FINANCING THE BOTTOM OF THE PYRAMID

MICROFINANCE STRATEGY
FOR SOUTH ASIA
FY2010–12

THE WORLD BANK
FINANCE AND PRIVATE SECTOR DEVELOPMENT
SOUTH ASIA REGION
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<th>Abbreviation</th>
<th>Full Form</th>
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<tr>
<td>ADB</td>
<td>Asian Development Bank</td>
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<td>ADF</td>
<td>Asian Development Fund</td>
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<tr>
<td>ARO</td>
<td>Agriculture and Rural Development</td>
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<tr>
<td>BICF</td>
<td>Bangladesh Investment Climate Fund</td>
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<tr>
<td>CBD</td>
<td>Community-based organization</td>
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<td>CGAP</td>
<td>Consultative Group to Assist the Poor</td>
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<td>DFID</td>
<td>UK Department for International Development</td>
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<tr>
<td>EAP</td>
<td>East Asia and the Pacific</td>
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<tr>
<td>ECA</td>
<td>Eastern Europe and Central Asia</td>
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<tr>
<td>GFC</td>
<td>Global Financial Crisis</td>
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<td>GLP</td>
<td>Gross Loan Portfolio</td>
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<tr>
<td>IFC</td>
<td>International Finance Corporation</td>
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<tr>
<td>LAC</td>
<td>Latin American and the Caribbean</td>
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<tr>
<td>LOC</td>
<td>Line of credit</td>
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<tr>
<td>MFI</td>
<td>Microfinance Institution</td>
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<tr>
<td>MIS</td>
<td>Management Information system</td>
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<tr>
<td>MRA</td>
<td>Microfinance Regulatory Authority</td>
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<tr>
<td>MSME</td>
<td>Micro, small, and medium enterprise</td>
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<tr>
<td>NBFC</td>
<td>Non-Banking Financial Company</td>
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<td>NGO</td>
<td>Nongovernmental organization</td>
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<tr>
<td>NGO-MFI</td>
<td>Microfinance NGO</td>
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<td>PAR</td>
<td>Portfolio at risk</td>
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<td>PEP</td>
<td>Private enterprise partnership</td>
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<td>PKSF</td>
<td>Palli Karma-Sahayak Foundation</td>
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<tr>
<td>POS</td>
<td>Point-of-sale</td>
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<tr>
<td>ROSCA</td>
<td>Rotating Savings and Credit Association</td>
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<td>SAR</td>
<td>South Asia Region</td>
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<td>SASFP</td>
<td>South Asia Region Poverty Reduction, Economic Policy, Finance and Private Sector Development Department</td>
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<tr>
<td>SHG</td>
<td>Self help groups</td>
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<tr>
<td>TA</td>
<td>Technical assistance</td>
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<td>UNCDF</td>
<td>United Nations Capital Development Fund</td>
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<td>UNDP</td>
<td>United Nations Development Programme</td>
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<td>USAID</td>
<td>United States Agency for International Development</td>
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<td>WBG</td>
<td>World Bank Group</td>
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</table>
Development of this microfinance strategy for South Asia has been a team effort, drawing on the expertise of colleagues in various units. Overall guidance was provided by Ernesto May, SASFP Director, and Simon Bell, SASFP Manager. Strategy development was facilitated by Mehnaz Safavian and involved Henry Bagazonzya, Cecile Niang, and Thyra Riley. The team benefitted greatly from the research assistance of James Rollins, and Jonathan Morduch and Aparna Dalal were instrumental in the development of the conceptual framework for the strategy.

Work began in July 2008 when the team agreed on the core themes of the strategy, after which numerous discussions and meetings were held, resulting in a great deal of analysis that contributed to the development of this strategy. Detailed comments were provided by A.K.M. Abdullah, Kiran Afzal, Anjum Ahmad, Shamsuddin Ahmed, Priya Basu, Sriyani Hugalle, Suhail Kassim, John Speakman, Sadruddin Salman, Niraj Verma and Michael Wong from the South Asia Finance and Private Sector Development Department, as well as by Greg Chen, Eric Duflos, Michael Goldberg, Martin Holtman, Douglas Pearce, Bikki Randhawa, Stephen Rasmussen, and James Seward.

Sakm Abdul Hye managed the editorial process.
FOREWORD

The South Asia Regional Strategy: Ending Poverty in a Region of Growing Contrasts (2008) recognizes that South Asia's decade-long rapid economic growth, declining poverty, and progress in human development provide an unprecedented opportunity for the World Bank to further contribute to the strategic goal of sustaining growth while also making development more inclusive of the poorest. Despite impressive gains in growth, employment creation, and productivity, South Asia still has the world's largest concentration of poor people, with 400 million people living on less than US$1 per day.

The South Asia Region's Poverty Reduction, Economic Policy, Finance and Private Sector Development (SASFP) Department has developed a strategy to tailor its policy and financial support to clients, with three main objectives:

- **Achieving Accelerated and Sustainable Growth** through macroeconomic stability, sustainable investment, and a competitive private sector;
- **Making Development Inclusive** through improved access to gainful employment and effective protection against risks; and
- **Improving Governance** through inclusive access to quality and cost-effective services.

This microfinance strategy note contributes to the department strategy by identifying ways to achieve accelerated sustainable growth by supporting a modern and competitive microfinance sector that is integrated into each country's financial systems. Empirical work shows that poverty rates are negatively correlated with access to finance; therefore,
the strategy supports making development inclusive by supporting institutions that can deliver financial services to the poor. The poor can use very small loans to invest in small livestock, trade operations, or microenterprises, which can have a notable impact on family incomes, nutrition, education, and self- and family employment. Savings and insurance services that are often packaged by microfinance institutions (MFIs) enable the poor to protect themselves against future calamities. Finally, improved governance is achieved in that microfinance institutions implement innovative approaches to deliver and recover very small loans in a cost-effective manner. Appropriate regulations and capacity building for good governance in these innovative institutions allow broader and more inclusive access to quality and cost-effective financial services for the poor.

The four pillars of the microfinance strategy that are further developed in this note are:

- Support to achieve modern, sustainable Institutions as part of a well-governed integrated financial sector;
- Encouragement for the adoption of Technology and Financial Infrastructure to enhance innovation and efficiency;
- Introduction of a broader range of Products and services to meet poor clients' demand, for example savings, insurance, remittance transfers; and
- Regulations and governance to support an appropriate policy and regulatory environment that recognizes the innovations that microfinance institutions use to reach the poor, for example group and character-based rather than collateralized lending.

The primary goal of the proposed strategy is to offer a roadmap for engagement with clients in the South Asia region with a view to increasing microfinance outreach.
INTRODUCTION

PURPOSE OF THE STRATEGY

This document presents the South Asia Microfinance Strategy for fiscal years 2010–12. The purpose of the strategy is to:

- Present the strategic direction of SASFP with respect to proposed microfinance activities in the South Asia region;
- Take stock of key challenges and opportunities currently facing the microfinance industry in each of the South Asian economies;
- Identify appropriate interventions for achieving strategic objectives, given good practice in and outside of the region and the complementary activities of partners in and outside of the World Bank Group (WBG); and
- Explain SASFP’s goals and methods to other members of the WBG, clients, and development partners to further collaboration.

This is a living document and will be updated to address changing internal and external client demands. The strategy takes into account the impact of the Global Financial Crisis (GFC) on the microfinance sector, but cautions that we are only just beginning to understand how the GFC is playing out vis-à-vis the users, providers, financiers, and regulators of microfinance in South Asia. The Consultative Group to Assist the Poor (CGAP)\(^1\) has launched a crisis-related research project to inform the microfinance industry on how the financial and economic crisis might be affecting MFIs and their clients. Preliminary results from 59 MFIs in South Asia show the effects of the GFC on the region: 47 percent of MFIs report repayment is down, 65 percent report a rise in portfolio at risk (PAR), and 56 percent report liquidity constraints. History is not necessarily a guide for predicting the outcome of this crisis since microfinance is no longer the uncorrelated market that it was during the downturns of the 1990s.\(^2\) In recent years, microfinance has become a fulcrum for development initiatives for the poor and marginalized segments of society in client countries and has come to be regarded as an important tool for poverty alleviation. Microfinance is inclusive of credit, thrift, insurance, and money transfer services involving small amounts. The terms microcredit and microfinance are often used interchangeably, with an emphasis
on the provision of credit to the poor, including through microenterprises that are often an important source of income for poor families in the vast rural and burgeoning urban economies of client countries.

To fill a gap in traditional financial markets, a range of institutional forms have evolved to provide microfinance. Those institutional forms include commercial and state-owned development banks, agricultural and rural development banks, self-help groups (SHGs), savings and credit cooperatives, credit unions, commercial banks, microfinance limited companies, microfinance NGOs (NGO-MFIs), and the associated second-tier organizations that intermediate funding, capacity building, advocacy and coordination services, and regulation. The strategy focuses on specialized methodologies, institutional strategies, products, and policies that allow microfinance services to be provided in an institutionally sustainable manner as part of sound, well-managed financial systems. The strategy, therefore, directly sets the agenda for the South Asia Finance and Private Sector Development group as it deals with microfinance as a set of financial sector development tools. The strategy also sets the agenda for active collaboration with partners in the Agriculture and Rural Development (ARD) network, CGAP, and the International Finance Corporation (IFC) whose mandate in this context is to provide specialized financial products to rural communities and engage with self-help groups, cooperatives, agricultural development banks, individual retail MFIs, and banks.

The microfinance strategy is guided by the principles of international best practice in microfinance development and a financial systems approach to integrating microfinance into the financial mainstream—an approach that has been successfully pioneered by microfinance giants around the world. The financial systems approach within the broader microfinance field sees the aim of the microfinance movement as being to develop the ability and willingness of the financial system to serve the poor on a fully sustainable—if not on a fully commercial—basis. The financial systems approach views donor and government subsidies as temporary phenomena, recognizing that the scale necessary to reach the vast potential market can be achieved only if microfinance connects to the mainstream financial system. Thus, the financial systems approach is concerned with finding pathways to bring microfinance
and the institutions that lend to the poor into the financial system. One widely applied pathway involves the transformation of microcredit organizations into formal (regulated) financial institutions that intermediate savings. A second pathway involves commercial banks and other financial institutions “down-scaling” to conduct microfinance activities through enhanced capacity, technological innovations (e.g., mobile or branchless banking), or in partnerships with specialized microfinance providers.

