model is similar to the full-service model, but the MFI has a primary care doctor on its staff.

Regardless of the model, setting the premium is critical and must be appropriate for the insurer, the MFI and the client. According to the results of some programs, annual premiums will not work for poor, so some MFIs have come up with creative alternatives. SEWA has a fixed deposit from which it takes interest for insurance. FINCA has a built-in savings product that allows people to withdraw savings for insurance. However, it has not yet been determined if and how customers can “rest” from insurance coverage just as they rest from taking a loan.

The three players in microinsurance, namely the insurer, the microfinance institution, and the client, have different objectives for this product. Insurers want to expand their market, clients want more ways to minimize risk, and microfinance institutions want to protect their assets. Insurance programs need pilot programs to assess the satisfaction of the three players’ different objectives.

Microinsurance is very new, and there are several MFIs currently offering different forms of insurance. Many of them have found that clients have a difficult time grasping the concept of risk pooling. Microfinance institutions must make it clear to clients that insurance buys them protection, and this can seem unconvincing to those who are unfamiliar with insurance. One initial finding is that MFIs seem to have the most success if they first solicit insurance partnership; later, if that does not work out, they should start with a simple insurance product for protection during the life of the loan cycle. If this is successful, they can slowly expand.

PARTICIPATING IN CREDIT BUREAUS

Liza Valenzuela, USAID, USA
Jacques Trigo, ACCION International, Bolivia (former Bolivian Superintendent of Banks)

A credit bureau is a database with information on loan clients. The purpose of credit bureaus is to provide accurate data on the credit history of clients. This information helps financial institutions or other firms make good credit or business decisions.

There are generally two types of information available in credit bureaus in developing countries. Some have negative information only, such as the names of clients who are delinquent on their current loan. Others have “positive” information, such as who has a loan outstanding (whether delinquent or not) and information on previous loans. Many credit bureaus also have additional, non-credit information, such as client address, marital status, public records information (tax, judicial), bill-paying status, etc.
Why are credit bureaus useful?

1) They help assess risk. Credit bureaus help financial institutions assess the risk of potential or repeat default of particular clients by providing them with information about client’s credit histories. By weeding out clients that have poor credit histories or that are already over indebted with other institutions, microfinance providers can help ensure the quality of their portfolios.

2) They help lower costs. By providing information up front on client repayment histories or indebtedness, credit bureaus can also help lower costs for financial institutions. This reduction in cost can be passed on to clients in the form of lower interest rates.

3) They help instill repayment discipline. Credit bureaus can also instill a credit discipline in a financial market. If clients know that future lending could be contingent on a good repayment history, they will make an effort to pay their loans and have a “clean” record.

4) They help supervisors assess the risks of supervised institutions. Financial sector supervisors benefit from having credit bureau information, because they are responsible for monitoring the quality of the portfolios of supervised institutions and the overall risk exposure of the financial sector.

How do credit bureaus get their information?

In most countries, private credit bureaus enter into mutual agreements with subscriber firms, in which the firms report data to the credit bureau, and the firm is then eligible to access the credit bureau database. Firms usually access the database to inquire about a potential customer (this is referred to as an “inquiry”). There is normally a fee per inquiry, which varies depending on the terms of the subscription agreement. Credit bureaus also collect data from public records, such as tax authorities or courthouses, to provide a more complete picture of a client.

In many countries, the banking supervisory authorities have a bank credit bureau to help them monitor systemic risk in the banking sector (called a “Central de Riesgos” in Spanish). Regulated institutions are required by law to present information to the supervisory authority (and the Central de Riesgos) on a regular basis. This information is normally shared only among the regulated institutions.

What happens when credit bureau information is wrong? Do individuals have rights?

In most developing countries, credit bureaus are a relatively new phenomenon, and hence, consumer protection laws have not been written yet (though many countries have laws restricting access to credit bureau information). In the United States, the Fair Credit Reporting Act is a specialized law that protects citizens from unscrupulous credit bureau practices. Some countries, such as Chile, have developed a similar law. In these laws, there are usually limitations as to the length of time the information is stored, as well as appeal rights for individuals.

Are credit bureaus useful to programs with group lending clients or are they only useful for individual loan products?

Some managers of community bank or solidarity group lending programs have said that credit bureaus are not relevant to them for two reasons: 1) because the clients (not the program) select each other, and 2) because if there are defaults, the groups members pay. Hence, in their opinion, credit bureau consultation does not provide any value-added to assess risk. This opinion may hold merit in countries that do not have a competitive market. But, again, in competitive markets, even the members of group loans access loans from...
other institutions, often without the knowledge of the other group members. Therefore, for these countries, it is useful to have group lending programs also report their data to the credit bureau and consult the credit bureau. In Bolivia, the largest community banking program found itself with high levels of arrears largely as a result of the fact that many of its clients had loans from other microfinance institutions.

If an institution sends information about its clients to a credit bureau database, won’t other institutions be able to get data on the good clients and steal them?

This is a common fear, particularly among non-governmental organizations. And this is always a danger, of course. But it must be remembered that in most countries with established credit bureaus, institutions are not allowed to “look for clients” in the credit bureau database. This would also be very costly. Institutions are authorized by credit applicants to access their credit history record from the credit bureau. Hence, if an institution is inquiring about a particular client, it is because the client has applied for a loan at that institution. The institution is not “stealing.” Rather, the client is exercising his/her option to get a loan from somewhere else.

What happens if there is no credit bureau in a country with a competitive microfinance market?

In all likelihood, the absence of a credit bureau will result in the over-indebtedness of clients. Over-indebtedness eventually leads to the deterioration of the credit portfolios of all institutions providing microfinance.

MANAGING THROUGH CRISIS OR DISASTER

Rulianti, Bank Rakyat Indonesia, Indonesia
Francisco Madrid, Financiera Solidaria S.A., FinSol

The Experience of FinSol, Honduras

FINOSOL transformed from an NGO in 1999 to become the first regulated MFI in Honduras. It is privately owned. Of Honduras’ 5.7 million residents, 58 percent work in the agriculture sector and 42 percent work in the service and industry sector, thus providing a healthy market for microfinance services.7

When Hurricane Mitch hit Honduras in 1998, FinSol was in the process of transforming into a regulated microfinance institution. At that time, FinSol provided group and individual microloans, as well as small business loans from 13 branches. The hurricane battered Honduras for a week, hitting populated areas and causing numerous mudslides. Two thousand of FinSol’s clients were affected, and the loan portfolio at risk leapt to 17 percent. The group lending portfolio was strongly affected, and the small business portfolio was affected slightly less.

To handle the crisis, FinSol’s management carefully assessed the situation. They then estimated the total damages to customer property and interviewed clients to learn what kind of support they needed. During these interviews, staff communicated to clients that FinSol would be available to help them manage the crisis.

Once staff and management had a good grasp of the situation, they evaluated the total financial impact on the portfolio. They then set up special credit policies to help manage the portfolio and mitigate further damage. FinSol evaluated each customer’s case

7 From ACCION International.
individually in order to provide the best service possible, enabling the MFI to respond to the crisis in the most appropriate manner. First, loan officers divided the portfolio into clients who were affected in their homes, those affected in their businesses, and the hardest-hit individuals who were in shelters after the hurricane hit both their homes and their businesses. FinSol then re-equipped its MIS to deal with the crisis, and established a special credit committee to review the cases.

**Lessons Learned**

In the face of a natural disaster, microfinance institutions must be flexible with their customers by rescheduling and refinancing loans. The MFI should not make the mistake of losing a good customer in the face of the crisis. With competition increasing in nearly all of the world’s microfinance markets, a time of crisis is a good time for an MFI to prove its worth to customers and enhance customer loyalty.

At the same time, FinSol found that it would have been useful to have a credit bureau in place in order to have prevented some of the bad loans caused by the crisis. After the hurricane, FinSol set up an informal credit bureau with other MFIs in the country.

However, an MFI cannot extend this grace period indefinitely. It should set up a definitive time period for “special treatment” after which the lending methodology goes back to normal; otherwise, customers will expect to receive special consideration well after the crisis has passed. At the same time, the crisis cannot be forgotten. It is important to follow up closely on the affected portfolio and expand products to include an insurance policy. For FinSol, clients resisted insurance before Hurricane Mitch hit; after Hurricane Mitch, they demanded this product. Furthermore, it may be useful to identify high-risk fragile areas and help clients identify the dangers of living in high-risk areas.

FinSol learned that the crisis was not an isolated event. Management and analysts monitored the macroeconomic impact of the crisis for months after the immediate damage was done, and evaluated FinSol’s credit policies to ensure that the institution dealt the best it could with the aftermath. Management also took steps to reinforce its credit methodology in order for operations to return to normal. In the face of so much damage, FinSol also learned that it had to reinforce collateral requirements. Finally, FinSol established a legal department to solve problems related to the crisis.

