

ANNEX

To the Devfinance quarterly review

July to September 2003

General information

➤ Remittances

Date: Wed, 20 Aug 2003 17:41:41 +1000
From: Michael Skully <Michael.Skully@buseco.monash.edu.au>
Subject: Devfinance: Remittances

August 20, 2003

M'sia, Indon banks tie-up to tap remittance market

KUALA LUMPUR - Malaysia's Bumiputra-Commerce Bank (BCB) and its Indonesian unit PT Bank Niaga tied-up on Wednesday to introduce a speedy remittance service for some 600,000 Indonesian workers here.

The 'CashLaju' (FastCash) service will cater to Indonesian workers here as well as small business traders with active cross-border trade in Indonesia, said BCB chief executive Rozali Mohamed Ali. The service, available at over 270 BCB outlets, allows monies to be paid to beneficiaries through Bank Niaga's 160 branches on the same day and to other Indonesian banks the next day, he said.

For beneficiaries without any banking accounts, the funds can be collected at some 10,000 post offices under PT POS Indonesia between three to 10 days.

Some RM2 billion (S\$922 million) were remitted by Indonesian workers here last year, of which BCB has only a 10 per cent share of the market, officials said.

They said the new service was also timely in anticipation of more robust intra-regional trade with ongoing market liberalisation.

Bank Niaga's executive director Catherine Hadiman said the bank handled remittances worth some 400 billion rupiah (S\$83 million) last year mainly from workers in the Middle East, Hong Kong and Taiwan.

Remittances through the bank are expected to double this year to 800 billion rupiah, with the Malaysian portion expected to account for 10 per cent of the total, she said.

'We were not focused before on Malaysia but with the new service, I expect 50 per cent can come from Malaysia next year,' she told reporters.

BCB, the second largest bank in Malaysia, holds a 51 per cent stake in Bank Niaga, the 10 largest among some 200 commercial banks in Indonesia.

It bought the stake last year from the Indonesian Bank Restructuring Agency (IBRA), which took over Bank Niaga in the late 1990s along with numerous other banks hit by the regional financial crisis.

On merger talks between BCB and Malaysia's fifth largest lender AMMB Holdings, Rozali said negotiations were ongoing and the central bank has given them until September 15 to reach a conclusion.

Sources told financial news wire AFX-Asia that the two parties were still haggling over pricing but a memorandum of understanding was expected to be signed soon.

Under the pact, AMMB will sell its retail banking operations to BCB's parent, Commerce-Asset Holdings for RM4 billion in cash, a source said.

Malaysian banks are seeking a new round of mergers to stay competitive ahead of market liberalisation in 2007.

Publications

➤ **Doing Pro-Poor Microcredit in South Africa**

Date: Mon, 28 Jul 2003 09:33:04 +1000 From: Michael Skully <Michael.Skully@buseco.monash.edu.au> Subject: Devfinance: Microenterprise in the USA
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Now available on the Community Microfinance Network website: = <http://www.cmfnet.org.za/>

The Cost of Poverty-oriented Microcredit in South Africa

[http://www.cmfnet.org.za/Documents/Monographs/The Cost of Poverty-Oriented MF in SA.doc](http://www.cmfnet.org.za/Documents/Monographs/The%20Cost%20of%20Poverty-Oriented%20MF%20in%20SA.doc)

1. This paper examines the performance of selected South African microcredit NGOs that have a poverty-alleviation focus to various benchmarks drawn from the Microbanking Bulletin (<http://www.mixmbb.org/>).
2. Donors, governments, and many analysts regard sustainability as the benchmark of MFI performance. However, the most relevant question is whether microcredit NGOs are doing as well as they can, given contextual factors in their context. Of particular contextual importance is the level of income inequality a society.
3. South Africa has the world's worst income inequality. This produces a situation in which microcredit NGOs must recover "first world" costs, particularly salaries, from revenues based on clients who can only afford loans on a par with "third world" countries.
4. Compounding this are structural obstacles to microenterprise in South Africa, as well as obstacles to productivity in microcredit NGOs. Taken together, this creates a "salary burden" for South African microcredit NGOs that is the highest in the world according to relevant benchmarks.
5. South African MFI managers face significant obstacles to improving productivity to compensate for the divergence between staff and client living standards. These include an inadequate skills base, the small scale of the market, rapid labour turnover, and limited resources for capacity development.
6. South African MFIs are confronted with the options of moving upmarket (which many have done) methodological innovation, new product development, or closure. Of these, there is a strong argument to be made for supported savings and credit (ASCA) approaches as an alternative to NGO-based microcredit. Such an approach has the advantages of greater voluntary input and social capital formation.

