The State of Global Microfinance:
How Public and Private Funds Can Effectively Promote Financial Inclusion for All

Testimony of
Elisabeth Rhyne, Managing Director
Center for Financial Inclusion at ACCION International

before the
Subcommittee on International Monetary Policy and Trade
Committee on Financial Services
U.S. House of Representatives

January 27, 2010

1. Background: ACCION International and the Center for Financial Inclusion

ACCION International (www.accion.org) is a U.S. non-profit institution founded in 1961 and working in microfinance for the past three decades. ACCION works through partner banks and microfinance institutions in Latin America, Africa, India and China to provide financial services to low-income people in 20 countries, including the United States. As of the end of 2009, ACCION´s affiliates and partners were reaching 3 million clients, with a total loan portfolio of $3 billion.

Most of ACCION's partners are regulated commercial banks and finance companies that pursue a double bottom line of financial performance and social mission. I would like to mention ACCION's partner in Haiti, Sogesol, a service company of Sogebank. ACCION and its entire Latin America Network are actively supporting Sogesol to reach out to its 13,500 Haitian client families to help them recover and rebuild.

ACCION has been a pioneer in developing commercial microfinance, having founded the first commercial bank devoted to microfinance (BancoSol in Bolivia, 1992) and the first equity fund for microfinance (Profund, 1994). Most recently, ACCION was party to the initial public offering (IPO) of its Mexican partner, Compartamos Banco. The IPO was one of the most significant – and controversial – events in the history of microfinance, and I will talk more about it later.

I am speaking to you today as part of ACCION's senior management, but I am also wearing a second hat, that of Managing Director of ACCION's Center for Financial Inclusion (www.centerforfinancialinclusion.org). The Center (CFI) was established in September 2008 to address industry-wide issues through research and collaborative action, especially as the industry moves from microfinance to the broader sphere of financial inclusion. We are concentrating right now on the Smart Campaign (www.smartcampaign.org), an industry-wide effort to make client protection part of the DNA of the microfinance industry. I will also return to this topic in a moment.

2. The State of Microfinance, 2010

Size, Reach and Increasingly Commercial Character. The Microenterprise Information Exchange (MIX), the key source of data about microfinance reports that at the end of 2008, the 1,100 MFIs in its database served about 86 million clients with loans and 96 million with deposits. The total loan portfolio of these institutions was about $40 billion, and total deposits of about $25 billion: impressive when considering that the median loan size was only $525 and the median savings account was $145. I would like to celebrate the magnitude of this accomplishment. Most of these nearly 100 million people had no access to formal financial services before they became clients of MFIs. It has taken more than two decades of dedicated industry-building to bring this about.

Although microfinance grew from NGO roots, today the industry is made up of a range of institutions that are increasingly commercially operated.

- Banks and finance companies make up 39 percent of the institutions and serve 60 percent of all borrowing clients.
- NGOs make up 36 percent of the institutions and 35 percent of clients.
- Credit unions and rural banks, 25 percent of institutions, serve the remaining 5 percent of clients.

In short, microfinance is increasingly delivered on commercial terms by regulated financial institutions and financed through commercial sources, while NGOs continue to play a very significant role -- especially in reaching the most difficult client groups.

Microfinance through the Crisis. In the early days of the global financial crisis it looked like microfinance might be immune from its effects. This has proven to be incorrect, but problems did not surface immediately. The first problem, in early 2009, was the seizing up of international credit markets, which made financing difficult to get and hit hardest those MFIs that do not take savings, especially NGOs and non-deposit finance companies. Credit is now flowing again, though not quite as freely as before. The larger problem at this stage is the long term effect of the worldwide recession (coupled with continued high food and fuel prices) on clients, who are suffering.