**VISION**

The vision is to support the development of a competitive, sustainable, integrated, and all-inclusive microfinance sector, which will contribute to broader financial outreach to the poor and ultimately help create jobs, grow the economy, and minimize the impact of the financial crisis on poor households and micro-entrepreneurs.

The current state of the practice presents an opportunity for SASFP to define a strategy to determine its ongoing role in supporting the development of the sector, particularly given the short- and medium-term effects of the GFC. The primary goal of the proposed strategy is to offer a roadmap for engagement with SAR clients with a view to increasing microfinance outreach. In doing so, SASFP identifies optimal roles for itself and lays out the future directions of its work to support microfinance outreach in South Asia. Increased financial outreach will be defined as expansion beyond the current MFI clientele with the end result of **REACHING OUT AND REACHING DOWN**—reaching out to a greater number of clients, from a wider geographic-
Increasing financial outreach is a broad mandate. Therefore, the direction of SASFP’s engagement in microfinance is based on the intersection of four key inputs:

- An update of the priorities for increasing outreach in South Asia;
- A review of the entry points to advance the microfinance frontier in South Asia;
- An understanding of the activities and comparative advantages of microfinance partners in South Asia so as to complement and leverage existing resources and expertise; and
- The integration of lessons learned from regional and global experience in supporting microfinance.

The intersection of these inputs forms the basis of the strategy formulation. The World Bank’s optimal role in supporting microfinance outreach is based on comparative advantages as a unit given priorities for the sector, appropriate entry points, and leveraging the skills and ongoing interventions of partners.
The strategy organizes key priorities for the microfinance sector in the region around four broad pillars of microfinance: Institutions, Technology, Products, and Regulations.

**Institutions**
Specialized microfinance institutions have proven that the poor are “bankable.” Yet challenges remain in increasing the outreach, efficiency, and sustainability of many MFIs, and for many more institutions, the objectives of achieving scale and self-sufficiency are neither a priority nor a feasible goal. Additionally, a range of specialized retail and meso-institutions—apex institutions, wholesalers, MFI networks, and associations—form an integral part of the institutional landscape to support microfinance development. Some of these meso-institutions and MFI practitioners can be useful points of contact for the World Bank and donors if they play leadership and policy advocacy roles with respect to a diverse microfinance sector and are committed to developing a sustainable and integrated microfinance sector. The challenge is, how can we harness the capacity of meso-institutions in client countries to facilitate the development of modern, professional, and efficient MFIs through a focus on strong governance, transparency, and efficient service delivery? How can we mitigate the impact of the global financial crisis on liquidity and portfolio performance for those financial service providers committed to outreach and sustainability?

**Technology and Financial Infrastructure**
The main priority for sustainable microfinance is to achieve efficiency and maintain low administrative costs while making small loans. Key elements of managing costs are (i) staff productivity in terms of the number of loans managed per branch and per loan officer and (ii) delinquency management, which can quickly destroy the financial viability of even strong MFIs. Thus, strong management information systems (MIS) that can automate information about loan collections and technologies to facilitate disbursement and repayment of loans, for example through branchless banking, ATMs, or mobile banking, can be a major boost to the overall productivity, efficiency, and financial viability of microfinance by reducing the costs and maintaining
thorough knowledge of clients. A priority for the strategy is to identify entry points for encouraging the adoption of innovative and efficiency-enhancing technologies and their complementary infrastructure.

**PRODUCTS**

Poor people manage a low and unpredictable income flow that is often impacted by natural phenomena, such as health-related challenges and disasters that affect crop production and access to markets. Risk management requires a diversification of liquidity sources, including savings, insurance, and remittances from labor provided in other regions or countries. Microfinance products and services that can accommodate flexible access to liquidity by the poor can often mitigate risk for poor households. A priority for the strategy is to identify entry points to support the introduction of a broader range of services that meet client demand for a wider array of these credit and non-credit products, such as saving and health, credit, and life insurance, working capital, longer-term funds for investment in businesses and equipment, loans with repayment schedules that can accommodate agricultural cycles, and payment and transfer arrangements to facilitate remittances.

**Regulations**

The development of appropriate microfinance regulations, laws, and licensing norms and the ability of central banks to regulate and supervise microfinance providers as formal financial institutions are major ongoing issues in all South Asian countries. Worldwide, experts in the microfinance industry believe strongly that the ability of microfinance institutions to operate sustainably requires an ability to take voluntary savings—if not from the public, then from their membership. Traditional regulatory authorities have been reluctant to assume the responsibility of protecting the public's savings because of the nontraditional ways that microfinance operations work. This reluctance stems also from the challenge of adequately supervising institutions that sometimes cannot demonstrate the financial management, controls, and information technology necessary to allow their operations to be transparent and facilitate monitoring by traditional central bank methods. The challenge here is to foster the development of a supporting policy and regulatory environment. How can we ensure flexible and appropriate regulation that recognizes the special character of microfinance
in terms of character-based rather than collateral-based lending? How can we ensure the capacity of central banks to be able to supervise these institutions? What will be the impact of the financial crisis on regulatory oversight and consumer protection, and can we use this as an opportunity to foster a more favorable regulatory environment for microfinance institutions?

**ENTRY POINTS**

The strategy takes into account entry points to engage with clients, based on a range of policy and technical assistance tools that exist or are emerging in support of microfinance, globally and within the South Asia region. They include the following:

- Technical assistance (TA) and capacity building directly to financial service providers (both first- and second-tier institutions), to networks, or to governments;
- Investment in financial infrastructure, such as credit information systems, credit registries, payment systems, back-end processing systems;
- Direct financial support through grants, matching grants, loans or lines of credit to financial service providers;
- Support for legal and regulatory reforms that balance the need to have a sound prudential environment for lending, facilitate microfinance and institutional growth, and the need for consumer protections;
- Provision of knowledge services and monitoring and evaluation frameworks, including micro-level data collection (household and enterprise surveys), impact analysis (MFI programs or products), research, or toolkits; and
- Support to apex institutions to crowd in commercial finance, raise standards, increase reporting and efficiency of MFIs, and ease crisis-related liquidity constraints.

Table 1 on the following page highlights World Bank Group engagement to date in supporting these activities.
TABLE 1
Current Microfinance Portfolio

<table>
<thead>
<tr>
<th></th>
<th>Afghanistan</th>
<th>Bangladesh</th>
<th>Bhutan</th>
<th>India</th>
<th>Malaysia</th>
<th>Nepal</th>
<th>Pakistan</th>
<th>Sri Lanka</th>
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<tbody>
<tr>
<td>TA and capacity building</td>
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<td>Investment in financial</td>
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<td>✓</td>
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<td>Support to financial service</td>
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<td>providers</td>
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<td>Support for legal and regulatory</td>
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<td>Provision of knowledge services</td>
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<td>Support to apex institutions</td>
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<td>✓</td>
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COMPARATIVE ADVANTAGE OF PARTNERS

The strategy draws from the work, experience, and comparative advantage of its key microfinance partners in the region, from within the WBG, and in client countries. Partners in the microfinance agenda are our collaborators—those with whom we jointly work or with whom we coordinate closely on project development and implementation—as well as stakeholders—those who are the direct beneficiaries of our work in the region.

Collaborators include the following:

- Consultative Group to Assist the Poor (CGAP)
- International Finance Corporation (IFC)
- Multilateral and Bilateral Donors (USAID, DFID, ADB, UNCDF, UNDP)\(^4\)
- South Asia Agriculture and Rural Development Department (ARD)
<table>
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<th>Stakeholders include the following:</th>
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<tr>
<td>Microfinance networks—organizations that act as coordinating bodies, engage in advocacy, and promote standards, self-regulation, and transparency with members</td>
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<tr>
<td>Apex institutions and financial service providers</td>
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<tr>
<td>Government, including regulatory and supervisory authorities (central banks), as well as relevant government ministries (finance, economy, small industries) and other microfinance regulatory authorities</td>
</tr>
<tr>
<td>Civil society</td>
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<tr>
<td>Microfinance clientele</td>
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</table>
The South Asia Region's Poverty Reduction, Economic Policy, Finance and Private Sector Development Department has developed a strategy to tailor policy and financial support to clients, with three main objectives:

- **Achieving Accelerated and Sustainable Growth** through macroeconomic stability, sustainable investment, and a competitive private sector;
- **Making Development Inclusive** through improved access to gainful employment and effective protection against risks; and
- **Improving Governance** through inclusive access to quality and cost-effective services.

This microfinance strategy note contributes to the department strategy by identifying ways to achieve **accelerated sustainable growth** by supporting a modern and competitive microfinance sector that is integrated into each country's financial systems. Empirical work shows that poverty rates are negatively correlated with access to finance; therefore, the strategy supports **making development inclusive** by supporting institutions that can deliver financial services to the poor. The poor can use very small loans to invest in small livestock, trade operations, or microenterprises, which can have a notable impact on family incomes, nutrition, education, and self- and family employment. Savings and insurance services that are often packaged by microfinance institutions enable the poor to protect themselves against future calamities. Final-

**Box 1**

CGAP's Five Core Elements of Donor Effectiveness in Supporting Microfinance

1. **Strategic Clarity and Coherence**: agency-wide vision in line with international good practice
2. **Strong Staff Capacity**: sufficient technical expertise to manage operations
3. **Accountability for Results**: transparency about microfinance programming and performance
4. **Relevant Knowledge Management**: systematic application of lessons learned
5. **Appropriate Instruments**: ability to work directly with the private sector
ly, improved governance is achieved in that microfinance institutions implement innovative approaches to deliver and recover very small loans in a cost-effective manner. Appropriate regulations and capacity building for good governance in these innovative institutions allow broader and more inclusive access to quality and cost-effective financial services for the poor. The strategy is also guided by CGAP’s Guiding Principles for Donor Intervention as indicated in Box 1.