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The views expressed are those of the author and should not be attributed to CMN participants unless otherwise indicated.

Subjects of interest

➤ The role of institutions

Date: Mon, 28 Jul 2003 16:46:58 -0400
 From: Lisa Lindsley <llindsley@ureach.com>
 Subject: Devfinance: Minutes from Microfinance Club of NY Debate

The following are the minutes from the June 24 debate on "Poverty vs. Commercialization" organized by the Microfinance Club of New York. Thanks to Tony Gooch and Darline Augustine for their contributions to this document.

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Moderator: Nancy Barry, President, Women's World Banking
 Panelists: Elisabeth Rhyne, Senior Vice President, African Operations & Research, Development & Policy, ACCION International
 Didier Thys, Executive Director, The MIX (Microfinance Information Exchange) and formerly of Freedom from Hunger

The moderator introduced the panelists and explained the ground rules for the debate and the follow-up questions, comments and concluding statements by the panelists and the moderator. Questions for the speakers, grouped in seven clusters, were distributed to the participants and the audience.

Nancy Barry described in broad strokes her own definition of the "Commercialization" and "Pro-poor" approaches to microfinance as well as the "middle ground" between the two.

	Commercialization	Pro-Poor
Motivation	The profit motive is necessary and sufficient to reach large scale	Have a moral motivation, see microfinance and especially microcredit as a need and a right of poor people
Measurements	Efficiency, profitability, financial integration, portfolio size	Poverty of clients and the change in the poverty of clients, number of clients
Products	Diversified products	Emphasis on credit
Clients	Emphasis on growth-oriented clients	Emphasis on subsistence clients
Use of Donor Funds	Donor funds utilized as equity and/or technical assistance	Donor funds utilized as loan funds
Funding sources	Seek funding in foreign capital markets	Seek funding from social investors

The "middle ground" approach favored by Women's World Banking seeks to use the best features of both of the other models and emphasized integration of the MFI into the financial markets of the host country.

The panelists were then invited to discuss the questions in Cluster 1, with Ms. Rhyne speaking first.

1. Please give your definition of "commercialization" and "pro-poor" approaches to microfinance. What are the underlying assumptions and essential elements of each approach? What are the differences in attitudes to profitability/sustainability in each? What are the benefits and the risks of each? Why do you think the polarization between

pro-poor and commercialization approaches has emerged? What are some of the underlying assumptions of your preferred model that you have seen change over time, and why? Are these two approaches converging, or becoming more polarized, and why?

****Elisabeth Rhyne****

Ms. Rhyne represents the commercialization point of view. She takes issue with the pro-poor name, because it implies that commercialization proponents do not care about poor. We should recognize that microfinance practitioners across the spectrum are motivated by a desire to reach the poor, but they may have different approaches as to how to assist them.

Differences between the two groups tend to focus on two main issues:

- How poor is poor?
- What are the tradeoffs between outreach and sustainability?

The Commercialization model originated with assumptions regarding reaching the poor and the inevitability of an end to subsidies, with sustainability being the only way to have a lasting impact. Outreach can be increased by supporting MFIs that can stand on their own two feet. The term most often used here is "sustainability."

The "sustainability" camp is now called the "commercialization" camp but the motivation continues to be reaching larger numbers of poor people with financial services. Commercialization is also known as the financial systems approach to microfinance. The slogan of Women's World Banking "Financial systems that work for the majority" describes this approach. The goal is a financial system that serves the whole population, not just the elites.