**The Case of Bank Rakyat Indonesia**

The Indonesian economic crisis of 1997 had a negative impact on all economic and business sectors, resulting in the general collapse of the economy, including the banking sector. Liquidity problems, negative spreads, decreases in the quality of performing loans and negative returns were the main problems in the banking crisis of Indonesia. In the prevalence of such conditions, only those banks that could still serve as financial intermediaries continued to exist.

The crisis also had an impact on Bank Rakyat Indonesia (BRI). However, unlike most banks, the impact of the crisis on BRI did not have a severe effect on its operations. This can be observed in the continued availability of loan extensions to the informal sector and in continued mobilization of funds from the public.

After joining the central bank’s re-capitalization program, BRI quickly entered the recovery phase. As a result, BRI has achieved the capacity to help the informal sector recover by extending loans to those microenterprises that have demonstrated sound performance in their finances. In contrast, many other Indonesian banks are still dealing today with problems resulting from the crisis.
BRI’s Business Portfolio Diversification

BRI is a state-owned enterprise that provides general banking services to all economic and business sectors. With 323 branches supported by 3,746 BRI Unit offices, BRI is the bank with the largest network in Indonesia. Through its network, BRI has extended loans to microenterprises, medium-sized enterprises, and corporations, with outstanding ratios respectively for each group of 30, 46 and 24 percent of the portfolio. The loan portfolio is extended through the BRI Unit system by loan schemes, especially for the microenterprise sector.

This composition has changed in comparison to the bank’s performance in 1996 before the crisis. At that time, the microcredit sector contributed to 16 percent of the portfolio. Retail (medium) contributed 57 percent, and corporations contributed 30 percent. Now, micro, small and medium enterprises are BRI’s main business targets. The distribution change of the loan portfolio allocation was a decision based purely on business considerations, since the crisis hit the corporate area so severely. Some of the negative impacts of the crisis were the Rupiah depreciation against the US dollar and interest rate increases, which placed some corporations at a disadvantage. The decrease in corporate business performance was not only observed by BRI, but by almost all Indonesian banks as well.

To avoid further deterioration in the quality of corporate loans, BRI administrators decided in August 1997 to stop extending loans to corporate and foreign exchange borrowers. This policy has been met with a positive response, given that loan extensions to micro, small and medium enterprises can fill the gap left by the reduction of the corporate loan portfolio.

Contributions and Resilience of Micro Business

Both micro and small/medium segments are part of the whole BRI business strategy and policy. The micro business sector contributed most to the resilience of BRI in dealing with the crisis. Even though microcredit outstanding is less than outstanding, micro businesses’ contribution to the profit margin is the highest.

The Performance of the BRI Units During the Crisis

Figure 13 demonstrates the resistance of the micro business sector to the impact of the crisis, as key indicators remained strong throughout the period.

<table>
<thead>
<tr>
<th>Year</th>
<th>Loans Outstanding</th>
<th>Arrears</th>
<th>Loan Productivity</th>
<th>Savings</th>
</tr>
</thead>
<tbody>
<tr>
<td>1996</td>
<td>4,076.2</td>
<td>148.8</td>
<td>3.65</td>
<td>31.1</td>
</tr>
<tr>
<td>1997</td>
<td>4,685.4</td>
<td>221.8</td>
<td>4.73</td>
<td>30.7</td>
</tr>
<tr>
<td>1998</td>
<td>4,696.8</td>
<td>265.3</td>
<td>5.65</td>
<td>32.0</td>
</tr>
<tr>
<td>1999</td>
<td>5,956.5</td>
<td>181.4</td>
<td>3.05</td>
<td>38.1</td>
</tr>
<tr>
<td>2000</td>
<td>7,827.3</td>
<td>196.3</td>
<td>2.51</td>
<td>34.8</td>
</tr>
</tbody>
</table>

Loans Outstanding and Arrears:

The year 1997 marked the beginning of the financial crisis. The low growth in loans outstanding and the increase in arrears during the crisis were not only a result of a decrease in the demand for loans and the weakening of competition within the micro sector. The low growth in loans occurred due to (1) changes in the supply of raw materials, (2) the postponement of business development by microentrepreneurs, and (3) the postponement of loan applications from prospective borrowers.
Loan Productivity:

Loan productivity reflects the repayment rate and interest income of the BRI Units. Loan productivity in 2000 was 40 percent, which is the highest productivity ever achieved by the BRI Units. This productivity occurred because of the slight adjustment lending rates underwent with respect to market rates and high repayment rates.

Fund Mobilization Development:

The most positive business indicator of the BRI Unit system during this time was fund mobilization. In 1998, the peak of the crisis, funds mobilized by the BRI Units increased 82.7 percent. This has been the highest increase since 1985, when BRI Units first introduced fund mobilization through deposit products.

Managing the Crisis

Even though most of the BRI Units’ clients managed to survive through the crisis, some did experience bankruptcy. BRI dealt with this situation carefully and fairly, giving credit-worthy customers a chance for continued loan extensions. Besides loan extensions, efficient fund mobilization to maintain BRI liquidity in tight money conditions remained a priority. Cost recovery and sustainability are basic principles of BRI Unit operation policies, so policies and strategies had to be based on sound business considerations and a comprehensive understanding of the characteristics of the microenterprises.

Loan Extension Policies:

There was no change in loan extension policies. Currently, loan extension is still solely based on the credit-worthiness of the clients. In this context, BRI strives to use prudent principles and avoid the interference of other parties. BRI Units’ management consistently follows commercial principles. The average total loan extensions for the last 5 years are described in Figure 14.

<table>
<thead>
<tr>
<th>Year</th>
<th>Average loans disbursement per month</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Rp. Billion</td>
</tr>
<tr>
<td>1996</td>
<td>381</td>
</tr>
<tr>
<td>1997</td>
<td>421</td>
</tr>
<tr>
<td>1998</td>
<td>407</td>
</tr>
<tr>
<td>1999</td>
<td>561</td>
</tr>
<tr>
<td>2000</td>
<td>728</td>
</tr>
</tbody>
</table>

The policy of continued extension of loans during the crisis was possible because of the following:

- Accessibility to a broad network of microfinance outlets gave BRI a strong infrastructure.
- BRI did not face any liquidity problems during the crisis.
- The demand for microcredit was still relatively high considering the crisis.
- The microenterprises had several advantages, such as high margins and high turnover.
- Loan clients were capable of paying high interest rates.
- The amount of time the credit officers spent on problem loans was minimum due to the low problem loans ratio.
This situation challenged BRI management to absorb business opportunities that others were unable to exploit. As a consequence of increases in deposit interest rates, BRI had to increase its lending rate. The interest rate adjustment from 1.5 percent per month to 2.2 percent per month increased loan productivity from 32 percent in 1998 to 38.1 percent in 1999.

This strategic decision was based on an assumption that the increase in the lending rate would not affect the demand for micro credit because clients would also be capable of generating higher income. Moreover, for most BRI Unit clients, the certainty in the disbursement of loans and the simplicity of the related procedures are more important than the interest rate. The proof of this is that the demand for loans is still high and there has been no negative impact on loan repayment quality.

*Loan Size Adjustment:*

The economic crisis caused high inflation rates, resulting in the depreciation of currency against the price of goods. Because of the high inflation rate, microentrepreneurs were in need of more funds to buy raw materials, since the prices of these inputs had risen substantially. Clients began to apply for bigger loans than before the crisis. Because many clients had already reached the maximum loan size, BRI increased the limit in response to demand.

*Problem Loans:*

To manage problem loans in microenterprises, BRI uses a different approach than that used with problem loans in medium-sized businesses. This different approach is based on considerations of efficiency in implementation due to the different services needed by microentrepreneurs, as well as the distinct characteristics of these services.

BRI uses three main programs to deal with these differences and the short term problem loans that emerged as a result of the crisis:

1. **Solving problem loans by deducting (forgiving) the interest.** Interest deduction is only for borrowers who have paid off all loans in default. This requirement is also for borrowers whose loans have been written off. Interest deduction has to be given selectively based on the clients’ capability. This policy does not only decrease the problem loans ratio in the BRI Units, but it also creates income for the BRI Units and maintains the principle of simplicity in operations and credit monitoring.

2. **Forming teams to reduce arrears based on the loan danger signal ratio.** The danger signal is an early warning system for line management to monitor and provide an action plan if the problem loan ratio rises above the limit. The danger signal may be different for each area, and depends on the characteristics of each BRI branch. The head office has set a maximum standard of 7.5 percent. If the ratio of problem loans increases and reaches the “Danger Signal,” an arrears reduction team works intensively during a certain period to collect the arrears.