Each country in the region has a unique story of struggle and success, a process that has given rise to an array of institutions, methodologies, approaches, and products, and various paths to growth of the microfinance sector. The experience of various institutional structures, delivery mechanisms, products, levels of outreach and supportive regulations vary widely across the region. As a result, levels of financial outreach, growth rates, and overall resources dedicated to microfinance activities are markedly different across countries. For example, growth rates are highest in Pakistan, India, and Afghanistan, while Bangladesh and Sri Lanka have the highest outreach in the region (Figure 1). The most striking differences in the region are around penetration rates, which is a proxy for financial outreach. In the strategy, countries are classified as high outreach (Bangladesh and Sri Lanka), medium outreach (Nepal and India) and low outreach (Pakistan and Afghanistan). Fig-

![Source: Mix Market Data, 2008. Data not available for Bhutan and Maldives. See Annex 1 for details.](image-url)
The Global Financial Crisis and Microfinance

Compared with other financial institutions, microfinance institutions (MFIs) have emerged relatively unscathed from the financial crises of the past few decades. During the currency crises in East Asia and the banking crises in Latin America in the 1990s, institutions serving poor customers generally performed better financially than mainstream banks. At that time, the clients and microenterprises financed by MFIs were not integrated into local banking and currency markets. The effects of today's global crisis are likely to be more complex, deeper, and more difficult to predict than in the past.

- How institutions are affected will depend on factors such as the structure of an institution's liabilities, its financial state, and the economic health of its clients. Preliminary evidence suggests that MFIs that can mobilize deposits are best able to weather the GFC.

- The most immediate concern in most countries is how the global liquidity contraction will affect the cost and availability of funding to non-deposit taking MFIs. Steep rate increases are being reported—up to 450 basis points or more for top-tier institutions in South Asia (CGAP 2008).

- Regulators may become overly conservative across the board, casting a wide net that inadvertently catches activities that are not linked to crisis-related risks. Restricting new licenses for deposit taking or limiting branch expansion may be examples of restraints that may needlessly limit access to finance while not providing additional support to stability.

- Some well-intentioned steps to alleviate effects of the crisis—for instance, loan forgiveness, subsidized lending, or interest rate caps—will hurt financial access in the long run.

- MFIs report that client purchasing power has gone down and cash needs have gone up, causing savings to be withdrawn and sometimes straining repayments. Most industry observers expect pressure on customers to translate broadly into higher arrears over time.

Source: CGAP, 2009
Figure 1 indicates relative growth rates of the sector, based on the number of new borrowers served between 2006 and 2007.

The variations in microfinance penetration highlight the differences in the maturity of the sector across the region and underscore the need to balance a broad strategic approach to the region with the ability to tailor activities to country-specific challenges and the level of development and absorptive capacity of the sector.

**Modus Operandi**

The methodology for designing the strategy takes as a point of departure a large body of existing analytical work—as regards data collection, which has gone a long way toward identifying the current unmet demand for financial services for the poor and overall microfinance penetration rates—in addition to a significant body of work reviewing the region’s experience in product development, regulatory frameworks, and policy interventions and support mechanisms.

The team engaged in a consultative process to develop the strategy. First, regional SASFP staff team members provided key information on the most current state of the policy dialogue and the most critical issues and challenges facing the sector in each country. Secondly, the team sought input from other partners in the WBG who played a critical role by advising the strategy team on emerging global good practice and key challenges facing the microfinance sector in South Asia and globally. Partners in the development of the strategy included CGAP and IFC global financial markets, as well as WBG staff from the South Asia Agriculture and Rural Development Department and other Regions where microfinance projects have been housed and/or where learning and experimentation have taken place. Finally, the strategy team convened a series of discussions with key private and public sector players, via video conference or in-country as staff travel permitted. These discussions sought input from key stakeholders and collaborators such as microfinance networks, practitioners, and members of the donor community. The objective of the discussions was to solicit input on the main challenges facing the government, NGOs, and the private sector community, and the optimal role the WBG can play in addressing these challenges.
The strategy is organized as follows: Section 1 provides an overview of the microfinance industry in the region, its history, key trends, and outreach and achievements to date; Section 2 looks at priorities for the microfinance sector and assesses entry points to address these challenges; Section 3 reviews partner activities; and Section 4 presents the broad strategic directions of support to the microfinance sector in high, medium, and low outreach countries.
Microfinance has a rich legacy in South Asia. It is estimated that, as a region, South Asia is home to about 49 percent of all the people in the world who use microfinance services. While the microfinance sector in South Asia has shown impressive results, the potential of the sector remains vastly underexploited, particularly compared to other regions. For example, 80 percent of microfinance funding is allocated to institutions in Latin America and the Caribbean (LAC), Eastern Europe and Central Asia (ECA), and East Asia and the Pacific (EAP) (Figure 2). Yet South Asia has many characteristics that suggest a strong potential for growth, including deeper capital and domestic markets than most other regions.

The overall percentage of poor and vulnerable people with access to financial services remains small. For example, less than 2 percent of poor households in Pakistan access microfinance services today, while less than 17 percent of households use a bank account. In India, too, where traditional microfinance reaches roughly 5 percent of poor households and is concentrated mainly in the southern states, the challenge of expanding outreach is considerable. Sri Lanka and Bangladesh rank among the top five countries in the world in terms of the percentage of poor and vulnerable people who use microfinance services; yet, even in these countries, there is still room for improvement (Figure 3).

**FIGURE 2**
Regional distribution of borrowers and gross loan portfolio (GLP)

In South Asia, diverse institutional structures and delivery systems exist across the region, but community-based organizations (CBOs) and NGO-MFIs deliver virtually all of the recorded outreach of financial services available to low-income clients in the region. At present only a small amount of additional microfinance outreach is provided by retail banking operations, post office banks, or insurance companies.

However, diverse institutional links channel microfinance services from funders to clients and some variation in delivery systems exists, which means that almost every conceivable type of microfinance activity in the world is available in South Asia. The delivery systems employed by various institutional types include the Grameen Model, self-help groups, cooperative programs, and Rural Support Programs.⁷

A range of products offered by microfinance institutions exists, but credit services continue to be the dominant microfinance activity. Provision of services to enable clients to deposit savings is an area of significant interest and innovation for MFIs, but poses risks linked to the intermediation process. In practice, most MFIs have been forced by regulatory restraints to limit deposit taking to credit-linked products, while CBOs have been able to offer deposit-taking services because of their relatively informal structure. Microinsurance is attracting increased attention, although it is largely in the experimental stage and implications for costs
or delivery systems are still unclear. Money transfers are increasingly discussed, but have received little attention in the region in terms of allowing MFIs to offer these services without being linked to banks. Some MFIs have recently begun to experiment with providing transfer services, a trend that is likely to grow given the high dependence on them by poor families as an income source. MFIs are also beginning to add leasing services to their menu of service offerings.

With respect to outreach, South Asian countries can be categorized into high outreach (Bangladesh and Sri Lanka), medium outreach (Nepal and India), and low outreach (Pakistan and Afghanistan). High coverage in Bangladesh is based on the programs of a few specialized institutions, with 73 percent of clients borrowing from the four largest institutions. Conversely, high outreach in Sri Lanka is grounded in an extensive network of community-based organizations that receive considerable government subsidies. India has also seen a substantial increase in the outreach of microfinance services in recent years, not only because of the growth of the Bank-SHG link program, but also because of the substantial growth of NGO-MFIs; this outreach, however, is concentrated in a few southern states. In Pakistan, outreach accounts for no more than 5 to 10 percent of the potential market, with services being provided by NGO-MFIs and specialized microfinance banks. Microfinance access extends to only 1.7 million out of an adult population of about 80 million, with an estimated potential market size in the range of 10 to 20 million active borrowers. In Pakistan and Afghanistan, the low level of outreach is partly due to ongoing security concerns.

In Bangladesh microfinance has become the basis for microenterprise promotion by some of the large microfinance institutions, and has also been extended to the “ultra-poor” through targeted programs. In both Pakistan and Nepal, the potential of microfinance demonstrated by regional experience has captured the attention of governments that have created specific legal frameworks to facilitate its growth.
BOX 3
Lessons Learned from Engagement in Microfinance – South Asia and Globally

- Microfinance is **not a panacea for chronic poverty**. Financial entitlements such as termination payments, micro-grants, training, and employment programs are often more suitable for assisting the chronically poor and high-risk, low-experience groups. Grants, rather than microcredit, can be best used to overcome a lack of productive skills on the part of the extreme poor, preparing them for eventual use of credit services.

- Microfinance is best **implemented as a professional banking activity** by a strong local microcredit organization dedicated to operational self-sufficiency.

- Microfinance is **rarely sustainable where the regulatory environment creates significant barriers** to sustainability by, for example, mandating interest rate caps or prohibiting non-collateralized loans.

- Sound microfinance is **seldom produced by government agencies, multi-service community organizations, or other entities whose mission and expertise are not focused squarely on retail credit and/or savings.**

- Projects should focus on the **development of sustainable retail MFIs** by enforcing financial performance requirements or providing money for building institutional capacity, not just funds for onlending.

- **Funding is not always the key bottleneck** holding back microfinance in the country. In most countries, the binding constraint is the scarcity of sound retail MFIs. If projects allocate more funding than can be absorbed by sound MFIs, political pressure for large and quick disbursements can lead to the selection of weak MFIs or inappropriate borrowers.

- Apex funding and technical assistance can help good MFIs, but **usually cannot create good MFIs** or turn bad MFIs into good ones.

- Successful apexes usually have a management structure and an oversight board in which the public sector has little or no representation, or where the public sector's influence is outweighed by the presence of powerful private sector, non-partisan individuals on the board. The **assertion that apexes are independent of political interference has little value unless that independence is built into the structure of apex governance.**

*Source: WBG staff and CGAP Donor Brief No. 1, April 2002*
PRIORITIES AND ENTRY POINTS FOR INCREASING OUTREACH

South Asian institutions maintain high repayment rates—top institutions report repayment rates of 98 percent or higher—and have low transaction costs due to cheap labor and relatively high population density. However, commercial sustainability continues to be a challenge throughout the region. Financial sustainability is reflected in the institutional capacity to become independent of donors or governments and is a major determinant of long-term outreach.

Sustainable growth of microfinance institutions depends largely on increased efficiency, capital and liquidity, and transparency. Efficiency (as measured by operating costs relative to loan portfolio) is important because in profitable MFIs, operating costs account for roughly half of interest yields, and therefore represent the biggest cost block, and associated interest rates are passed on to clients. Liquidity is important to ensure that institutions can meet client demand, while transparency is integral to maintaining a sustainable and responsible growth rate for the sector.