Commercialization stresses helping the poor by building financial institutions that will develop and innovate. Microfinance originated where the poor do not have access to financial services or have access only to services of poor quality, but to make a lasting impact, microfinance will need to integrate with the financial sector. Two models in the commercialization approach: NGOs which transform to regulated financial institutions; and "downscaling" or financial services delivered to microentrepreneurs by existing formal financial institutions.

The aim of microfinance is having financial institutions serve the sector because they see that it is profitable, but microfinance is not yet at this point.

Polarization between pro-poor and commercialization is due more to the politics of microfinance than to the practice of it. Sound bites are necessary to communicate the impact of microfinance to non-practitioners, and these inevitably focus on poverty.

****Didier Thys****

Everyone wants to do reduce poverty, so there are no evildoers in the Pro-Poor versus Commercialization debate. The issues are:

- How deep do you go (depth vs. breadth)?
- How should subsidies be allocated

The experience at Freedom From Hunger (FFH) involves asking the questions: "Are we reaching the right people? Are we having the right impact?" Important, but secondary to these questions were the financial indicators of the partner MFIs. In other words, sustainability is a means to an end and not an end in itself. FFH works with about 40 MFIs and continuously looks as to whether each one is sustainable, and whether it has good portfolio quality, but that is only important to sustain the gains that an institution is creating when it is having an impact on people's lives and that is always the first issue that gets looked at.

The Pro-Poor v. Commercialization debate can be called institutionalists v. welfarists." So the difference between the two perspectives is largely a question of nuance. It leads to differences in emphasis in what you measure - the health of the institution or the impact on clients. There probably is not a "schism" between the two groups in terms of the societal outcomes they are aiming for, but there are significant differences about what the strategies and measurements used to understand as to whether progress is being made towards those outcomes.

Within the context of commercialization, if it is broadly defined as having business models for Microfinance Institutions where operating revenues exceed operating expenses and net operating income can help drive the expansion of the organization, then you can allow for a number of institutional models, regulatory systems, and investment approaches working towards a common goal. Too often, however, Commercialization often gets reduced to a few ideas: statutory regulatory frameworks and supervision regimes, for profit shareholding institutions, and publically underwritten investment funds designed to mimick commercial investment funds and organizations.

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2. Is the polarization between "commercialization" and "pro-poor" approaches useful and necessary? What are the differences in how institutions using each approach measure performance? What is common and what is different in performance measures? Is poverty and impact measurement essential to a pro-poor focus? If so why? What are the benefits, and the costs? Is there tension between achieving profitable/sustainable operations and providing financial services to poor people? If so, how are these tensions best addressed? Are there significant differences between the two approaches in the role of subsidies in microfinance; if so what are they? Given the origin and purpose of microfinance institutions using commercialization or pro-poor approaches, shouldn't both be expected to provide sustainable financial services focused on poor people? Are there ways in which institutions with a focus on commercialization can avoid drifting away from the poor, and are there ways a pro poor organization can be more efficient?

****Didier Thys****

FFH decided a year ago to be polarizing because FFH saw that the general industry consensus was against improving the metrics to ensure that designated allocations of public subsidies for approaches seeking to work with people who live on less than \$1 a day were being met. The current universally used metric, average loan size was outdated and biased too heavily towards strategies that promoted working capital loans. The industry had evolved beyond this one product framework and the metric could not be used to look at strategies which also looked at longer term investments, savings, insurance and business development services. The time had come for more meaningful depth of outreach measures and the tools and systems to develop and use them and several organizations had to take a stand to move the industry in that direction because most actors were perfectly content not to look at this issue in any substantive way.