The most obvious consequence is slower growth. During most of the 2000s microfinance grew rapidly – nearly 25 percent annually from 2000 to 2007. This growth slowed substantially in 2008 -- in Latin America to 11 percent and in Africa to 14 percent. The numbers for 2009, not yet available, will likely reflect continued slower growth. Portfolio quality and profitability are also down, but in most of the industry, the decreases are manageable. There are a few hot spots, for example, Nicaragua, where the economic downturn, combined with political problems, is creating serious repayment issues in which a few institutions will not survive. However, looking forward and around the globe, the prospects are for the microfinance industry to emerge from the crisis in good health. Some MFIs will have become stronger through investments to better manage risk.

Despite the pause for consolidation brought on by the financial crisis, the longer term story is that microfinance is emerging from its protected status inside international development into the mainstream financial sector. It is no longer microfinance but financial inclusion (as in the title of this hearing). The industry is starting to pursue a comprehensive vision for financial inclusion that will incorporate all these dimensions:

- *Beyond Credit*: A full range of services: savings, credit, insurance and payments. The more we learn about the financial needs of the poor, the more we recognize that savings, payments and insurance are highly valued.
- *Quality*: Convenience, affordability, safety, dignity and client protection are all areas that can sometimes be overlooked in the race for scale.
- *Continued outreach to the still-excluded*: The ultimate goal is <u>full</u> inclusion to everyone who can use the services: the poor, rural, informal, and groups who are often discriminated against (women, ethnic minorities, disabled).
- *New entrants*: new private sector players are changing the game, especially with new technologies. They range from telecoms companies to mainstream financial institutions to big box retailers.

The move from microfinance to financial inclusion challenges microfinance to continue evolving and raises important questions for policy makers. In the last part of my testimony, I would like to turn to two of these questions: What are the changing roles of public and private capital in this industry? How can microfinance keep its social mission alive as it becomes more mainstream and commercialized?

3. Issues of Concern to the Subcommittee: The Role of Public versus Private Funds

The reason microfinance now reaches 100 million people instead of perhaps 10 million is that it has learned how to finance itself from commercial sources. Starting with the creation of BancoSol in 1992, the industry has moved well beyond its initial donor dependency. In the late 1980s USAID and the IDB together invested something less than $5 million to help ACCION launch Prodem, the precursor of BancoSol. Today BancoSol is a commercial bank with a loan portfolio of $340 million, serving 127,000 borrowers and 254,000 savers. This is a major development success and a highly leveraged use of foreign assistance.

It would not make much sense for USAID to give BancoSol a grant to cover operating expense or loan capital today. Both the bank and the microfinance field have evolved. In response to the changing frontier, donor support has also evolved through two major phases and into a third. In the first phase, grants financed the launch of microfinance non-profits, which were not expected to be financially self-sufficient. Once self-sufficiency and even profitability were demonstrated and more MFIs became regulated financial institutions, the second phase began: the investment arms of the donor organizations, like the World Bank's IFC and the IDB's Inter-American Investment Corporation, made loans, guarantees and equity investments in microfinance. The goal of this phase was to lay the groundwork for attracting private and commercial finance. The first equity funds, like ProFund, were capitalized by primarily public money. Once success of these funds was demonstrated, the third phase began, in which private capital entered, most of it carrying both a social and financial bottom line.

This path illustrates the basic decision rule facing anyone in charge of determining where to place public funds: *re-deploy public monies to riskier, frontier uses and away from any activity that can be financed privately*.

In today's microfinance industry around the globe, some activities occupy phase one, some phase two and some in phase three. But which is which? Today's challenge is to sort this out according to current industry frontiers.

At the absolute frontier, where grant funding is needed, are the following:

- Microfinance services that reach marginal groups, including rural and remote populations, the disabled and others who have not yet been served with commercial models. This includes pioneering programs like BRAC and Grameen's to support urban beggars and CARE and Oxfam's savings groups in sparsely populated rural Africa.
- R&D to assist institutions to develop new products like savings, microinsurance and specialty credit products such as loans for clients to purchase renewable energy devices.
- R&D to apply new technologies for delivery (such as mobile banking).
- Capacity building in countries where microfinance is lagging, such as in central Africa.
- Development of industry infrastructure, such as credit bureaus and regulatory policy reform.
- Financial education for clients

At the risk frontier, where public investment capital is needed to overcome private risk aversion (direct loans, loan guarantees, equity) include:

- Equity and some debt investment in second and third tier MFIs, especially in riskier countries.
- Mechanisms to support the entry of private capital in riskier countries, such as foreign exchange hedging.
- Standing by as emergency lender. In early 2009 when credit markets seized up, the international finance organizations (IFIs) stepped in and kept financing flowing to many MFIs during the leanest months. The challenge is for those IFIs to recognize that it is now time for them to yield again to private investors, as Mr. Von Stauffenberg will elaborate.

