## CHAPTER 12:

# Mainstreaming Microfinance – *Quo Vadis* Microfinance Investments?

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## Microfinance – Past and Present

Microfinance is a relatively new term. Its roots lie in the 1970s when tiny, subsidised loans were provided to low-income groups with a focus on the agricultural sector. With the failure of the donor-sponsored development banks that typically provided these services in developing countries through the 1980s (Gonzalez-Vega 2003), microfinance gained momentum and began to expand at break-neck speed. Donor-dependent microcredit programmes were implemented by non-governmental microcredit organisations (MCOs). These organisations successfully issued loans to poor households and microenterprises in the informal sector. The most important effect of these pivotal efforts was to demonstrate that the target groups (micro and small enterprises and poor households and individuals) were bankable even though they did not possess the usual marketable collateral. In spite of this important achievement, the overall developmental impact remained meagre, primarily for the following reasons:

- the range of microfinance services was restricted to credit,
- regional outreach was limited and
- the number of clients was small.

Moreover, these microcredit initiatives often lacked a systematic approach, leading to the prevalence of fragmented projects without a sound vision. And, they were heavily dependant on external grant funding.

The 1990's saw the emergence of microfinance programmes that sought gradual integration into the finance sector. Financial sustainability became a key concept and the objective of many microfinance practitioners and specialists. They viewed cost-covering operations as an imperative. This development was based on

the realisation that only a financially viable institution could gain the trust of the target group that would be necessary to mobilise savings or to attract dual-objective private investors seeking development impact as well as meeting financial objectives. Consequently, there was a proliferation of microfinance models. These included, for example, the Grameen Bank, the scaling-up of MCOs into licensed microfinance banks championed by Acción International, or the establishment of greenfield specialised microfinance banks such as the ProCredit model, all of which aimed at integrating microfinance into the mainstream financial system.

By the end of the 1990s, an institutional framework was created that could increase outreach on a large scale and offer a variety of microfinance products. An example is the creation of networks of microfinance institutions (MFIs), such as the ProCredit Banks (discussed below) that enable these specialised microfinance banks to provide a broad range of retail financial services such as credit, savings products and money transfers for low income households on an unprecedented scale. By doing so, they empower economically weak sections of society by giving them the tools to improve their standard of living. The rapid growth of these institutions was made possible through funding provided from a group of public and private institutions, among them KfW Entwicklungsbank.[1]

The UN has designated 2005 as the Year of Microcredit (YOM), demonstrating that microfinance is now well established on the international development agenda. There is a widely acknowledged track record of successful MFIs. Their operations prove that banking the "unbankable" is commercially viable and that this target group of the working poor wants access to a broad range of services: credit, money transfers, savings and other financial products. Contrary to expectations, the solid portfolio quality of mainstream MFIs shows that uncollaterised loans are repaid. Even weaker MFIs in developing countries and transition economies often show a portfolio at risk (balances in accounts affected by a delay in loan repayment of greater than 30 days) of less than 5 %. Moreover, MFIs in urban areas have succeeded in implementing cost-covering delivery mechanisms, allowing them to operate in a sustainable manner. These experiences have convinced even the strongest sceptics that financial services can be extended to microenterprises and households in ways that benefit both the private financial sector and the rest of the economy. Successful microfinance projects provide an excellent example of a development process that does not by-pass the poor but that is driven by them.

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[1] KfW Entwicklungsbank operations in microfinance go well beyond its leading role in supporting the network of ProCredit Banks. Overall, KfW Entwicklungsbank provides financial and technical support to 83 MFIs in 37 developing and transition countries. The total microfinance portfolio of KfW amounted to EUR 463 million at the end of 2004, making KfW Entwicklungsbank a leading financier of microfinance worldwide. Two-thirds of this support has been in the form of financial cooperation funds from the German government, while the remainder consists of funds provided by KfW Entwicklungsbank at its own risk.