FIGURE 4
Country-level self sufficiency in South Asia
Financial self-sufficiency (%)

Source: Mix Market Data, 2008.
Measures of efficiency (operational efficiency and productivity) indicate that MFIs in South Asia do comparatively well when benchmarked globally (Figure 5). In Sri Lanka and India, operational efficiency is consistent with global good practice, while in Bangladesh, Afghanistan, and Pakistan, there is still considerable room for improvement in both operational efficiency and productivity gains. Increases in productivity-enhancing operating principles will lower costs, allowing MFIs to increase scale up and to maintain more reasonable interest margins to clients. To increase operational efficiency, MFIs need to implement better financial manage-
ment and internal controls, credit appraisal and portfolio tracking systems, risk monitoring and management, and accounting and auditing policies as steps toward increasing operating efficiency and financial sustainability.

In addition, microfinance service providers may be facing short-term liquidity constraints as part of the fallout from the global financial crisis. As international funding dries up, local deposits are becoming even more critical to fuelling microfinance institutions' lending, and the ability to mobilize savings and private equity will be an important part of the growth trajectory of the sector.

Accurate and transparent financial information, based on generally accepted accounting principles, is critical for two reasons. First, such information contributes to better decision making and greater efficiency. Second, external sources, such as commercial lenders, depositors, supervisory authorities, and even other donors, rely on accurate financial reporting to decide whether an institution is creditworthy or financially sound. This information determines whether the institution will gain access to additional sources of funds for expansion.

Microfinance growth in many countries is happening at a fast pace. Greater transparency and accountability throughout the microfinance sector is required to prevent a few weak MFIs from deterring potential funding to the sector as a whole. Furthermore, elimination of deceptive customer practices, over-indebtedness, monopolistic behavior, and poor corporate governance will be integral to responsible outreach and to avoiding a potential public sector backlash. Governance, managerial capacity, and increased transparency are needed for MFIs (beyond the top-tier ones) to not only absorb unprecedented flows of commercial funding, but also attract new investors. The challenge lies in building the capacity of the numerous smaller organizations to absorb these resources.

The main entry points to support increased outreach and sustainability through more efficient, transparent, and well-capitalized financial service providers include the following:
Supporting credible and politically independent apex institutions under a more progressive paradigm. Rather than being a vehicle for subsidized funding, this new model supports apex institutions that onlend at or near commercial rates or take equity positions so as to crowd in private sector funding and foster continued commercialization. Apexes can leverage their position to play a role in nurturing the development of sustainable microfinance providers (including banks) by setting minimum standards and performance targets around increased transparency and governance, as well as more efficient financial management and internal controls, credit appraisal and portfolio tracking systems, risk monitoring and management, and accounting and auditing policies. Apexes in South Asia are in different levels of development, with different track records of sustainable operations. One challenge will be to define appropriate interventions for a variety of apexes, particularly those that have been successful;

- Facilitating policy discussions around appropriate prudential regulation to enable a wider range of microfinance institutions to take deposits where advisable and/or other value-added services such as remittances;

- Playing a more proactive role in knowledge sharing on governance practices, cross-country experiences, and forging partnerships between MFIs and established commercial financial institutions to support better financial management and internal controls of financial service providers;

- Leveraging public finance instruments and credit guarantees to catalyze private investment, especially in economies like Pakistan where the regulatory environment is generally favorable but where microfinance lending remains relatively limited; and

- Undertaking micro-level data collection to assess market demand, penetration, and access with a view to identifying gaps and opportunities to increase financial access.
BOX 4

World Bank Support to Bangladesh's Successful Apex Institution

Palli Karma-Sahayak Foundation (PKSF) is a well-respected and established force within Bangladesh's financial sector. In 2001, the World Bank financed a US$105 million Poverty Alleviation Microfinance Project to the Government of Bangladesh with the objective of reducing poverty by expanding access to financial services to the poor through microfinance programs. A principal component was capacity building to enhance the institutional and financial sustainability of PKSF and its partner organizations and to enhance PKSF's ability to disseminate best practices to increase the cost effectiveness of microfinance delivery throughout the country. The project's Implementation Completion Report evaluated the project outcome as satisfactory with likely long-term, sustainable benefits. Borrower satisfaction and PKSF's performance as the lead implementation agency were deemed highly satisfactory. Under the project, PKSF accomplished a tremendous expansion of outreach to 2.1 million borrowing clients, 90 percent of whom were women. This level of outreach exceeded the appraisal target of 1.2 million by 75 percent. PKSF expanded its cumulative disbursements in terms of loans outstanding from Tk 1,100 million to Tk 7,900 million and loans outstanding in the field rose from Tk 732 million to Tk 5,848 million. As a financier of small and medium-sized partner organizations, PKSF's role was deemed exemplary: it has firmly established itself as a leading and successful apex organization to extend funding to microfinance institutions of all sizes. Because of the high standards of portfolio performance, reporting, staffing, and training that partner organizations needed to maintain in order to continue to receive support from PKSF, the institution is attributed with having led the sustainable development of the microfinance sector in Bangladesh.
Another challenge facing the microfinance sector in South Asia is the lack of technology and financial infrastructure. Technical limitations such as low connectivity and poor back-end processing systems affect costs and staff productivity and limit access. Many small MFIs still need to implement basic information systems to automate accounting and management reporting. Furthermore, the lack of automated payment systems that enable cash transfers restricts fund mobility, especially in areas where clients face security concerns. Technical innovations such as mobile banking, branchless banking, biometrics, and point-of-sale devices can be used to better serve dispersed populations in rural areas at a lower cost. Back-end processing and innovative delivery channels are integral components of a comprehensive technology platform.

Back-end technology stores data, automates procedures and reporting, and supports data analysis. These information systems help microfinance institutions track, analyze, and report on their operations. Small MFIs may manage with manual ledgers or spreadsheets, but most MFIs eventually need custom-built or commercially available software to track financial transactions and create reports for management, donors, and regulators. Information systems technology can include handheld computers that record client information, scoring techniques that predict customer behavior, and connectivity technologies that transmit data among staff and branches. While the benefits of automating core banking systems to cut operating costs, streamline lending processes, scale up activities, and integrate with the rest of the financial sector are widely recognized, they often remain out of reach for individual microfinance institutions. Centralized microfinance hubs have recently been implemented to make technology-led efficiency gains accessible to MFIs.

Large MFIs and banks can use non-traditional delivery technologies, such as ATMs, point-of-sale networks (devices in retail outlets which use debit/credit cards to facilitate electronic payments and transactions), and mobile banking. These technologies allow customers to make payments, transfers, cash withdrawals, and deposits outside of branch offices.
BOX 5

Shared Microfinance Services Hubs Make Technology-led Efficiency Gains Accessible

Some of the challenges facing MFIs regarding automation of back-end processing on an individual basis include high up-front costs, limited connectivity capability, unavailability of technical support, and high maintenance costs. One solution that has emerged to address some of these challenges is the outsourcing of information systems management to application service providers (ASPs) who manage centralized microfinance processing hubs. The automation of MFIs opens the door to new products and services.

FINO (Financial Information Network & Operations Ltd), an ASP in India developed within ICICI Bank, now provides a centralized technology platform to clients of MFIs, banks, insurance providers, and the Government via a biometric smart card. FINO claims to have enrolled 5 million customers who perform balance enquiries, deposits and withdrawals of cash, and statement and receipt printing.

Similarly, IBM Global Services is in the early stages of planning for a Latin America-wide strategy for a centralized ICT platform for microfinance, located in Mexico and serving all MFIs in Spanish-speaking Latin America through a web-based solution. The platform envisioned includes a model of service delivery, hosting, and tailored functionality.

Fortunately, recent developments in technical offerings in South Asia present a tremendous opportunity to not only expand outreach, but also improve institutional capacity. Box 6 highlights examples of innovative technology applications and Box 7 describes a World Bank-supported project in Maldives to enable mobile access for all bank accounts.

Credit bureaus that inform lending practices are widespread in developed credit markets, but they are largely missing in the microfinance sector in South Asia. The absence of credit bureaus is largely due to a coordination failure in implementing an identification mechanism for clients. Interested parties face the challenge of agreeing on who should build and pay for the identification systems, who should issue the cards, and most importantly, who should own client information. Nonetheless, global experience has shown that microfinance clients can be incorporated into credit information systems and that the payoffs from
BOX 6
Innovative Technology Applications Increase Outreach

• The Andhra Pradesh Government in India, after a successful pilot reaching half a million villagers, is rolling out the delivery of government pensions and unemployment benefits under the rural employment guarantee program. A network of bank business correspondents operates with a Near Field Communication-enabled mobile phone, synchronizing with a bank’s server over a wireless connection and a fingerprint scanner to enroll the villagers. All deposit/withdrawal transactions are reported to the partner bank on a daily or hourly basis while the bank ensures that the business correspondent has enough funds to support daily withdrawals. During the pilot, the Government gave banks 2 percent of the amounts being transferred as a commission, to be shared with their business correspondents.

• In Pakistan, Tameer Bank has partnered with local retail outlets including pharmacies, telecom outlets, and post offices to install point-of-sale devices closer to the customers. Bank customers (individual and small businesses) can visit these registered outlets to withdraw and make deposits, repay loans, pay utility bills, and remit money. The set-up costs of using correspondent agents as alternatives to bank branches are reportedly 30 times lower and running costs, 100 times lower.

• Similarly, in Kenya, Equity Bank is using the Nakumatt chain of retail stores as branchless banking agents, while WIZZIT, a South African mobile phone banking facility with 16 million registered clients has partnered with Dunn, a chain of 400 clothing stores acting as WIZZIT account opening locations.