In terms of significant differences between the Pro-Poor and Commercialization Camps, the Pro-Poor group favors using a "double bottom line" that looks at impact (the "social bottom line") as well as profitability in evaluating the work of an MFI. This approach looks at a blended value proposition or Social Return on Investment (SROI) where social and financial returns are evaluated together. The Commercialization group focuses on financial metrics, particularly return on equity. One of the weaknesses of the Pro-Poor practitioners is that many of their social metrics remain weak, fragmented, anecdotal, and not subject to widespread use and application. There is a lot to do in this area.

****Elisabeth Rhyne****

ACCION began a project focused on measuring the poverty levels of clients served by institutions it works with. ACCION began by analyzing the data on MiBanco (Peru) clients stored in the MIS of MiBanco, a Peruvian microfinance bank which began lending as an NGO. ACCION Investments in Microfinance, ACCION's finance arm, was very interested in the results because the information could be used to develop a social scorecard to attract investors who pursue a double bottom line.

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3. Role of different legal structures

What are the advantages of regulated vs. unregulated legal structures in providing financial services to low income people? Are there things that banks can do that NGOs cannot, and vice versa? Is there a difference between the kinds of institutions that can do the commercialization approach vs. the poverty-focused approach i.e. can regulated financial institutions use a pro-poor approach, can microfinance NGOs and grassroots groups use a commercialization approach? With all the focus over the last ten years on "transformation" why have so few NGOs converted to regulated structures, and why are so few clients reached by NGOs that have converted to regulated financial institutions? Why have so many converted MFIs migrated away from serving large and growing numbers of poor people, and why have so few converted MFIs mobilized savings from the public? What is constraining private financial institutions from entering the microfinance market, and how can these constraints be best addressed? What about cooperatives banks and credit unions? With one third of outreach globally being provided by microfinance NGOs, mainstream banks, and cooperatives, why is there so little focus on the role of cooperative institutions? What are their limitations and benefits?

****Elisabeth Rhyne****

One result of NGO transformations, even those with socially responsible investors, is that managers are pressured to be profitable. All MFIs with shareholders operating in a commercial manner experience pressure towards mission drift, but this is only one of many pressures. Whether or not they move up market depends more on market conditions.

The big difference between banks and NGOs is that banks can take savings from the public. Banks can provide fee-based services (such as bill-paying and money transfers) that are hard for NGOs to provide. Banks have access to diversified funding sources (such as issuing bonds and certificates of deposit) to fund expansion and are not constrained by funding. On the other hand, NGOs can take risk and conduct R&D more readily than can banks. They also can pursue an "empowerment agenda" e.g. education, consciousness-raising, building self-governance skills, networking, etc.

Ms. Rhyne took issue with the wording of some of the questions, which seemed loaded against NGO transformations to banks. She noted that different regions present quite different pictures and suggested that conversion is mainly a Latin American phenomenon. In Africa (particularly West Africa), banks are often regarded with suspicion by the stakeholders (in line with a general anti-privatization position).

Ms. Rhyne questioned whether there has really been widespread migration away from the very poor by the converted MFIs. On the whole, regulated MFIs haven't mobilized savings, but they also haven't moved away from their clients. She noted that market situations differ from place to place, and this influences the result. On the question of why savings haven't developed more extensively, she suggested that there exists a belief among MFIs that savings are expensive to capture. Competition among MFIs is changing this; MFIs seek to offer additional services such as savings in order to retain their clients.

Coops and credit unions have begun to be incorporated into the microfinance industry. Credit unions are "getting their act together." Commercial banks are beginning to see microfinance as a profitable market, but there is still a need for a demonstration effect. Banks either feel they don't know how to do microfinance, or they underestimate the difficulty.

****Didier Thys****

The advantage of working with a regulated financial institution is that you don't have to worry about the institutional viability of the partner program, and can focus on reaching the poor. It is also easier to mobilize capital. The disadvantage is that you are subject to regulations that often hinder your ability to develop the right products and services, particularly if those policies are modeled on the classic banking policies that marginalized the poor in the first place. Interest rate caps such as the ones in West Africa are a case in point. They are currently driving regulated institutions out of the rural and remote rural areas since services cannot be priced to cover the costs of reaching out to those clients.