3. **Writing off loans early for lost loans that are difficult to rescue.** The objectives of the writing off policy are to (1) maintain the ratio of problem loans at an acceptable standard, (2) accelerate problem solving, and (3) enable BRI staff to focus on marketing loans. When loans are 12 months past due, they will automatically be written off from the balance sheet and will be recorded manually in a special register. BRI’s experience is that after 12 months past the due date, BRI cannot restructure the loans. To compensate, the loan management system has a loan loss reserve and a high-spread interest income.
**Fund Mobilization:**

To meet the liquidity needs of BRI for saving withdrawals and loan extensions, BRI Units consistently mobilize funds from the community, focusing on savings products. Within this framework, during the crisis, BRI Units offered lower interest rates than market rates, even though the interest rate during the crisis was still higher than in normal conditions.

Setting interest rates below market rates is possible because most client response is considered inelastic to interest rate changes. For BRI Unit savers, the interest rate is not the most important factor in choosing a bank in which to save their money. The accuracy of this assumption about the attitudes of savers was confirmed during the crisis by the significant increase in savings, despite the fact that the interest rate was below the market rate.

The low cost of financing of BRI Units makes it possible to gain maximum spread from the loans. As it has already been mentioned, no policy to suspend the extension of loans existed during the crisis. While the extension of loans continued, the lending rate was adjusted to market rates. This resulted in high loan productivity.

**Conclusions:**

Six factors contributed to BRI’s success in surviving the crisis:

- BRI has a diverse customer base, which allows its loan portfolio to be based on all business segments, including corporate, medium-sized, small and micro finance entities. Microcredit extension through the BRI Unit system made the most significant contribution to the BRI’s resilience during the crisis, followed by retail credit extension.
- Despite the crisis, BRI Units continued extending loans to micro entrepreneurs and selecting clients based on their credit-worthiness.
- BRI successfully continued to extend loans because of the availability of funds mobilized from the community at a low cost.
- BRI Units maintain the principles of cost recovery and non-subsidization in operations. In this way, interest rates for both lending and saving, are always adjusted to market rates to enable BRI Units to make a profit.
- The availability of funds when needed is more important than lower lending rates.
- Problem loan management in micro business employs simple, but effective methods. It is based on the conditions of clients who require a different approach compared to problem loan management schemes in other business sectors.

**LIQUIDITY AND INTEREST RATE RISK MANAGEMENT**

_Silvia Wisniwski, Bankakademie, Germany_

Risk taking is a core element of financial intermediation. Financial institutions face many risks that can be classified into two broad risk categories: operational and financial risks. More specific financial risks include credit, price, currency, liquidity and interest rate risks. Most MFIs focus particularly on controlling credit risk and operational risk. Other risks receive much less attention, although they can have a significant negative impact on the MFI. This section focuses on two particularly important risks, examining the various methods to safeguard a sound liquidity cushion and to reduce interest rate risks.
**Goals of Risk Management**

The goal of risk management for an MFI should be to optimize the risk-reward trade-off that comes with making strategic decisions. The MFI should plan and fund business development in such a way that solvency risks are avoided, capturing them early in the decision process rather than after a crisis has occurred. Management must be sensitized to risks so that they can identify them and mitigate them before they have negative effects on the MFI.

**Liquidity Risk Management**

Liquidity comes in many forms: stock of cash holdings, current cash inflows, borrowed cash, and liquid assets converted into cash. Liquidity risk, the inability to honor all cash payment commitments as they fall due, is not usually a major concern for MFIs in their early years because they work primarily with equity and long-term loans. However, this situation changes as they grow into regulated financial intermediaries that provide many products. Even when long-term finance prevails, there might be a considerable liquidity risk. Sometimes, liquidity problems hit institutions that never believed they would face these risks.

A lack of confidence among larger or strategic depositors is one indicator of a possible liquidity crisis. Serious loan repayment problems; unsound liquidity management; including the mismatch of maturities, high-risk financial investments and market interruptions can lead to a similar crisis. Or, if the MFI issues CDs or other large deposits, the institution is vulnerable to deposit withdrawal if confidence wanes. An MFI can also run into danger when linking funds with one bank. If the bank holding the funds has problems, the MFI’s funds may be blocked or lost. Similarly, while access to a bank line of credit is useful, the bank must be chosen carefully in order to ensure availability of funds when needed.

**Methods for Sound Liquidity Management**

Two methods for facilitating liquidity management involve sound liquidity forecast and planning and sound liquidity monitoring. An MFI looking to protect itself from this type of crisis should closely monitor each of the following:

- loan and deposit transactions
- interest payments on loans for deposits
- cash attrition from loan losses
- operating expenses
- long-term investments
- total change in cash (MFI should know cash inflows and outflows for at least 12 months)

The following three basic liquidity ratios are useful in monitoring particular areas of risk. Be careful to look at these ratios in context (5% might be acceptable in one country, where 30% may be within a good range elsewhere).

- **Cash Position Indicator**: Cash and Deposits Due from Banks/Total Assets
- **Total Deposit Ratio**: Total Customer Deposits/Total Assets
- **Cash Reserve Ratio**: Cash Assets/Savings Accounts
Figure 15: Liquidity Ratios of Selected Financial Institutions:

<table>
<thead>
<tr>
<th>Bolivia 2000</th>
<th>Cash Position</th>
<th>Total Deposit Rate</th>
<th>Cash Reserve Ratio</th>
</tr>
</thead>
<tbody>
<tr>
<td>BancoSol</td>
<td>6.9%</td>
<td>61.5%</td>
<td>23.9%</td>
</tr>
<tr>
<td>Caja Los Andes</td>
<td>7.7%</td>
<td>28.9%</td>
<td>52.7%</td>
</tr>
<tr>
<td>FASSIL</td>
<td>11.1%</td>
<td>79.0%</td>
<td>105.7%</td>
</tr>
<tr>
<td>FIE</td>
<td>16.0%</td>
<td>44.8%</td>
<td>2026.6%</td>
</tr>
<tr>
<td>Coop. Jesus Nazareno</td>
<td>22.1%</td>
<td>82.4%</td>
<td>34.0%</td>
</tr>
<tr>
<td>Coop. Loyola</td>
<td>14.4%</td>
<td>86.0%</td>
<td>48.1%</td>
</tr>
<tr>
<td>Coop. San Roque</td>
<td>7.0%</td>
<td>76.5%</td>
<td>8.7%</td>
</tr>
</tbody>
</table>

In order to understand these ratios, the liability structure of an MFI and whether the ratios are adequate, each MFI must do its own analysis to determine what is adequate.

There are great challenges in liquidity forecast and planning, especially given the potential for unknown economic shocks. Microfinance institutions need to plan for future liquidity crises by building up their own safety nets, identifying outside sources of funds before a liquidity crisis hits, and monitoring key liquidity benchmarks. If the original risk management plan does not succeed, other options may be to scale back the loan portfolio by distinguishing alternative risk categories or to maintain time deposits (which may necessitate increasing rates). An MFI may also improve liquidity by collecting loan receivables, cashing out investments or restructuring the loan portfolio by selecting the strongest borrowers. To avoid these types of actions, it is important that an MFI regularly update the overall liquidity plan and recalculate estimates for ratio targets.

**Interest Rate Risk Management**

Interest rate risk, the risk of declining earnings due to the movement of interest rates, derives from the mismatch of maturities and the varying price of intervals. As maturity mismatches are frequent in MFIs, interest rate risks are more of a concern for those MFIs that operate with market-priced funds. However, even in those cases, many MFIs do not actively use financial instruments to mitigate these risks. Rather they use a passive approach where they try to match the maturities as much as possible.

**Methods to Mitigate Interest Rate Risks**

There are no complete, foolproof solutions to managing interest rate risk. While typical hedging instruments, including swaps and futures, as well as other methods used in traditional banking, may not be appropriate for microfinance institutions, the objectives are still relevant. For example, the objective of futures is to match interest rate sensitive assets with interest-rate sensitive liabilities. For example, excess long-term liabilities would be matched to short-term loans by selling a future equivalent to the overexposure of long-term liabilities or an MFI could purchase a future with a short-term maturity.

**How to Strike a Balance Between Risk Mitigation and Profitability**

There is no perfect balance between risk mitigation and profitability. Mitigating liquidity and interest rate risks is a delicate balancing act. While cash outflow commitments should...
be honored on a daily and ongoing basis, costs of foregone earnings on idle liquidity must be minimized. When closing the interest rate repricing gap, costs must not exceed benefits.

The application of active risk mitigation techniques requires sound management capabilities and a good knowledge of financial markets to prevent risk gambling. From this perspective, it is important to alert MFIs that not all risk mitigating techniques might be appropriate for them in a given moment of time and that accepting and passively managing these risks can ultimately be less risky than engaging in complex risk mitigating strategies.