• The Rural Bankers Association of the Philippines, with support from USAID, has partnered with Globe Telecom’s G-Cash to allow its retail clients in 375 branches to send sales receipts and bank deposits via mobile phone, without being subject to a minimum balance requirement and fees charged by the commercial banks. Microfinance institutions under this program become “cash in” and “cash out” outlets that are accredited to convert actual money into electronic money and vice versa.
BOX 7
Maldives Mobile Banking Project

The Maldives Mobile Banking Project is the first branchless banking project funded by the World Bank. The project represents the first time a country will create a single national payment system in which mobile phones and local agents are the main payment instruments and devices. The Maldives Interoperable Payment System (MIPS) will work with all mobile network operators and all banks. Funds may be transferred from any account in any bank; deposits and withdrawals may be made with designated agents. The project was undertaken at the request of the Government of the Maldives after a regional World Bank microfinance workshop in 2005. The Maldives is uniquely situated for this pilot because though mobile phone usage is ubiquitous, bank branches do not exist on most islands. The system will overcome spatial limitations, increase bank coverage, and reduce time and safety concerns associated with traveling to and from banks with cash. The Maldives Monetary Authority (MMA) has been working closely with the World Bank and CGAP. Drawing on its comparative advantages, CGAP has provided specialized technical expertise in design and implementation, project management, legal and regulatory framework advice, and market research and impact studies.

these initiatives have been significant. Information on clients allows MFIs to make unsecured loans and extend unsecured credit inexpensively and profitably, leading to greater outreach.

Microfinance institutions have made great achievements even in environments with poor legal frameworks, including those for secured lending. Yet, it would be a mistake to assume that they would not benefit from reforms in the legal framework for secured transactions. Although MFIs rely on substitutes for collateral (peer pressure, access to repeat loans, innovative enforcement mechanisms), reform of collateral laws may have a real impact. The reason—when movable property and fixtures can be used as collateral, microfinance borrowers are better off since they generally do not own real estate on the same scale as borrowers from the formal sector. Indeed, anecdotal evidence suggests that in some countries that have undertaken reform of secured transactions, the initial uptake in using the system for registering security interests was bigger among MFIs than among commercial banks.¹⁰

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A reformed system for secured transactions also permits the refinancing of portfolios of unsecured loans held by microfinance lenders. Where a framework for secured transactions supports securitization, permitting the refinancing of small unsecured loans by businesses that do not take deposits, it reduces the cost of unsecured lending and promotes the development of nonbank competition. In India, for example, microfinance institutions are increasingly considering going the route of securitization to cut borrowing costs and free up capital. For investors, the asset pools are safe as they are backed by cash flows, thanks to the high recovery ratio of MFIs. With rating agencies now rating these structured instruments, the trend is catching on. In a securitization deal, pools of assets such as auto, personal, and construction loans are pooled and hived into special investment vehicles, which are bought by investors. For the better MFIs with strong asset quality, no high delinquencies, and a strong underlying cash flow, the loans are amenable to being structured and sold. This system enables them to tap sources beyond bank lending and equity. For MFIs, securitization offers capital relief as it is off-balance funding. It also offers funding that is 100 to 150 basis points lower than term loans.

ENTRY POINTS FOR TECHNOLOGY AND FINANCIAL INFRASTRUCTURE

The expansion of the financial sector in many regions of South Asia has been dramatic, but further growth risks being held back by the existing financial infrastructure. The World Bank Group can play a particularly key role in supporting the development of technology and financial infrastructure in the following ways:

- Investing in the creation of payment systems that automate cash transfer transactions for clients, including “currency chests.” In the current environment, the spread of branch banking is limited, in rural areas especially, by the basic mismatch of the supply of and demand for cash. Appropriate regulations and financial infrastructure are necessary to achieve improved intermediation;

- Investing in public private partnerships for the implementation of shared microfinance services hubs, making technology-led efficiency gains accessible to groups of MFIs and integrating MFIs into the financial sector;

- Coordinating platform specifications for technology providers,
including biometric standards and protocols for identity cards. In addition, rules must be established for the fair sharing of customer financial information to enhance competition—coupled with the appropriate protection of customer privacy;

- Facilitating coordination and development of institutional infrastructure such as credit bureaus that incorporate the microfinance sector, or secured transaction systems that allow MFIs to securitize their portfolios; and
- Ensuring effective regulation of branchless and mobile banking.

**PRIORITIES AND ENTRY POINTS TO DEVELOP PRODUCTS**

Poor people need access to a wide range of financial services in order to seize business opportunities, invest in home improvements, meet seasonal expenses like school fees and holiday celebrations, as well as for life-cycle events such as weddings and funerals. Poor households need safe, reliable, convenient mechanisms to save as a means of protecting against emergencies and promoting long-term asset accumulation.

However, many MFIs offer a limited range of fairly rigid financial products that are not always appropriate to meet the needs of the poor. Client satisfaction surveys of MFI customers, together with field research on market demand among the poor suggest that clients believe too few financial services are available and that terms are often inflexible. They

**FIGURE 6**

Voluntary savings outreach in South Asia

- Population who are voluntary savers

\[
\begin{array}{cccccc}
\text{Sri Lanka} & \text{Bangladesh} & \text{Nepal} & \text{Pakistan} & \text{India} & \text{Afghanistan} \\
20 & 15 & 10 & 5 & 0 & 0
\end{array}
\]

seek a wide array of flexible services such as individual loans, deposit services, transfer payments, and insurance.\textsuperscript{13}

Few institutions offer voluntary savings accounts with flexible deposit and withdrawal terms that are suited to the variable cash flows of poor households. Deposit services are costly because of small deposit amounts and a high frequency of transactions. Often, savings services are linked to compulsory deposit services with weekly loan repayment cycles—partly due to cost and regulatory constraints. Prudential regulations in Bangladesh and India limit some of the largest microfinance institutions (NGOs like the Bangladesh Rural Advancement Committee (BRAC) and Non-Banking Financial Companies (NBFCs) like Spandana and SKS Microfinance in India) from offering voluntary savings products. While progress can be made through technology and process innovations such as mobile and branchless banking, supportive policies around branch setup and customer identification requirements are needed.

In addition to savings products, clients are also increasingly interested in a wider range of tools to foster investments and smooth risks. For example, the demand for housing microfinance is high, and MFIs report that clients already channel a good portion of microenterprise loans to home improvement. Housing microfinance consists mainly of loans to low-income individuals for renovation or expansion of existing homes. To date, most of the success in this field has been demonstrated by home improvement loans.\textsuperscript{15}

Demand for agricultural microfinance is also increasing as farm and non-farm rural enterprises face financial constraints to increasing productive capacity. Until recently, conventional microfinance credit products were not necessarily compatible with agricultural finance because of the mismatch between seasonal demand for credit products and larger investment loans to finance equipment, compared to microfinance's traditional credit products characterized by short and frequent repayment methodologies. However, a new trend toward agricultural microfinance has emerged in recent years, which combines the most promising features of traditional microfinance (ability to screen, monitor, and regulate) with those of traditional agricultural finance (products and
Because international best practice institutions such as Grameen Bank in Bangladesh, BancoSol in Bolivia, Bank Rakyat Indonesia (BRI) in Indonesia, and Rabo Bank in the Netherlands have built strong sustainable banks for the poor by sustaining their credit programs with public savings, institutions throughout South Asia have set as a strategic objective the goal of becoming licensed by the central bank in order to receive public savings. This is the case even in countries where “priority sector” or “deprived sector” lending directs the commercial banking system to provide adequate funding to qualified MFI’s—eliminating the argument that access to savings would relieve a binding funding constraint.

A lesson learned can be found in the statement of the founding executive of BancoSol, Pancho Otero, who describes the challenge that taking savings presents to an institution.

“When it came to the supply-side—delivering the services—BancoSol discovered that savings were more expensive and more difficult than expected. Otero reflects, ‘We busted our brains trying to do savings. It’s hard to do savings and credit at the same time. Staff can’t learn both at once. One requires you to trust the client, while the other requires the client to trust you.’ Adding savings required some fundamental adjustments in staffing and in streamlined design at the branch level for moving credit quickly. It also required new computer systems, designed to give clients immediate information on the status of their accounts. Problems popped up when BancoSol began a too rapid rollout of the new savings products. When computers didn’t work, clients were left to stand in long queues wondering whether BancoSol was really a good place to put their money. BancoSol ultimately solved its delivery problems, but at the cost of a persistent perception that savings are expensive and hard to implement as a microfinance product.”

At present, only about 30 percent of BancoSol’s portfolio comes from its savings deposits, while at BRI savings are over twice the size of the loan portfolio. At Grameen Bank, savings exceed the loan portfolio, which is covered by savings deposits by about 150 percent.
repayment terms consistent with financing needs of agribusiness and agriculturally based households). Leasing products, area-based insurance, and contracting with processors, traders, and agribusinesses are examples of products that have met the needs of rural clients without sacrificing the quality of institutions and their portfolios. For example, leasing addresses both collateral constraints and the need to finance larger scale investments. For most rural enterprises, leases are also a means of acquiring equipment (and not just its use) and ownership is transferred to the lessee at the end of the lease period, either automatically or at a token price. 16 However, most rural farmers have no access to products that can benefit them such as leasing and warehousing receipts. There is also a “missing middle” where rural SMEs do not receive enough funding from microfinance and have no access to bank funding. Focusing on market gaps to the rural poor is an important aspect of increasing outreach to vulnerable sections of society. Creating financial instruments that can allow MFIs to reach more clients that graduate from the use of revolving funds managed by village organizations will be essential if the development of demand-driven products by rural communities is to be achieved. It will be critical to working with colleagues who focus on rural products to develop products that are not currently being covered.

Adequate risk management products such as life, health, and weather insurance are also important. Microinsurance offers protection to low-income individuals against specific perils in exchange for regular monetary payments (premiums) proportionate to the likelihood and cost of the risk involved. Risk pooling allows many individuals or groups to share the costs of a risky event. However, existing microinsurance schemes that provide more than simple credit life insurance find it difficult to become sustainable. Health insurance, the most vital form of insurance for low-income households, is the most difficult to operate. 17 Administering weather insurance is, similarly, dependent on the presence of an extensive support system of automated weather stations that reduce basis risk (correlation between rainfall at the current rainfall stations and rainfall on farmers' fields). Disaster insurance has recently received attention as another potential product as it may be able to protect the poor against the devastating effects of natural events such as earthquakes and typhoons. The absence of technical infrastructure
makes it difficult for insurance companies to provide appropriate contracts in a cost-effective manner. Support for the development of these products is an area suited to the WBG, and SASFP in particular, since there is a strong public good element to the design of risk management products.