The benefit of an organization like Freedom from Hunger working with an organization like WOCCU, for instance, is that WOCCU's Model Credit Union Building system focuses on strengthening the quality of the financial enterprise as a whole and it becomes easier to integrate a pro-poor product because the liquidity and business like management systems are there. Attention is not spent on building financial enterprises from the ground up but on extending the service capacity of healthy financial institutions to a new under-served market.

Many NGOs don't transform because it is difficult. Nor should all NGOs transform. Becoming a regulated financial institution should not be the mission of every microfinance program, but of the few that see that strategy as the most effective means of pursuing their mission. Most NGOs don't get into microfinance to become banks, however. They get into microfinance to serve the needs of their clients who in many cases, they have been working with on an array of issues.

They also look to microfinance to diversify their revenue base and lower their subsidy dependence and some good ones have been able to develop social enterprise models where the revenues from their financial services are used to subsidize aspects of their social service delivery systems. Transforming into a bank would require most NGOs to either give their social services or structure them in a way where they actually lose the economies of scope they gain by working from a common institutional platform.

One bottom line indicator for evaluating the success of transformations is whether they end up reaching more clients through the transformation process. The jury is still out. Transformation has led to large gains in the asset size of an organization, but very often you don't see any sizeable gains in the breadth of outreach of the organization. Some

economists would attribute this to the fact that transformed institutions operating in a competitive environment are now "profit maximizers" instead of "client maximizers" and that the two goals are not necessarily mutually supportive (see Wydick and MacIntosh, Competition and Microfinance.

There was a discussion regarding aggregate historical data on transformed MFIs, whether they have increased their assets, clients, loan portfolio, etc. According to Elisabeth Rhyne, the Bolivia case was a market crisis.

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4. Role of different legal structures in increasingly competitive markets

As the outreach of microfinance increases, and as different types of institutions enter, what are some of the trends? Are for-profit structures crowding out not-for profits; and if so why? Over time, will different types of entities focus on different client segments e.g. not for profits on poorer clients, for profits on larger, growth oriented clients? If so, what are the implications on cost structure and sustainability of each? What are low income clients saying they value in lending, savings, and other financial services, and what kinds of legal entities are best able to respond to these evolving needs? Are clients migrating from one institution to another to get their needs met? What is your definition of fair vs. unfair competition in microfinance i.e. is going after the best clients of another institutions fair game? What are the issues of overlapping that can emerge? How are the issues of competition best addressed? What are examples of productive linkages established between for-profits and not-for profits in microfinance; are these linkages an important part of the future?

****Didier Thys****

For-profit and non-profit organizations don't tend to compete in the same operating environments. The competition that tends to occur is either between for-profit MFIs for particular clients and between non-profits working in common geographic areas. Still the dominant trend remains that they tend to either address different client niches within the same spatial areas or work in completely different geographic spaces.

Where there seems to be competition between the for-profit and non-profit camps, is with governments and donors for the allocation of subsidies. This would imply that there are some strong differences on the need and use of subsidy within the industry. One difference is whether subsidy should still be allocated to underwriting the development of retail service capacity (operating investments) versus focusing more on broader infrastructure issues and the other is about whether subsidy should be constrained or unconstrained if it is invested in retail institutional capacity. Pro-Poor types would probably favor more use of subsidy for expanding retail service capacity with some constraints to the institution on the target market to be served whereas the Commercial Camp would tend more to supporting the development of the broader infrastructure and the promotion of unconstrained subsidy for those investments that did go to retail service organizations. In looking at the issue of constrained versus unconstrained subsidy, Wydick and MacIntosh have made some interesting observations where policies with constrained investment subsidies will lead to greater depth of outreach than policies supporting unconstrained subsidies to retail microfinance organizations. They also note that in a perfectly competitive market with no subsidies, the tendency will be to go up market as well. One thing to note along these lines in terms of competing for the same clients. If a 'client maximizing institution' uses the rents it accrues from its better off clients to underwrite services for poorer clients down market, as competition intensifies between institutions on the upper end of the market, they will increasingly reduce the size of those rents to remain competitive with those clients and lose their ability to reach their poorer clients. The critical assumption here is that cross subsidizing needs to take place in order for an institution to go down market and Mr. Thys is not convinced that this is the case.