At the current stage of development, MFIs face less liquidity risks than interest rate and foreign exchange risks. MFIs are strongly exposed to interest rate risks through volatile markets and competitive markets where customers have a choice. It is also the case, however, that many MFIs have excess liquidity, which reduces profitability. Additional liquidity risks also exist in MFIs with long-term liabilities when the depositors do not rollover their long-term deposits or banks do not renew loans.
CONCLUSION:

The following section, “Major Themes Emerging from the Conference,” is based on the comments of Elisabeth Rhyne and David Wright during the closing session of the conference. These comments are drawn from their own attendance of working group sessions as well as the feedback from the conference’s note-takers.

MAJOR THEMES EMERGING FROM THE CONFERENCE

Transformation May Not Always Be Necessary for MFIs to Advance

Since transformation is a long and often painful process (witness the experiences of K-Rep Bank and BRAC Bank), some working group sessions discussed that it may be sufficient for an MFI to become commercially minded and accept commercial goals instead of going through the formal transformation process. Because many transformed institutions have seen great success, transformation is often thought of as a given. But if the purposes and goals of an institution do not point towards transformation as a necessary part of the institution’s evolution, it may be possible to act more like a commercial institution without actually becoming one.

On the other hand, transformation has not taken place as often as it might because the donors continue to supply funds, thus reducing the need to transform. Nevertheless, donors remain important, because the field is not yet ready for a complete transition to private investors. Until it becomes viable for donors to leave the field, they must be more imaginative, disciplined, and hands-off in the transformation stage than they have been. Moving from donor money to full commercial money represents a great leap in style and discipline. One interesting development over the past few years has been the emergence of strategic partners and strategic investors who have helped MFIs move forward.

A Different Ownership Mix is Emerging

In the ownership mix of transformed MFIs, a percentage of control will be held by the originating NGO, the strategic partners, and some local investors. Even employee ownership is an option. Sometimes, instead of direct ownership, NGOs spin off a private entity that invests into the transformed MFI. This practice can help rid the institution of any remnants of donor funds, which rest with the NGO and would otherwise distort the equity of the transformed MFI. In the transformation discussions, there remains a lot of discomfort surrounding ownership changes, particularly when private sector owners enter the mix. Commercialization in a fundamental sense includes private sector owners, but microfinance players are not always sure of how deeply they want to be involved with private sector owners.
An Enabling Environment for Banking Regulation is Crucial to the Development of the Field

Currently, there is no internationally recognized model for regulation and supervision of microfinance institution. Instead, within various countries, there are different levels of regulation and supervision according to the particular MFI. Through experimentation, we are finding that players other than the superintendency of banks can in special cases be the regulators and supervisors. One issue that is rarely discussed, however, is the question of who exercises sanctions if a government contracts out the supervisory role to another body.

Depending on the environment, the solution does not necessarily lie in creating special regulatory categories for microfinance institutions. Instead, the solution to regulatory supervision should be worked out on a country by country basis through dialogue between the different parties involved. In creating appropriate regulatory frameworks, it is important for supervisory authorities to learn more about microfinance.

The Need for Client-Responsive Products is Growing

Microfinance institutions and the field in general have developed a better understanding of the informal sector household, how the enterprise and household fit together, and how financial services support risk management in the household. MFIs are currently moving from the recognition of the need to understand clients better to the implementation of market research tools. A variety of experiments are going on; the question is which will provide worthwhile results, and how MFIs can act on them.

A discussion is developing on new product development that follows from the diversity of client needs. A year or two years ago, there was a surge in new product development as MFIs developed products for each client need, leading to product proliferation. Now there is a more balanced approach: more flexible products may be as important as new products because one flexible product can serve a variety of needs. In a competitive environment, savings, money transfers, and insurance are important products. MFIs have taken a bit longer to develop these products because they require different skills and techniques than their familiar credit products.

Automation of Microfinance is Taking Hold

The efficiency that automation may bring could be the answer to reaching out into areas that otherwise could not be served and reducing cost. MFIs that are experimenting with some of the most promising technologies do not yet have enough experience to prove that a greater level of productivity that can be achieved with the new technologies. And, an MIS bottleneck is stemming from the fact that new technologies must interface with MIS. This may prove a stubborn obstacle. However, examples of new technologies such as the Palm Pilot and smart cards are beginning to show promise.

The Microfinance Industry Is Becoming More Business-Like and Professional

The industry is now bigger, broader, and more diverse than ever before. This more diverse and complex industry has become more demanding, requiring a level of competence that was not required a few years back. Competition has driven this requirement, and the challenges competition poses to microfinance competency run deep.
The Need for MFIs to Sustain Crises

Increasingly, the world is facing a variety of crises, from earthquakes in El Salvador to political meltdown in Indonesia. MFIs must be able to sustain themselves through such events.

Transformed MFIs Must Not Lose Sight of Their Social Mission

Several players have witnessed a strong temptation for MFIs to weaken their social mission. Some ways to avoid this push are to adopt credit union status, to separate the NGO into two separate financial and social organizations, or to develop new products to reach down to the poorest section of the population. BRAC, for example, supports enterprises that provide employment for very poor people.

The Microfinance Industry Needs to Engage with a Wide Range of Actors

Over the course of the conference, it became obvious that in order to fulfill its ultimate mission of bringing financial services to the world’s poor on a permanent basis, the industry as a whole needs to engage in dialogue with commercial banks, regulatory authorities, market researchers, software companies, insurance companies, health providers, and the world of investors. It is up to the microfinance industry to bridge the understanding gap before it is able to reach its fullest potential.
APPENDIX A – CONFERENCE SPEAKERS/PRESENTERS

“Challenges to Microfinance Commercialization” Conference

June 4-6, 2001
List of Speakers/Presenters
Challenges to Microfinance Commercialization
June 4-6, 2001  Washington, DC

Plenary Presenters

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"Challenges to Microfinance Commercialization” Conference
June 4-6, 2001
List of Speaker/Presenter Biographies

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June 4-6, 2001   Washington, DC

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CEO and Founder
Swayam Krishi Sangam

Vikram Byanna Akula is the CEO and founder of Swayam Krishi Sangam (self-help society), a Grameen Bank Replication Project in one of the poorest parts of India. Swayam Krishi Sangam (SKS) was recently awarded the CGAP Pro-Poor Innovation Challenge Award for its Smart Card Initiative, which uses Smart Cards to improve microfinance delivery. Mr. Akula has spent several years working and researching microfinance and rural development. He has worked as a community organizer with the Deccan Development Society in India and as a researcher with the Worldwatch Institute, a policy institute in Washington, D.C. He holds an MA from Yale and is completing a Ph.D. in Political Science at the University of Chicago. Mr. Akula was a Fulbright Scholar in India and was awarded the Echoing Green Public Service Entrepreneur Fellowship for his work with SKS.

Wayan Alit Antara
Director
Bank Rakyat Indonesia

Wayan Alit Antara is currently the Director of Bank Rakyat Indonesia (BRI), the world’s largest microfinance institution. Mr. Antara first joined BRI as a career banker in 1976, after graduating form the University Gadjah Mada (UGM) Yogyakarta with a major in Agricultural Economy. Before being promoted to Director, he held several senior positions including General Manager, Treasury at the BRI Head Office in Jakarta, Deputy General Manager, and Commissioner of PT. Inter Pacific Securities.

Pierre-Marie Boisson
Chairman of the Board, Chief Economist
Sogesol, Sogebank

Pierre Marie Boisson is currently Chairman, Chief Economist and member of the Executive Committee of the Board of Société Generale Haitienne de Banque (SOGEBANK). Mr. Boisson is also Chairman of the Board for Societe Generale de Solidarite (SOGESOL), a recently established microcredit organization. In his capacity as Chief Economist of SOGEBANK, Mr. Boisson is responsible for strategic planning, management, and financial counseling for the whole group. He also serves as Secretary of the Board of SOFIHDES, a private development finance corporation, and Treasurer of the Board for Union School, an overseas American School in Haiti. Before joining SOGEBANK in 1991, Mr. Boisson led a USAID-sponsored reorganization assignment of Haiti’s Professional Bankers’ Association in 1990. He is a former staff member of the World Bank’s International Finance Corporation (IFC) where he spent two years (1988-1990). Additionally, he has worked for a total of nine years for Haitian public organizations, including four years as a member of the finance minister’s cabinet. He holds an MPA from Harvard University (1988), an MSM from Arthur D. Little Management Education Institute (1987), and a BS in civil engineering from the University of Haiti’s Faculté des Sciences (1975).
Monica Lynne Brand
Senior Director, Research and Development
ACCION International

Monica Brand conducts research in microfinance on product development, marketing and business process re-engineering. This research informs the on-site technical assistance that Ms. Brand carries out, which includes the design and launch of new products, and marketing plan development for ACCION’s affiliates. Before joining ACCION in 1997, Ms. Brand worked for the Development Fund in San Francisco, helping design a $50 million statewide lending intermediary to finance small business and community facilities. She also has experience as a loan officer for an environmental fund and as a business trainer for the Women’s Initiative for Self-Employment (WISE), instructing low-income female microentrepreneurs. Ms. Brand’s professional experience also includes work in Cape Town, South Africa, where she founded an entrepreneurial training organization for small- and medium-sized business owners. Among the works Ms. Brand has authored include ACCION’s monograph, Maximizing Efficiency: The Path to Enhanced Outreach and Sustainability. Ms. Brand holds both a MBA and a Master's of Education from Stanford University.