An additional area of product development revolves around the targeting of the ultra-poor—those with income levels that preclude them from participating in microfinance. In Bangladesh, BRAC has developed a program that targets the bottom 10 percent of households—households that remain outside the purview of most anti-poverty programs. The program was based on the recognition that its microfinance programs rarely reached the poorest. BRAC’s main aim is to develop capacity for income generation by providing a minimum amount of assets, along with intensive training and supervision on the effective use of those assets, for two years. It is expected that after the two-year period, those households will be able to sustain the gains achieved through participation in labor and tenancy markets and in microfinance programs and will emerge from the poverty trap. A “quick and dirty” monitoring of the coping mechanism for the escalation in food prices found that beneficiaries who have been with this program for a longer period coped better with the crisis.

ENTRY POINTS FOR PRODUCTS

The following are some ways in which the Bank might provide support:

- First, do no wrong—product development is not a donor activity and should be left to managers of financial institutions. Enthusiasm for new products should not lead us to push financial institutions to offer new services or work in new regions before they are ready. Innovation is constantly occurring to provide clients with relevant products, but these products may not have reached significant scale.

- Support product development by providing flexible innovation grants, challenge funds, technical assistance, or seed funding to enable a variety of institutions to experiment with refining or designing products based on client demand. In particular, fund research and development of savings products and delivery innovations.
Support impact assessments of product and service innovations with an eye to scale and cost-effectiveness. Support information exchange and learning among practitioners and donors to maximize replication of successful product development efforts.

Financial inclusion ultimately depends on the presence of a supportive regulatory environment that promotes market entry and competition in microfinance. Savings mobilization—and the requisite prudential regulation—is high on the agenda for NGO-MFIs in several South Asian economies. It is important to note that most South Asian countries have not been as proactive in the area of microfinance regulation as in some other regions. Many central banks in Latin America, in particular, have created the framework to allow MFIs to transform, often into separate licensed entities.

The level of regulation in the microfinance sector is highly variable in South Asia, ranging from virtually laissez-faire in Afghanistan to highly regulated in Nepal. Each country is in discussions about the need for regulation specific to microfinance, with Nepal and Pakistan having already established such regulation. Regulators are forced to respond as providers expand their reach, introduce new products, and alter their financial structures. A delay in implementing appropriate policy responses can adversely affect sector growth. For instance, in Bangladesh the lack of clarity on what microfinance-focused NGOs can do is hindering these organizations from experimenting with new products such as leasing, insurance, and small-business lending. Other challenges to efficient regulation include fragmented regulatory frameworks requiring coordination among the different regulators. In Nepal for example, microfinance providers are regulated by three organizations and are subject to four regulations with differing levels of oversight and control. Implementation of technology-led innovations such as payment systems and mobile banking require partnerships with additional regulators such as telecommunications regulatory authorities.
The second regulatory sphere affecting microfinance revolves around appropriate regulations to support branchless banking—the use of information and communication technologies (ICTs) and nonbank retail channels to reduce the costs of delivering financial services to clients beyond the reach of traditional banking. Much of the current buzz is around mobile phones and banking correspondents. Regulation will go far in determining not only whether branchless banking is legally permitted, but also which models of branchless banking are economically feasible and how far they will go in reaching previously underserved poor populations.

Finally, increased competition is presenting regulators with the classic "regulators dilemma": whether to allow the expansion of credit, with its material benefits for consumers (and economic growth) to continue, despite the risks, or to intervene in ways that may slow the broadening of access, but provide greater safety to consumers who are particularly vulnerable due to their difficult economic situations. Competition between MFIs has increased in several regions in Bangladesh and India with studies pointing to an overlap of clients and the possibility of over-

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**BOX 9**

**The Rush to Regulate Microfinance: Some Lessons Learned**

- Do not rush to regulate, but build capacities of MFIs.
- Regulating too early typically stifles innovation, which is needed to develop products, methodologies, and systems.
- It is impossible for a central bank regulatory authority to effectively supervise a large number of small MFIs.
- It is very difficult to prevent people from putting their savings into risky MFIs/schemes.
- Recognize the nature and diversity of institutions.
- Evaluate the capacity of the central authorities to carry out the regulation/supervision functions.
- Regulate to protect against the risk of major crises where there are large MFIs mobilizing substantial savings.
- Regulate to create legal opportunities to enter microfinance on a commercial basis.
- Consultation with stakeholders, donor agencies, parliamentarians, central bankers, and MFIs leads to practical regulatory steps.
indebtedness; the issue is likely to become pervasive across the region with sustained sector growth. Competition also raises concerns around predatory lending and abusive recovery practices. While it is obvious that regulation must protect against both state and private practices, the level and nature of regulation is unclear and most governments are still experimenting and learning.

**ENTRY POINTS FOR REGULATION**

SASFP, through its policy dialogue, is ideally suited to help persuade governments to establish supporting policy environments. Among activities that the Bank might support are the following:

- Promote better prudential regulation through different regulatory frameworks for different levels of microfinance development. This includes coordinating discussions with governments and central banks about policies, laws, and regulations needed to facilitate the mobilization of deposits. In more advanced countries, where there is a critical mass of institutions that are strong enough to obtain licenses to mobilize deposits from the public, encourage appropriate minimum capital requirements, and build supervisory capacity.
- Fund capacity building of both government and non-governmental regulatory and supervisory bodies, including by providing technical and financial resources to set up and maintain effective supervision.
- Showcase examples of successful regulatory and supervisory frameworks, both related to the content and process of reform.
- Promote simplified regulatory oversight on microfinance institutions by supporting mapping exercises to understand the regulatory landscapes and technical assistance supporting the consolidation of acts and twin arrangements between regulators.
- Support better non-prudential regulation. Where microfinance is not yet ripe for regulation, prepare the groundwork by encouraging MFIs to follow sound accounting principles and disclosure. Encourage regulatory changes that allow credit-only institutions to lend without prudential licenses where applicable or for formal legal recognition of MFIs unregulated by central banks, which could help clarify their legal position and legitimize their activities.
- Educate politicians and the public to (i) understand why sustainable
MFIs charge relatively high interest rates to avoid public backlash that could undermine access, and (ii) facilitate appropriate policy on interest rates that recognizes the social concerns of regulators and the financial imperatives of lenders.

- Facilitate development of regional and country standards such as a code of conduct for lending institutions and consumer protection protocols.
- Promote proportionate regulatory policies that provide space for innovation and permit branchless banking to ensure safe scale up. This would include basic “precondition” regulations such as allowing nonbank retail outlets to serve as agents as well as risk-based anti-money-laundering procedures adapted to the realities of remote transactions conducted through agents. It should also include next-generation policy and regulatory areas covering issuance of e-money and other stored-value instruments, effective consumer protection, inclusive payment system oversight, and policies governing competition among providers.
- Consider non-regulatory approaches, such as promoting consumer education and financial literacy.

- Support to APEX institutions
- Facilitation of policy discussions
- Knowledge sharing and partnerships
- Leverage of public finance and guarantees
- Investment in payment systems and shared microfinance hubs
- Support to credit bureaus and secured transactions systems
- Effective regulation of branchless banking
- Flexible innovation grants, challenge funds
- Impact assessments of product and service innovations
- Information exchange to maximize replication
- Support to better prudential and non-prudential regulation
- Capacity building to supervisory bodies
- TA to understand regulatory landscape
- Support to regional and country regulatory standards
- Non-regulatory approaches, such as consumer education and financial literacy
PARTNERS AND COLLABORATORS

SASFP's comparative advantage lies in bringing the convening power of the World Bank Group to engage in dialogue with clients, in its global experience in good practice knowledge generation, in its development of analytic tools around the "access to finance" agenda, and in its ability to support governments with financial and technical assistance through lending instruments. Yet building and strengthening the microfinance sector to extend financial access to the underserved is a broad and complex undertaking, one that cannot be accomplished without building on and leveraging the strengths of collaborators.

To date, CGAP and SASFP have been partners in supporting microfinance in South Asia on a number of different fronts. In the South Asia region, CGAP has been active in engaging with governments on regulatory issues, developing innovative projects around technology and branchless banking, and advising the WBG and other donors on both strategic and technical issues related to the access agenda. For example, CGAP is advising the Microfinance Regulatory Authority (MRA) in Bangladesh, supporting a project in Andhra Pradesh, India, for developing technology, and providing technical assistance and financial resources for a WBG project on branchless banking in the Maldives. Going forward, SASFP will continue to leverage CGAP's expertise working with staff to support project design and dialogue and replicating, scaling up, and investing in innovative projects where key results have shown high impact and potential.

IFC mobilizes private sector resources and invests in sustainable microfinance to maximize outreach. IFC also works on building requisite infrastructure, particularly on credit bureaus and microfinance institutions, and provides advisory services that focus on legal and regulatory changes, particularly on those that mobilize deposits. SASFP's work with IFC and its private enterprise partnerships (PEPs) is highly complementary; in particular, our work in dialogue on regulatory and supervisory issues paves the way for greater outreach by institutions in which IFC invests. Working on regulation with respect to technology and branchless banking assures that such institutions can be highly efficient and sustainable. IFC's technical assistance and advisory ser-
vices to MFIs raise standards and levels of competition for the sector, and their work on financial infrastructure increases the efficiency of all financial institutions. SASFP has collaborated with IFC on joint investment lending on financial sector infrastructure, such as payment systems and technology platforms. For example, in Bhutan, the Asian Development Fund (ADF) has been financing the implementation of the credit information system, while the World Bank and the Bangladesh Investment Climate Fund (BICF) are in the first phase of supporting the feasibility assessment and implementation of an automated clearing house and a point-of-sale network. Going forward, SASFP will continue to coordinate activities, either undertaking investments jointly or in spaces that are highly complementary.

The South Asia Rural Development Department leads Rural Livelihood Projects in the South Asia region, which focus on developing rural community institutions that manage and receive microfinance loans for low-income, rural, and vulnerable groups, and link these to community sources of funding. SASFP supports this work by contributing staff expertise in project design and assistance on Operational Policy (OP) 8.30 on Financial Intermediary Lending, the guiding document that ensures that our credit instruments promote, rather than undermine, sustainability in the sector. We see value-added in promoting microfinance to geographically underserved areas, provided it is done in a way consistent with OP 8.30, as these regions are often not penetrated by traditional microfinance institutions. Focusing on time-bound and capped grant assistance that may eventually graduate non-borrowers to borrowers, or the development of Bank-SHG linkages, is another means of supporting outreach without distorting financial markets.