Areas that can now be left to private funding include:

- Much of the debt finance for second tier MFIs, especially in less risky countries
- Debt and equity in first tier MFIs
- Deposits in profitable, regulated MFIs
- Microfinance investment vehicles aimed mainly at the first tier

I see a parallel with ACCION International's situation with respect to Compartamos. The sustained growth and profitability of Compartamos put it clearly over the bar of private sector prudential and profitability standards. ACCION's advisors told us in no uncertain terms that it would not serve our mission to leave our funds in Compartamos when those funds were needed elsewhere. The IPO has allowed ACCION to redeploy the proceeds from the sale to set up new microfinance organizations in locations where microfinance is just beginning, including the Amazon region of Brazil, Inner Mongolia in China, the poverty-stricken state of Bihar in India and (under development) Cameroon in central Africa. The same process of continually moving to the frontier applies to U.S. government and multilateral resources.

4. Issues of Concern to the Subcommittee: Keeping the Social Mission in Microfinance

Microfinance grew out of non-profit roots with a social purpose to help clients build their businesses and improve their quality of life. There is legitimate concern that as non-profits give way to for-profits, and especially as new entrants come into the industry with purely commercial origins, this social purpose may be weakened or forgotten. Given the vulnerability of the low income people served by microfinance, it is important that their welfare and development remain at the core of the industry. I share this concern, and that is why I would like to stress three important ways to protect the social mission in commercial microfinance.

First, social performance management. Social performance management is the attempt to track the social bottom line in a way that is as rigorous as the financial bottom line. Measuring social performance is notoriously difficult and social goals are diverse. Nevertheless, the microfinance industry has made some progress toward workable social performance management, including the Social Performance Reporting Framework of The MIX and Grameen Foundation's Progress Out of Poverty index. The specialized rating agencies for microfinance have developed social performance ratings. As social reporting becomes more rigorous, it will be more useful to investors who want to ensure that they direct their dollars to organizations that pursue a strong social mission.

Second, client protection. All financial service providers have a responsibility to treat clients with transparency and dignity and to avoid selling products in a way that could cause harm. The global financial crisis was triggered by practices like teaser rate mortgages that represented a massive failure to respect basic client protection principles. The sub-prime debacle put client protection near the top of everyone's list of industry risks, creating an opportunity to rally the entire microfinance industry to action. The Center for Financial Inclusion is working together with many other players in the industry through The Smart Campaign to promote a code of client protection and back it up with tools, resources and structures to assist MFIs in implementing good practices. We have nearly 900 endorsements, including about 200 of the top MFIs in the world, and we will not stop until client protection is deep in the fabric of the industry.

Third, social investment. Most of the private capital flowing into microfinance comes from socially responsible investors who seek double bottom line returns – financial and social – from their investments. This is a good thing: social investors are the kind of investors and owners that will keep microfinance focused on the social mission over the long term. The socially responsible investment sector is growing rapidly. More and more people in the United States want their investments to do good in the world, and they are going beyond the traditional form of social investing, "negative screens" applied to stock portfolios. Current U.S. vehicles for social investment are not very supportive of what we might call "positive-screen investments." Developing supporting structures is a great opportunity for the coming years that could benefit not only microfinance but investment in health, education, environment and other sectors. In the mean time, the message to investors from the microfinance industry is that the kind of investors MFIs want are those who are willing to take a long term perspective and give explicit value to social aims.

Thank you for the opportunity to share my views with you today. I would be happy to respond to your questions and comments.