Warren Brown
Director of Research and Development
ACCION International

Warren Brown joined ACCION in 2000, after working at Calmeadow since 1999, where he researched MFIs in disaster situations and completed extensive work in microinsurance, especially in Africa. At ACCION, Mr. Brown’s work focuses on new product development, as well as in managing the development of a loan product for housing and building improvements in El Salvador and the Dominican Republic. Prior to his work in microfinance, Mr. Brown worked in the field of corporate strategic consulting with Monitor Company, an international consultant firm. Mr. Brown is from Canada and holds a degree of Business Administration from the Richard Ivey School of Business in Ontario, Canada.

Juan Buchenau Hoth
Agricultural Microfinance Expert
Frontier Financial International

After finishing studies in agriculture and economics at the University of Hohenheim in Germany, Mr. Buchenau spent seven years as the leader of a German-sponsored project in Mexico that created and consolidated a regional rural co-operative. After a short period as an independent consultant, he carried out a number of assignments for Internationale Projekt Consult (IPC) and in 1991 became a permanent member of IPC’s staff. In 1992, he was appointed long-term adviser to AMPES—an association of medium and small enterprises in El Salvador—where he led a team that designed, established and operated a rural credit unit. He also played a major role in the transformation of the AMPES Credit Service into Financiera Calpiá, a formal financial institution. From 1995 until 1999, Mr. Buchenau coordinated the efforts of Caja Los Andes in Bolivia to expand its financial services in rural areas. He designed and implemented products and procedures adequate to rural enterprises. Seconded to Frontier Finance International (FFI), IPC’s Washington based affiliate, in 1999 Mr. Buchenau directed various initiatives, including a countrywide program designed to improve the supply of housing credit to low-income households in Ecuador and the coordination of country studies of rural financial markets in Latin America and in Uganda.

Carlos Eduardo Castello
Senior Vice President, Latin American Operations
ACCION International

Carlos Castello has directed the department of Latin American operations for ACCION International since 1995, first as vice president and since January 1999 as senior vice president. He is responsible for the management and coordination of ACCION’s technical assistance to its 20 Latin American affiliates and partner institutions. Mr. Castello supervises the work of teams of microfinance specialists who provide assistance in credit technology, organizational development, business planning, financial
management, management information systems, development of new financial products and branch expansion strategies. He is also responsible for the development of new microenterprise initiatives in the region. Prior to his move to ACCION’s Somerville headquarters, Mr. Castello worked in Bogota, Colombia from 1992 to 1994 as the director of ACCION’s regional technical assistance hub, Centro ACCION. Mr. Castello’s extensive experience in microfinance includes his work from 1985-1992 as ACCION’s director for operations in Colombia and as executive director of the Association of Solidarity Group Programs of Colombia. A native of Colombia, Carlos Castello holds a MS in economics and development and a MS with distinction in foreign service from Georgetown University. He graduated from Union College with a BA in international administration.

Michael Chu  
Managing Director and Founding Partner  
Pegasus Venture Capital  

Michael Chu is the managing director and founding partner of Pegasus Venture Capital, an investment firm dedicated to the deployment of venture capital in the Latin marketplace. From 1994 -1999, Mr. Chu served as President & CEO of ACCION International, which he joined in 1993, upon his early retirement from the investment firm of Kohlberg Kravis Roberts & Co. (KKR). At KKR, Mr. Chu was an executive and limited partner in the New York office. Mr. Chu’s extensive private sector experience includes senior management positions with Corn Products Company in Uruguay, Boston Consulting Group, City Investing Company, Printing Finance Company and PACE Industries. Mr. Chu has served on various boards, including ACCION International and the Calvert Foundation. Mr. Chu was President of the board of BancoSol from 1997 to March 2001, and served on the boards of several other microfinance institutions. Mr. Chu also currently serves on the boards of various private companies. He is a member of both the Harvard Business School’s Latin America Advisory Committee and its Initiative on Social Enterprise Advisory Board. He has been awarded a D.B.A. honoris causa from Bryant College. Mr. Chu, a native of Kunming, China, grew up in Montevideo, Uruguay. He holds a BA degree with honors from Dartmouth College and an MBA with high distinction from the Harvard Business School.

Craig F. Churchill  
Social Finance Unit Advisor  
International Labour Organization  

Craig Churchill is currently based in Geneva working at the International Labour Organization’s Social Finance Unit. Previously, he was the Director of Research and Policy at Calmeadow, where he oversaw various research initiatives, including editing the MicroBanking Bulletin. Prior to joining Calmeadow, Mr. Churchill was the Coordinator of the MicroFinance Network, a global association of leading microfinance practitioners. His microfinance experience also includes working for Get Ahead Financial Services in South Africa and ACCION International. He has authored or edited over 20 publications, including “Building Customer Loyalty” with Sahra Halpern (MicroFinance Network 2001), “Insurance Provision in Low-Income Communities” (Parts I and II) with Warren Brown (Microenterprise Best Practices, 1999 & 2000); Client-Focused Lending: The Art of Individual Microlending (Calmeadow, 1999), and “The Organizational Architecture of Microfinance Institutions” (Microenterprise Best Practices, 1997).

Monique Cohen  
Senior Technical Advisor  
Office of Microenterprise Development, USAID  

Monique Cohen is a senior technical advisor in the Office of Microenterprise Development at USAID. She is responsible for the design and management of USAID’s AIMS (Assessing the Impact of Microenterprise Services) Project. Her responsibilities also include the direction of the Office's initiatives on poverty and microfinance. She is co-chair of the CGAP Working Group on Impact Assessment. She coordinated and co-authored a microfinance contribution to the World Bank’s World Development Report 2001 on Poverty, “Microfinance, Risk Management and Poverty.” Previously, Ms. Cohen worked in USAID’s Office of Housing and Urban programs, both in Washington and in the
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regional office for the Near East based in Tunis. She has consulted with both international donor agencies, foundations and NGOs. She has a Ph.D. from Clark University.

**Martin Connell**
*President*
*Calmeadow and ProFund*

Martin Connell is co-founder of Calmeadow, a Canadian based NGO that focuses on microfinance. He has personally been active in the microfinance sector and has served as a member of the boards of Prodem, BancoSol, ACCION, CGAP(PAG), and ProFund. He is currently President of Calmeadow and ProFund, and Chair of the Steering Committee for AfriCap (a $15,000,000 investment fund being developed to invest in leading African M.F.I.’s). Mr. Connell is a member of the MicroFinance Network Steering Committee.

**Rosalind Copisarow**
*Founder*
*Fundusz Mikro and Street UK*

Rosalind Copisarow established Fundusz Mikro, a nationwide microfinance institution in Poland. In the five years since its inception (in 1994), Fundusz Mikro has made 30,000 loans, disbursed $45 million, opened branches in 33 cities and currently employs 94 people. In 1997, Fundusz Mikro became a member of the Microfinance Network, a network of 23 leading microfinance institutions of the world and in October 1999, the company was awarded a special prize by the US Government, presented by the First Lady, Hillary Rodham Clinton. In September 2000, Rosalind was awarded the Officer's Cross of the Order of Merit by the President of Poland for her contribution to the economic development of the country. Rosalind also serves on the Policy Advisory Group of CGAP (the Consultative Group for Assistance to the Poorest). Previously she co-founded the Microfinance Centre for Central and Eastern Europe, a network organization to support the mutual learning of practitioners in the region. Most recently, Ms. Copisarow has established Street (UK) to serve the poor and financially excluded microentrepreneurs of the UK.

**Carlos Danel**
*Co-Executive Director*
*Financiera Compartamos*

Carlos Danel is the Co-Executive Director of Financiera Compartamos, a privately owned and regulated Microfinance Institution working in the rural areas of Mexico. Compartamos currently serves 75,000 low-income clients in seven regions of the country with working capital loans that average $200. Mr. Danel is also a member of the faculty at the Microfinance Training Program sponsored by the World Bank and has participated in numerous forums and workshops on microfinance, financial management and planning. Before joining Compartamos, Mr. Danel was involved with social housing development and financing in Mexico City.