Multilateral and bilateral donors, such as ADB, USAID, DFID, and UNCDF, are key players and collaborators in the microfinance agenda in all South Asian countries. Work programs and levels of engagement vary by country, depending on each donor's priorities and client demand. Regardless of its level of engagement in the microfinance sector, SASFP maintains a collaborative relationship with multilateral and bilateral donors in South Asian countries. In Afghanistan, for example, donors support the microfinance agenda through a multi-donor trust fund, with the WBG implementing the microfinance project. In other
countries, such as Bangladesh and India, SASFP closely coordinates initiatives with bilateral donors, such as DFID, to ensure that efforts to support the sector and key messages to the governments are consistent and not duplicative. There are also countries, such as Sri Lanka or Nepal, where SASFP is less engaged in the microfinance agenda, but still maintains close contact with donors and stakeholders and is poised to increase engagement pending demand by clients and any other gap that can be filled by SASFP.

Microfinance stakeholders in the region include governments, apex institutions, microfinance networks, MFI s, MFI clients, and civil society. SASFP engages with stakeholders in a variety of ways. For example, SASFP responds to demand from governments for policy advice, provides technical assistance and capacity building for supervisory and regulatory bodies, and provides financial resources through grants or lending instruments in support of microfinance projects across a spectrum of interventions ranging from financial infrastructure, to technology, to regulation.

In addition to governments, SASFP also supports first- and second-tier institutions through lines of credit (direct or indirect), capacity building, and support for research and analytical work that helps identify market demand, impact analysis of programs, or analysis of outreach gaps. Finally, MFI clients and civil society are important stakeholders, whose voices are taken into account in project design and strategic approaches to engagement.
**STRATEGIC INTERVENTIONS—HIGH, MEDIUM, AND LOW**

South Asia is diverse, and the maturity of the microfinance sector varies highly across countries. Our strategic interventions are guided by the unique challenges facing high, medium, and low outreach countries and the types of interventions that will move each country closer to the frontier of microfinance outreach. **High outreach** countries are characterized by highly efficient and commercially viable institutions, poised to integrate into the mainstream financial sector. **Medium outreach** countries are in a transition stage, where consolidation and growth are taking place and institutional efficiency and commercial viability vary considerably across the sector. **Low outreach** countries are at the start-up phase, characterized by a fragmented MFI sector and institutions at low levels of efficiency and sustainability.

In **high outreach** countries MFIs are mature, have reached significant outreach to poor borrowers, and are poised to evolve into deposit-taking and sustainable institutions, with a wider array of products to offer clients, and to penetrate into underserved geographical and socio-economic strata. The challenges facing high outreach countries include the need to develop a regulatory framework that is favorable for MFIs to start mobilizing deposits and to leverage both domestic and foreign

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**FIGURE 7**

Levels of outreach

Efficiency

- Sri Lanka
- India
- Nepal
- Bangladesh
- Pakistan
- Afghanistan

OUTREACH FRONTIER

LOW MEDIUM HIGH

Outreach
Percent of poor people served

private sector capital sources. Additionally, institutions can still considerably improve levels of efficiency and productivity. This is evident when comparing South Asian institutions with their counterparts globally and is essential for the purposes of mobilizing funding and passing cost reductions on to final borrowers. This is particularly important in the current financial climate, where strong, profitable institutions are at risk of political backlash on the matter of interest rate caps.

An increase in technology applications and the strengthening of financial sector infrastructure would go a long way toward expanding outreach. In high outreach countries, higher penetration rates have also raised issues of predatory lending and over-indebtedness. In these countries, consumer protection and financial literacy efforts would help to address these issues, while microfinance networks can aim to raise industry standards and work toward developing truth-in-lending practices. Additionally, as competition in the sector continues to thrive, and with increases in efficiency, interest rates should begin to come down as institutions balance the need for a double-bottom line approach. Finally, new products and programs that target the ultra-poor and geographically underserved will help ensure that microfinance extends deeper into underserved populations and responds to clients' demand for a broader range of financial and credit products such as savings and insurance.

In medium outreach countries MFIs are in a transition phase. Institutions are growing quickly, but there is still a long way to go in the area of geographical and socioeconomic outreach, i.e., reaching out and reaching down. In these countries, an ill-defined regulatory space may still hinder institutions from mobilizing deposits, and the range of efficiency and outreach of the sector is highly varied, with very strong, sustainable institutions mixed with newer, less mature MFIs. Challenges here include increasing the capacity of newer institutions and focusing on incremental changes in regulation, given constraints in the political economy and a more conservative approach to regulation as a result of the financial crisis. A focus on raising industry standards, better governance, and increased transparency will level the playing field of the sector overall. Investment in financial infrastructure and technology applications will move the microfinance sector closer to the outreach frontier and complement institutional development at the micro level.
<table>
<thead>
<tr>
<th>Priorities</th>
<th>Entry Points</th>
</tr>
</thead>
<tbody>
<tr>
<td>Greater integration needed to promote savings, intermediation, and integration with the financial sector</td>
<td>Focus on the development of a regulatory environment conducive to savings mobilization</td>
</tr>
<tr>
<td>Improved efficiency and productivity critical to move MFIs to full commercial viability</td>
<td>Increase use of technology applications and financial infrastructure</td>
</tr>
<tr>
<td>Focus on the development of a regulatory environment conducive to savings mobilization</td>
<td>Aim to raise industry standards and increase consumer protection and financial literacy</td>
</tr>
<tr>
<td>Highly mixed levels of efficiency and sustainability across institutions</td>
<td>Focus on research and development and on raising equity</td>
</tr>
<tr>
<td>Ill-defined regulatory space for microfinance sector, both prudential and non-prudential issues not yet addressed</td>
<td>Address liquidity issues stemming from the GFC</td>
</tr>
<tr>
<td>Rapid growth of some MFIs, but significant gaps in outreach to the underserved</td>
<td>Focus on development of a favorable prudential and non-prudential regulatory environment to create regulatory space even for non-deposit taking institutions</td>
</tr>
<tr>
<td>High levels of efficiency and productivity, large gap to operational or financial sustainability</td>
<td>Increase technology applications and financial infrastructure</td>
</tr>
<tr>
<td>Low levels of efficiency and productivity, large gap to operational or financial sustainability</td>
<td>Work to raise industry standards, consumer protection, and financial literacy</td>
</tr>
<tr>
<td>Rapidly growing institutions that may have limited absorptive capacity</td>
<td>Expand through training, capacity building, and increased integration</td>
</tr>
<tr>
<td>Fragmented sector, with a large number of MFIs and limited capacity</td>
<td>Address liquidity issues stemming from the GFC</td>
</tr>
<tr>
<td>Low levels of efficiency and productivity, large gap to operational or financial sustainability</td>
<td>Focus on capacity building of MFIs through TA, training, and technology</td>
</tr>
<tr>
<td>Low levels of efficiency and productivity, large gap to operational or financial sustainability</td>
<td>Limit lines of credit and liquidity until institutions mature</td>
</tr>
<tr>
<td>Rapidly growing institutions that may have limited absorptive capacity</td>
<td>Provide only non-interest subsidies; focus on building a market-oriented sector for long run sustainability</td>
</tr>
<tr>
<td>Fragmented sector, with a large number of MFIs and limited capacity</td>
<td>Address liquidity issues stemming from the GFC</td>
</tr>
</tbody>
</table>
In low outreach countries, relative newcomers are facing a different set of challenges. In both Afghanistan and Pakistan, the regulatory environment allows the sector space to evolve and mature, but institutions are still struggling to increase efficiency, productivity, and sustainability, which are the main constraints to scaling up. The rapid growth that characterizes MFIs raises questions about absorptive capacity. MFIs are concentrated in large urban centers, and institutions may not yet have the capacity to expand to more underserved areas or clientele.

In low outreach countries, the focus will be on getting the basics right. Building the capacity of MFIs through technical assistance, training, and technology will increase absorptive capacity for external funds and move the sector more quickly toward the goals of sustainability and a larger scale. Support for specialized microfinance providers and full cost-recovery interest rates should be the objective, and a focus on capacity building, rather than funding large credit lines through the government, is warranted. Investment in financial infrastructure now will pay off as MFIs develop in the medium term. Rather than support innovations in product development, the focus in low outreach countries will revolve around getting the basics right as a prerequisite to long-term growth.
Monitoring and Evaluating the Effectiveness of Microfinance Interventions

The World Bank is committed to measuring the effectiveness of its development aid using a results framework that reflects the cause-and-effect relationship between development interventions and the ultimate goal of bringing about change. Based on accumulating evidence from impact studies, access to microloans by the poor produces significant improvements in household welfare. In the financial systems targeted by this strategy, the objective of our interventions is to support the development of sustainable institutions that make access to financial services by the poor an integral part of a sound financial system. Sustainable institutions can provide ongoing, reliable, and increasing access to the financial services that allow the poor to improve family livelihoods through increased incomes and the ability to pay for social services (education, health, and nutrition).

In the results framework, the intermediate objective of developing sustainable institutions is a proxy for the effectiveness of microfinance in the process of reducing poverty. Thus, microfinance institutions' loan collection and cost recovery rates are important and frequently used generic indicators and targets that can be adapted to a specific project's monitoring and evaluation framework. They are determined by an evaluation of the following factors:

- Portfolio at risk with payment 30 days overdue or non-performing loans with payment 90 days overdue;
- Rate of operational self-sufficiency or financial self-sufficiency;
- Average loan size (as a proxy for client poverty); and
- Outreach (number of clients reached).
Community-managed revolving loan funds are usually not set up with the expectation that they will become institutions that can finance their own growth to serve ever-larger numbers of members. However, in the context of the World Bank's policy framework (OP 8.30), which sets strict requirements for the financial integrity of products that are considered to be loans, even revolving loan funds must be judged by whether loan repayment by members is high enough for the funds to continue to revolve for five or more years. Otherwise, resources intended for the whole community are quickly siphoned off by a minority of defaulters—a situation that is not only inequitable, but that can damage a community's "social capital" by producing animosity and distrust.