**Nabil A. El Shami**
*Executive Director*
*Alexandria Business Association (ABA)*
*Small & Micro Enterprise Project*

Mr. El Shami has more than twelve years experience in the promotion and development of small businesses and microenterprises in Egypt and Arab countries. He is the executive director of Alexandria Business Association (ABA) Small & Micro Enterprise Project. He has undertaken assignments for USAID, the UNDP, and the World Bank to participate as a resource person in seminars and training workshops on microcredit and finance. He assisted in the establishment of new microenterprise foundations in Egypt by providing technical assistance and training. He also provided services in all areas of microcredit and finance to institutions and NGOs in Egypt and Arab countries. In May 1998, he was elected to become a member of CGAP’s Policy Advisory Group. Mr. El Shami is also a member of the Steering Committee of the Microfinance Network.
Stefan Harpe
*Investment Manager*
*AfriCap*

Stefan Harpe joined Calmeadow in 1995 and was, until recently, Director of International Operations. Mr. Harpe is currently the Investment Manager of the AfriCap Fund, a specialized investment fund for microfinance institutions in Africa. During his work, he has provided strategic advice to microfinance organizations and implemented the investment activities of ProFund, a $21 million venture fund for commercial microfinance institutions in Latin America. Prior to joining Calmeadow, Mr. Harpe worked as a special assistant in the Minister’s Office of Economic Development and Trade, where he was responsible for policy advice to the minister. He also worked as the Vice President of Corporate Finance for Scotia McLeod. Mr. Harpe spent a year in Paris at the OECD Development Centre working on macro-economic policies in low income countries, particularly in sub-Saharan Africa. He received an MBA from the University of Western Ontario and a Bachelors of Science from the London School of Economics.

Mónica Hernández de Phillips
*Executive Vice President and Founder*
*Banco Solidario, Ecuador*

Mónica Hernández de Phillips is currently the Executive Vice President of Banco Solidario S.A. in Ecuador, a leading microfinance institution in the country. Prior to her work at Banco Solidario, Ms. Hernández de Phillips was executive director and founder of the Fundación Alternatives para el Desarrollo (Ecuador). She has fifteen years of experience in social development institutions, health management programs, and social interest and planning projects. Additionally, she is an initiator and promoter of projects and programs oriented to low-income populations.

Pedro J. Jimenez
*Former Executive Vice President*
*BANCOADEMI*

Mr. Jimenez currently works as an independent consultant. Most recently he was the Executive Vice President of BANCOADEMI, heading the microfinance organization ADEMI / BANCOADEMI since its beginning in 1983. Mr. Jimenez established the first two industrial free zones in the Dominican Republic and has been General Manager of several private firms prior to joining ADEMI. He has also held academic and public sector positions in the Dominican Republic. Through his association with ADEMI, he has worked as a consultant for development organizations for countries in Africa and Latin America, sponsored by the World Bank, the IDB and USAID. He holds a BS in Agricultural Economics and Administration from Texas A&M University.

Kurt Koenigfest
*General Manager*
*Banco Solidario, Bolivia*

Mr. Koenigfest has served as General Manager of Banco Solidario (BancoSol) since May 2000. Prior to this position, he held several positions at the Banco Nacional of Bolivia, including Commercial Vice President, Product Design National Manager, Product and Services National Manager and Credit Card National Manager. Mr. Koenigfest worked at the Banco de La Paz from 1989 to 1992 as Credit Card National Assistant Manager. Mr. Koenigfest has a B.S. in Business Administration from the University of North Texas.
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Carlos Labarthe Costas  
*General Director*  
*Financiera Compartamos SA*

Carlos Labarthe is General Director of Financiera Compartamos SA, a Mexican regulated microfinance institute that has almost 75,000 active clients. Mr. Labarthe oversees operations, strategic planning and human resources. Mr. Labarthe was previously director general for Asociación Programa Compartamos. He has presented at several fora on microfinance on a variety of topics in microfinance. He is a member of CGAP’s Policy Advisory Group (PAG). Mr. Labarthe studied Industrial Engineering at the Universidad Anáhuac (Mexico) and he has been trained in microfinance at the Economics Institute in Boulder, Colorado. Additionally, Mr. Labarthe is a member of the Steering Committee of the MicroFinance Network.

Francisco Madrid  
*General Manager*  
*Financiera Solidaria S.A., FinSol*

Francisco Madrid is the General Manager of Financiera Solidaria S.A. (FinSol), the first regulated microfinance institution in Honduras. Previously, he was the executive director of the non-profit organization, the National Foundation for the Development of Honduras (FUNADEH) from which FinSol was created. Mr. Madrid led the executive team that transformed FUNADEH from an NGO into a regulated financial institution. Mr. Madrid received a degree in industrial engineering and systems from Louisiana State University, and he has a postgraduate diploma in financial management from the Maastricht School of Management (Belgium).

Michael J. McCord  
*Senior Technical Advisor*  
*MicroSave-Africa*

Michael J. McCord is a Senior Technical Advisor to MicroSave-Africa, which promotes practical expansion and improvement of MFI and financial institution products and services for the poor through a controlled and demand led process. In his position with MicroSave-Africa, he focuses on the areas of new product development and microinsurance. He co-facilitated the USAID/MBP virtual conference on MicroInsurance, and is developing the MicroInsurance Center. He has also worked with CGAP in the development of their virtual MFI External Audit Information Center. Prior to this, he was FINCA International’s Regional Director for Africa for two years. He also worked for five years as FINCA Uganda’s chief executive; in this capacity, he developed a marketing culture and improved, developed and introduced several new products, including a group personal accident insurance and comprehensive health insurance. Before that, he was a banking executive for six years in the United States. He has written on various subjects including the function of laws, MFI accounting and analysis, pilot testing of MFI savings products, and microinsurance. His special fields of expertise include MFI institutional development, microinsurance, MFI audit, and new product development.

Gavin McGillivray  
*Senior Financial Advisor*  
*Department for International Development (DFID)*

Gavin McGillivray, Senior Financial Advisor at DFID, is currently working on the Financial Deepening Challenge Fund, which encourages initiatives from financial institutions in developing countries and the UK to develop profitable financial services accessible and beneficial to the poor. Mr. McGillivray previously worked in development finance in Latin America. In addition he has private sector experience working for an investment bank.
Carlos I. Membreño
Field Consultant
ACCION International

Mr. Membreño joined ACCION International in 1997 as Project Resident in Managua, Nicaragua, where he provided technical support to ACCION’s affiliate, FAMA. Since 1999, Mr. Membreño has worked as an ACCION Field Consultant with PalmPilots. In May 2000, he became the team leader and designer of Palm applications, and has overseen implementation of PalmPilots at Banco Solidario (Ecuador), BanGente (Venezuela), Finámerica (Colombia), and Compartamos (Mexico). Mr. Membreño has also participated actively in evaluations for MIS for microfinance institutions. He is an Industrial Engineer from UACA (Costa Rica) and studied Computer Sciences at George Brown College in Canada.

Tomas Miller Sanabria
Investment Officer
Multilateral Investment Fund, Inter-American Development Bank

Mr. Sanabria currently works as investment officer in the equity unit of the Multilateral Investment Fund (MIF) at the Inter-American Development Bank in Washington, D.C. Previously, he worked as an executive at the Corporación Andina de Fomento (CAF) in Caracas, Venezuela; in the Stadivm Generale College; and in the brokerage house, Inversiones Sama, in Costa Rica. Mr. Sanabria is a member of the Academy of Central America. He holds a Ph.D. (1996) in Agricultural and Resource Economics from Colorado State University, an MBA (1986) from University of Dallas and a BA (1984) from the Autonomous University of Central America.

Manuel Montoya
General Manager
MiBanco

Manuel Montoya is the General Manager and a member of the board of directors of MiBanco, the first private microfinance bank created in 1998 and specializing in serving small businesses and microenterprises in Peru. Mr. Montoya has thirty-three years of experience in the business and social sectors. He is one of the founders and has served as Executive Director of ACCION Comunitaria of Peru, the primary shareholder of MiBanco. Mr. Montoya led the transformation of ACCION Comunitaria of Peru from an NGO to a financial institution. He also has participated actively in national and international organizations that support the emerging sectors. He is a member of the board of directors of Private Agencies Collaborating Together, and serves on the Committee of Directors of the ACCION Network as well as on the Advisory Committee of the Americas Foundation of Development (SOLIDARIOS). Mr. Montoya is a representative of the Consultative Group of NGOs in the World Bank, represents MiBanco in the MicroFinance Network, and in the Global Network for Banking Innovations in Microfinance. Mr. Montoya was born in Lima, Peru, and studied business administration at the University of Pennsylvania and the University of Lima.

Ms. Inez Murray
Organizational Strategy and Effectiveness Coordinator
Women’s World Banking

Ms. Murray is the Women’s World Banking (WWB) Organizational Strategy and Effectiveness Coordinator. Working with regional teams, she coordinates the delivery of technical services related to competitive strategy and organizational change. Ms. Murray is also leading an innovative initiative in the area of business development services. Before joining WWB, Ms. Murray worked as a senior consultant in the strategy practice of Booz, Allen and Hamilton in New York, and as a business analyst for Management Horizons, a management consulting company based in London. She has also worked on short term consultancies for various NGOs including conducting a program evaluation of Trickle Up in Calcutta and developing for-profit businesses for Puntos De Encuentro in Managua. Ms. Murray has a Masters in International Affairs from Columbia University where she specialized in Economic and Political Development and an MA in Economics and Business Studies from Trinity College, Dublin.
Kimanthi Mutua  
*Founder and Managing Director*  
*K-Rep Bank*  
Mr. Mutua is the founder and the Managing Director of K-Rep Bank, the first microfinance bank in Kenya and a globally acclaimed leading microfinance institution. A co-founder member of the K-Rep Group, he has devoted close to two decades in designing, developing and running viable micro-finance institutions. He serves as a member of boards and is advisor to several national and international institutions, including a former member of the Steering Committee of the Microfinance Network, and former chair of the CGAP Policy Advisory Group (PAG).

Maria Otero  
*President & CEO*  
*ACCIION International*  
Maria Otero is President and CEO of ACCION International. She was previously ACCION’s Executive Vice President, from 1993-1999. Ms. Otero joined ACCION in 1986 as director of its microfinance program in Honduras. Ms. Otero has authored several monographs on microfinance and co-edited *The New World of Microfinance*. She serves as chair of the Steering Committee of the MicroFinance Network, co-chair of the Microenterprise Coalition, and has served in a variety of advisory and board positions, including the Policy Advisory Group of CGAP. In 1994, President Clinton appointed Ms. Otero as chair of the Board of Directors of the Inter-American Foundation, a position she held until December 1999. Ms. Otero currently sits on the board of several institutions including the Calvert Foundation, the United States Institute of Peace, and the Advisory Board of the United States General Accounting Office. She also serves on the board of BancoSol and Mibanco. Since 1997, Ms. Otero has been an adjunct professor at John Hopkins School for Advanced International Studies. She received a Masters in International Studies from Johns Hopkins SAIS and a Masters in Literature from the University of Maryland. Ms. Otero was born and raised in La Paz, Bolivia, and resides in Washington, DC.

Pilar Ramirez  
*President*  
*FIE*  
Pilar Ramirez is one of the founders the Bolivian NGO, FIE. FIE is the pioneering institution that works with microcredit in urban areas of Bolivia. After institutional growth in outreach and full sustainability, FIE formed a limited liability company, the FIE Private Investment Fund, which opened in March, 1998, and on which Ms. Ramirez has served as the Board President since its beginning. A psychologist by training, Ms. Ramirez has a Master of Arts in Psychology from the New School for Social Research in New York City and a Master in Public Administration from Harvard University. In 2000, she was selected for the IDB’s Social Entrepreneur for Latin America award. She is currently the Chair of the CGAP’s Policy Advisory Group (PAG).

Alvaro P. Retamales Contreras  
*Director General*  
*Bandesarrollo Microempresas S.A., Chile*  
Alvaro P. Retamales Contreras has served as the Director General of Bandesarrollo Microempresas S.A. in Chile since 1997. Prior to this post, he was director general at Financiera Acceso S.A. in Bolivia. Mr. Retamales also worked for the deputy director of Finances for Grupo Mellafe y Salas and for Banco O’Higgins in several positions. Mr. Retamales is currently completing his MBA at the Universidad Adolfo Ibañez. He holds both a diploma in Poverty Reduction Strategies in Latin America and a BA in Industrial Engineering from the Universidad de Chile.
Elisabeth Rhyne
Senior Vice President, Research, Development & Policy
ACCION International

Elisabeth Rhyne joined ACCION International in October 2001 as senior vice president, managing its Research, Development and Policy Department. Ms. Rhyne directs ACCION’s research efforts to develop new financial products for the poor, including rural lending products, housing credit and microinsurance. She also directs ACCION’s initiative to launch activities in sub-Saharan Africa, and its work in four African countries. Ms. Rhyne has published numerous articles and books on the topic of microfinance. She is also co-editor of The New World of Microenterprise Finance. Her new book, Mainstreaming Microfinance: How Lending to the Poor Began, Grew and Came of Age in Bolivia, was released by Kumarian Press in May 2001. Ms. Rhyne's experience in microfinance includes her work as Director of the Office of Microenterprise Development at the U.S. Agency for International Development (USAID) from 1994 to 1998, where she was key in developing USAID’s policy towards microenterprise development, and developed and managed USAID’s microenterprise program. Projects developed under her guidance include Microenterprise Best Practices, the USAID Implementation Grant Program, the PRIME fund, and the AIMS Project. From 1989 to 1993, she designed and coordinated USAID's GEMINI project, a microfinance research initiative responsible for publishing over 100 titles on microenterprise best practices. Prior to joining ACCION, she worked as an independent microfinance consultant based in Mozambique. Ms. Rhyne's consulting assignments have included advising several government banks on microfinance policy, as well as conducting diagnostic assessments and business planning for more than 10 microfinance institutions. Ms. Rhyne earned a MA and Ph.D. in public policy from Stanford University.

David C. Richardson
Senior Manager of Technical Development
World Council of Credit Unions

David C. Richardson is the Senior Manager of Technical Development at the World Council of Credit Unions (WOCCU). In this capacity, he is responsible for the development and integration of new technical products and services to improve credit union financial management and supervision. Additionally, he participates as a member of the WOCCU Corporate Management team, which provides corporate direction in all technically related matters. Mr. Richardson has worked at WOCCU since 1987 and in two other positions: Senior Technical Advisor (1994-1998) and Chief Financial Advisor (1987-1994). Prior to these this, he worked as the Agricultural Investment Director at the Mutual Life Insurance Company of New York. Mr. Richardson has published extensively for the Model Credit Union Development Monograph series. He received his BS from Brigham Young University and his MA in Agri-Banking and Business Management from Texas A&M University.

Marguerite S. Robinson
Fellow Emeritus
Harvard Institute for International Development

Marguerite S. Robinson, holds a Ph.D. in social anthropology from Harvard University, and is an Institute Fellow Emeritus of the Harvard Institute for International Development, where she worked from 1978-2000. She has conducted extensive fieldwork in Latin America and Africa. Beginning in 1970, Dr. Robinson served as a long-term advisor the Ministry of Finance, Government of Indonesia, and to Bank Rakyat Indonesia (BRI) on the development of the BRI’s microbanking system. She has also advised many governments, financial institutions, and donor agencies on the development of sustainable microfinance and is the author of books and papers on social and economic development. Her forthcoming three-volume book, The Microfinance Revolution, explores the demand for microfinance and the history, theories, controversies, and practices of the financial systems approach to commercial microfinance in countries and institutions around the world.
Mrs. Rulianti  
*General Manager of the Micro Division*  
*BRI*

Mrs. Rulianti has been at BRI since 1981. She became deputy manager of their Micro Division in 1988, Manager of the Micro Division in 1991, and since 1999 has served in her current position as general manager of the Micro Division. Mrs. Rulianti is an agricultural engineer and has taken several courses in microfinance including Rural Financial Markets, Financial Information Systems for Management, and the Implications of Financial Crisis and Microfinance Institutions.

Gabriel Schor  
*Managing Director*  
*IPC*

After studying economics and sociology at the University of Frankfurt, Dr. Schor worked as a research assistant in the Department of Business Finance at the University of Trier, and obtained his doctorate under the supervision of Dr. R.H. Schmidt. While still a student he worked on a free-lance basis for IPC, carrying out a number of short-term consulting missions dealing with appropriate energy technologies and with institution-building measures in financial markets. Since 1990 he has been a Managing Director of IPC with overall responsibility for several projects in Latin America focusing on the design of state interventions intended to enhance the efficiency of rural and urban financial markets. Recently, he has broadened the scope of his activities to include the evaluation and design of projects in the sphere of education and training. In particular he has played a prominent role in the creation of training voucher schemes designed to raise the level of skills among microentrepreneurs and other low-income target groups in a number of Latin American countries.

Alex Silva  
*Executive Director*  
*Profund S.A.*

Mr. Silva has served as the executive director of Profund S.A. in Costa Rica since 1994. Previously, he worked as the Central American Representative and senior investment officer for the Inter-American Investment Corporation. Mr. Silva has over 20 years of experience in international finance with particular expertise in the areas of financial engineering, evaluation of financial intermediaries, strategic planning and corporate finance. Mr. Silva raised $22 million for the world’s first venture capital fund specializing in financial institutions serving small business and microenterprise, and he has coordinated the evaluation, financial structuring and documentation of a portfolio of Latin American investment projects totaling about $250 million. Mr. Silva is a member of the Board of Directors of seven microfinance institutions located in Mexico, Nicaragua, Venezuela, Colombia, Paraguay, Ecuador, Peru and Bolivia. He is also a member of CGAP’s Policy Advisory Group and teaches at the Economics Institute in Boulder, Colorado. Mr. Silva has an MBA from Cornell University and a diploma in Business Administration from the Université de Louvain in Belgium. He received a Bachelors of Science in Industrial Engineering from Cornell University.