Why use institutional sustainability as a test of microfinance effectiveness if the ultimate objective of microfinance is improvement in client welfare, and not the establishment of institutions? Indeed, reliable studies carried out in Bolivia, Indonesia, India, Zimbabwe, and Bangladesh, and on Grameen Bank and BRAC borrowers using large sample sizes and control groups (of similar cohorts that do not receive microfinance and that help demonstrate causality) have revealed a significant impact of microfinance on factors such as client savings, incomes, food expenditure and consumption of high-protein foods, educational enrollment of children, receipt of services during natural disasters, graduation out of poverty, and self-employment. These impact studies have also confirmed that no single intervention can defeat poverty. Poor people need employment, schooling, and health care; some of the poorest require immediate income transfers or relief to survive. Nevertheless, access to financial services forms a fundamental basis on which many of the other essential interventions depend. Moreover, improvements in health care, nutritional advice, and education can be sustained only when households have increased earnings and greater control over financial resources. Therefore, impact studies have shown that financial services can reduce poverty and its effects in multiple, concrete ways. Littlefield, Murduch, and Hashemi conclude that "the beauty of microfinance is that, as programs approach financial sustainability, they can reach far beyond the limits of scarce donor resources."

However, directly testing the impact of financial services on clients is surprisingly complex, expensive, and time consuming, which explains why most microfinance projects do not report such information.
number of groups are now trying to develop inexpensive methods that simply track client progress without establishing what caused that progress. Future years may see tracking reports of this latter type in more microfinance projects.

In 2006, CGAP published in its focus note "Aid Effectiveness in Microfinance" an evaluation of microcredit projects of the World Bank and the United Nations Development Program. The evaluation revealed a disappointing picture. In both agencies, fewer than one quarter of the projects that funded microlending were found to be successful. The rest failed or appeared unlikely to produce lasting results such as retail institutions and programs that could continue offering clients quality financial services over the long term without losing their capital and requiring continuing infusions of money from governments or development agencies.

The evaluation also noted common characteristics of successful programs as those that had adopted the United Nations Capital Development Fund microfinance unit's "MicroStart" model, which includes four main elements:

- Project implementation is done, or closely guided by, a technical service provider from a prequalified list of providers that have already demonstrated their ability to produce sustainable microfinance.
- There is regular reporting, including reporting of key indicators such as the number of clients, average loan size (a very rough proxy for client poverty), repayment, and cost recovery.
- MFIs that do not meet performance standards are dropped from the project unless the technical service provider is confident that the MFI manager will correct the problem(s).
- A specialized microfinance unit collaborates closely with the project team in designing, implementing, and monitoring the project.

CGAP advises that including these principles of good practice in World Bank-financed interventions could improve the effectiveness of our microlending activities.
ANNEX

EXPLANATION OF DATA SOURCES AND ANALYSIS METHODS

MIX benchmark data does not include all MFIs in each country, or even all MFIs that publish data on MIX Market. Every attempt is made to include all large MFIs in the benchmarks, but some do not participate because they choose not to or are untimely in submitting data. Similarly, not all MFIs in a country report to MIX Market, especially those that are smaller and lack capacity and those that believe their indicators would not present a positive image. This shortfall in data reporting has two effects: performance indicators may be more positive than if all MFIs reported, and outreach and GLP figures are underestimated.

1. COUNTRY-LEVEL DATA for efficiency, productivity, financial performance, revenues, portfolio at risk, and outreach are taken from MIX benchmarks for fiscal year 2007, and data points on the areas mentioned are institutional medians. Data pertaining to FY07 is defined as that which demonstrates a majority of activity taking place in 2007, that is, any financial statement dated July 1, 2007–June 30, 2008. Because of this definition, FY07 benchmarks are the most current since FY08 is not yet complete. Fiscal year reporting typically fell on the following dates for FY07:

<table>
<thead>
<tr>
<th>Country</th>
<th>Date</th>
</tr>
</thead>
<tbody>
<tr>
<td>Afghanistan</td>
<td>31 December 2007</td>
</tr>
<tr>
<td>Bangladesh</td>
<td>30 June 2008</td>
</tr>
<tr>
<td>Bosnia and Herzegovna</td>
<td>31 December 2007</td>
</tr>
<tr>
<td>Cambodia</td>
<td>31 December 2007</td>
</tr>
<tr>
<td>Colombia</td>
<td>31 December 2007</td>
</tr>
<tr>
<td>India</td>
<td>31 March 2008</td>
</tr>
<tr>
<td>Morocco</td>
<td>31 December 2007</td>
</tr>
<tr>
<td>Nepal</td>
<td>16 July 2007</td>
</tr>
<tr>
<td>Pakistan</td>
<td>31 December 2007 or 30 June 2008</td>
</tr>
<tr>
<td>Sri Lanka</td>
<td>31 March 2008</td>
</tr>
</tbody>
</table>

The benchmark data typically encompasses all of the large MFIs, but does not include every MFI that reports to the MIX.
2. Levels of current borrowers and gross loan portfolio (GLP), charter type, best performers, and data on the top five microfinance institutions all come from MIX Market’s Web site. Most of the dates correspond to data from the past fiscal year (and thus the benchmarks), but many MFIs have updated their data since the last data collection exercise was conducted to determine benchmarks. The top five for each country are the largest five MFIs by GLP and with enough data to be useful for the analysis. The following MFIs are included:

For each indicator, the “best practice” graph shows the best performing MFI from the above list for each country. “Top 5” graphs (both alone and compared to country data) use the MFIs above and take a weighted average by GLP for each indicator. This shows the performance of the combined GLP for the top five MFIs in each country.

<table>
<thead>
<tr>
<th>Country</th>
<th>MFIs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Afghanistan</td>
<td>First MicrofinanceBank – Afghanistan, BRAC Afghanistan, Afghanistan Rural Microcredit Program, Foundation for International Community Assistance, Child Fund Afghanistan</td>
</tr>
<tr>
<td>Bangladesh</td>
<td>BRAC Bangladesh, Grameen Bank, ASA Bangladesh, PROSHIKA, BURO Bangladesh</td>
</tr>
<tr>
<td>Bosnia and Herzegovina</td>
<td>ProCredit Bank, MIKROFIN, EKI, Partner Microcredit Organization, LOK Microcredit Foundation</td>
</tr>
<tr>
<td>Cambodia</td>
<td>ACLEDA Bank, Sathapana Ltd., PRASAC MFI Ltd., AMRET Co. Ltd., Angkor Mikroheranhvatho Kampuchea</td>
</tr>
<tr>
<td>Colombia</td>
<td>Banco Caja Social Colombia, WWB Cali, Fundación Mundo Mujer Popayán, Fundación Mundial de la Mujer Bucaramanga, Finamérica</td>
</tr>
<tr>
<td>India</td>
<td>SKS Microfinance, Spandana, SHARE Microfin Limited, Shri Kshetra Dharmasthal Rural Development Project, Asmitha Microfin Ltd.</td>
</tr>
<tr>
<td>Morocco</td>
<td>Association Al Amana for the Promotion of Micro-Enterprises Morocco, Fondation Zakours, Fondation Banque Populaire pour le Micro-Credit, FONDEP Micro-Crédit, Fondation ARDI</td>
</tr>
<tr>
<td>Sri Lanka</td>
<td>Wayamba Development Bank, SANASA Development Bank, Ruhuna Development Bank, Sabaragamuwa Development Bank, Sarvodaya Economic Enterprise Development Services</td>
</tr>
</tbody>
</table>
1. CGAP is an independent policy and research center dedicated to advancing financial access for the world’s poor. It is supported by over 30 development agencies and private foundations that share a common mission to alleviate poverty. Housed at the World Bank, CGAP provides market intelligence, promotes standards, develops innovative solutions, and offers advisory services to governments, microfinance providers, donors, and investors.


3. The Finance and Private Sector Board has issued a set of minimum standard indicators to be used in lines of credit (LOC) for micro, small, and medium enterprise (MSME) support for IFC investments, community-managed loan funds, and institutional development. Indicators include (i) Bank funding at appraisal of the commitment amount, and, during monitoring, of the disbursed amount (except guarantees); (ii) outreach, measured by the number of active loans as of the most recent reporting date and for MFIs, the number of voluntary deposit accounts; (iii) the percentage of women as active borrowers; (iv) the outstanding loan portfolio as of the last reporting date; (v) repayment, measured by PAR as of the preceding 30 days; and (vi) profitability, measured by return on assets or return on equity, subsidy-adjusted for institutions that receive substantial subsidies.


5. The penetration rate is defined as the number of poor borrowers served as a percentage of the total population.

6. This figure does not take into account Bank-SHG linkage programs. See Annex I for a detailed description.

7. Formal providers are sometimes defined as those that are subject not only to general laws, but also to specific banking regulation and supervision (development banks, savings and postal banks, commercial banks, and nonbank financial intermediaries). Formal providers may also be any registered legal organizations offering any kind of financial services. Semi-formal providers are registered entities subject to general and commercial laws, but are not usually under bank regulation and supervision (financial NGOs, credit unions, and cooperatives). Informal providers are non-registered groups, such as rotating savings and credit associations (ROSCAs) and self-help groups. Ownership structures: MFIs can be government-owned, like the rural credit cooperatives in China; member-owned, like the credit unions in West Africa; socially minded shareholders, like many transformed NGOs in Latin America; and profit-maximizing shareholders, like the microfinance banks in Eastern Europe. The types of services offered are limited by what is allowed by the legal structure of the provider; non-regulated institutions are not generally allowed to provide savings or insurance.

9. Three Hyderabad-based MFIs—SKS Microfinance, SHARE Microfin, and Spandana—raised equity from international and domestic private equity firms and venture capitalists. SKS Microfinance raised US$37 million in third-round funding, Spandana raised US$12 million, and Share received US$27 million. In Bangladesh, MFIs have been able to raise capital through bank debt. Standard Chartered recently lent a combined US$5 million to BURO Bangladesh and Shakti Foundation.

10. Based on conversations with stakeholders in Albania and Bosnia and Herzegovina.


15. Land acquisition and new housing construction are still dominated by subsidies rather than financial services.


17. Administration of health insurance is dependent on a third-party provider and a support system.


20. Banking correspondents typically include local merchants, post offices, and lottery dealers equipped with card swipe and barcode-reading point-of-sale terminals.


25. Ibid.