Imam Sukarno  
*Director of Banking Licensing and Banking Information*  
*Bank Indonesia*

Imam Sukarno has been with the Bank of Indonesia since 1975. He has served there in several capacities, including Director of Rural Banking Supervision and in his current position as Director of Banking Licensing and Banking Information. Mr. Sukarno has been lecturing at the Indonesian Banking Institute since 1986 and has given middle management and senior executive courses. He has also spoken at various seminars including the Microfinance Development Seminar (Frankfurt, 1999), the Pacific Micro Development Seminar (Manila, 2000), and the APPRACA Seminars (Thailand, Malaysia, China, South Korea and Germany, 1988-1995). Mr. Sukarno received a Masters in Management from the Asian Institute of Management in Manila.
Witold Szwajkowski  
**CEO**  
Fundusz Mikro

Mr. Szwajkowski is CEO of Fundusz Mikro in Warsaw, Poland. He has been with the organization since 1995 and served as CEO since 1998. In his current position he is responsible for new product development. Previously, from 1990 to 1992, Mr. Szwajkowski worked for the Polish Development Bank as credit director and for the Polish Privatization Company, Kleinwort Benson, as a portfolio manager. In this capacity, he served one of the fund managers who facilitated the mass privatization program in Poland. Mr. Szwajkowski received his Masters degree of mechanical engineering from the Warsaw University of Technology.

Jacques Trigo Loubiere  
**Senior Fellow for Policy**  
ACCION International

Jacques Trigo Loubiere joined ACCION International as Senior Fellow for Policy in March 2001. In this capacity, Mr. Trigo Loubiere leads ACCION’s work with Latin American and African bank superintendencies and regulatory agencies, advising them on effective banking, monetary and financial policies to supervise and support microfinance institutions. Prior to his position at ACCION, Mr. Trigo served from 1995 to 2001 as Bolivia’s Superintendent of Banks and Financial Entities, where he led the regulatory effort to formalize microfinance institutions. As an ex-regulator, Mr. Trigo is the leading expert on the supervision and regulation of microfinance. He worked for the Inter-American Development Bank as Executive Director for Uruguay, Paraguay, and Bolivia and as Chief of the IDB’s Country Economic Analysis Unit. Mr. Trigo Loubiere has held several other positions within the government of Bolivia, including president of the Central Bank. Mr. Trigo Loubiere earned a Masters degree in economics from the Universite de la Sorbonne in France. He holds a Bachelors degree in economic science from the Universidad Mackenzie in Brazil. Mr. Trigo Loubiere resides in La Paz, Bolivia.

Lisa Valenzuela  
**Deputy Director**  
Office of Microenterprise Development, USAID

Lisa Valenzuela works as the Deputy Director of USAID. This office is the technical center for microenterprise activities in USAID and implements the Agency's Microenterprise Initiative. Ms. Valenzuela also manages the Microenterprise Implementation Grant Program (IGP), an annual competitive grant program aimed at increasing the scale and sustainability of microenterprise finance efforts in developing countries. Ms. Valenzuela has worked for over 15 years in micro and small business development, both in the United States and overseas. She joined USAID in 1988, and has served in Bolivia and Honduras. In both countries, she supported microfinance institutions and credit unions, and their regulatory framework. Prior to joining USAID, she worked with a U.S.-based private voluntary organization, designing microenterprise programs in the Central America region. In the early 1980's, she worked in the small business departments of two Community Development Corporations in California. Ms. Valenzuela received an MS from Georgetown University and a BA from Duke University.

Sylvia Wisniwski  
**Founder and Head**  
Bankakademie, Micro Banking Competence Center

Sylvia Wisniwski is head of Bankakademie International, the international consultancy of Germany’s bank training and qualification institute Bankakademie. She is the founder of the Micro Banking Competence Center, and has been head of the Center since its inception in October 1999. Before joining Bankakademie, she was one of the project managers in the section Financial Systems Development and Banking Services at the headquarters of the German Technical Cooperation (GTZ). In this position, she was responsible for projects in Asia and East Africa. She has worked for more than seven years as an
independent consultant for various donor agencies, providing technical assistance, support in project design, and monitoring and training to microfinance institutions in Latin America, Central and Southeast Asia and East Africa. Her special fields of expertise include rural and agricultural finance, savings mobilization, and risk and liquidity management in microfinance institutions.

David Wright
Independent Consultant in Medium, Small and Microenterprise Development

David Wright, an microfinance independent consultant, previously worked as the Head of the Enterprise Development Department for the United Kingdom’s Department for International Development (DFID). He has extensive experience in microfinance development. Mr. Wright played and important role in the donors’ committee of CGAP (Consultative Group to Assist the Poorest) and has chaired its Executive Committee. He serves as the director of ProFund, an apex finance institution in Latin America, and as Director of a South African NGO, the Small Business Project.

Graham A. N. Wright
Program Director
MicroSave-Africa

Mr. Wright is Program Director for the CGAP/DFID/UNDP funded MicroSave-Africa program, which promotes the development and implementation of high quality financial services for the poor. He has authored several papers, most recently, “MicroFinance Systems: Designing Quality Financial Services for the Poor.” He is currently chair of the CGAP Savings Mobilization Working Group, a member of the CGAP Product Development Taskforce, and a Research Associate at the Institute of Development Policy and Management, University of Manchester, UK. Mr. Wright has provided technical assistance to a variety of microfinance service organizations in Bangladesh, the Philippines, and throughout Africa, including a sustainable rural saving and credit program for BURO, Tangail, in Bangladesh. He also provided long-term technical assistance in a remote mountainous area of the Philippines and has also worked on training, systems design, research and evaluation of both rural and urban financial services for many donors. Mr. Wright previously worked in management consultancy, training and audit with Arthur Andersen & Co. in London and Vienna. He holds a Master of Arts degree in Economics and Psychology.

About the Editors:

Kelly Hattel is the current Director of the MicroFinance Network. Ms. Hattel brings over ten years of private and public sector experience to the Network. This broad experience includes her work on project financing and development for ventures in Southeast Asia and nearly three years spent in West Africa, working in the areas of microenterprise development and microcredit lending. Later, as an independent consultant, she researched and co-authored a UNAIDS/USAID study on the impact of AIDS on microfinance institutions in Africa. Most recently, she worked for a financial consulting firm as senior consultant, where she focused on issues pertaining to the US savings and loan industry. She received a Bachelors degree in International Studies and Law from The American University in Washington, DC and a Masters degree in International Economics with a concentration in Development from the Johns Hopkins University School of Advanced International Studies.

Sahra S. Halpern was Junior Researcher at the MicroFinance Network until July 2001. Her work on publications involved routine contact with the directors and managers of Network member institutions. Ms. Halpern conducted primary research and co-authored Building Customer Loyalty: A Practical Guide for Microfinance Institutions and Automating Microfinance: Experience in Latin America, Asia, and Africa. In addition, she was the editor of the Network’s 2000 conference summary, Microfinance in the New Millennium.
SUGGESTED READINGS


PUBLICATIONS FROM MICROFINANCE NETWORK:

CONFERENCE PAPERS:

OCCASIONAL PAPERS:
- Guidelines for the Effective Governance of Microfinance Institutions, ** by Anita Campion and Cheryl Frankiewicz, 1999.

TECHNICAL GUIDES:

*Also available in Spanish
**Also available in French and Spanish

THE MICROFINANCE NETWORK

The MicroFinance Network is a global association of leading microfinance practitioners. Network members are committed to improving the lives of low-income people through the provision of credit, savings, and other financial services. The Network believes that this sector should be served by sustainable microfinance institutions. The MicroFinance Network is a vehicle for accomplished institutions to provide each other with technical assistance and to learn from each other’s experiences.

Regulated Financial Institutions
- ALCEDA, Cambodia
- Banco ADEMI, Dominican Republic
- BancoSol, Bolivia
- Banco del Desarrollo, Chile
- BRI Unit Desa, Indonesia
- Caja Los Andes, Bolivia
- Centenary Rural Development Bank, Uganda
- Citi Savings and Loan, Ghana
- Compartamos, Mexico
- Confia, Nicaragua
- Cooperativa - Emprender, Colombia
- FINAMERICA S.A., Colombia
- Kafo Jiginew, Mali
- K-REP Bank, Kenya
- MiBanco, Peru
- PRODEM FFP, Bolivia

Non-governmental Organizations
- ABA, Egypt
- ASA, Bangladesh
- BRAC, Bangladesh
- FINCA, Kyrgyzstan
- Fundusz Mikro, Poland
- PRIDE, Tanzania
- TSPI, Philippines

Support Institutions
- ACCION International, USA
- CALMEADOW, Canada

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