In terms of what clients value, product flexibility is important and many MFIs forget this. For Pro-Poor programs that rely heavily on short-term working capital loans with frequent payments, the cash flow pressure can get heavy as client gets a larger loan and clients are often asking for more flexible terms.

In terms of other products, Pro-Poor MFIs have been historically weak on offering a wider variety of products and particularly weak on offering good savings products. When a Pro-Poor client leaves a program, they often have nowhere to go.

****Elisabeth Rhyne****

It is acceptable to pursue the best clients of your competitors if you do so by offering superior products and service. On the other hand, stealing clients by giving too much debt to a client is an unethical and ultimately self-defeating business

practice. Clients are generally not great at judging their own debt capacity. The use of credit bureaus and a heavy regulatory hand can contribute to mitigating an endemic pattern of over-borrowing.

5. Policies and practices in microfinance

Is the belief in both approaches that institutions engaged in microfinance should be able to charge whatever interest rate they choose, relying on competition to bring transaction costs and interest rates down? Why? Are microfinancing institutions improving their efficiency and reducing their interest rates with competition and innovation in the industry? How have MFIs used loan terms, methods to calculate interest rate as well as simple interest rates to increase earnings to the institution and costs to the clients? Are there any limits to this market-oriented approach to interest rates? What are the most important changes in financial sector policies, regulations, and legal structures that need to be made if country-level financial systems are to work for microfinance? What are measures and instruments needed for regulated institutions? What are measures and instruments needed for unregulated institutions—those choosing to convert and those choosing to remain not-for-profits?

****Elisabeth Rhyne****

MFIs must charge the necessary interest rate to be economically viable. Where there have been interest rate caps services have been slow to develop. Policy makers are moving towards caps because it is politically attractive to advocate interest rate caps. Where competition has been strong and sustained, interest rates have decreased. Many microfinance institutions in Bolivia, for example, are now at 20-25% while they were charging 30-35% about a few years ago.

A need to address the topic of consumer protection is surfacing in the microfinance industry. MFIs need to be transparent with their clients regarding the effective interest rate charged. Consumer protection will be a serious issue for MFIs in the future. There are three main consumer protection concerns in microfinance: lending more to a microenterprise than they can handle, interest rate disclosure, and inappropriate collection methods. The SEEP network has issued a paper "Trust through Transparency" which begins to address these issues.

****Didier Thys****

The microfinance industry must self-regulate, and the consumer protection concerns have developed in the last couple of years. MFIs are just beginning to calculate the costs of delivering different products. Efficiency is improving and interest rates are decreasing. West African MFIs in particular have a "one size fits all" interest rate policy which will change through analysis and competition.

6. Vision for the future

If over 500 million low income clients are still to be served, why is the microfinance industry not bigger? What do you view as the most important three constraints? How can these be best addressed? What is your most optimistic picture of microfinance in 2010, and what are the three most important measures to make this vision a reality? What would it take to get mainstream financial institutions seriously involved as wholesalers and/or retailers in microfinance? Are there changes in the mentality, approaches, objectives and understanding of microfinance of mainstream financial institutions needed for major, productive and sustained involvement? If so, what are they? What are the changes in the microfinance industry/community needed to build bridges with domestic and international financial institutions?

****Didier Thys****

We are not sure if anyone really knows how many people are being served. A private bank in Peru has been serving 75,000 microentrepreneurs for 3 years and was not counted with the MFIs. The principal constraints on industry are capacity, in other words the lack of retail service capacity and the lack of capital to develop it. The transactions costs of microfinance are still a huge barrier to expanding financial services to more microenterprises. Mainstream financial institutions can help by mitigating cross-border foreign exchange risk which has been a barrier to capital markets financing of microfinance portfolios.

****Elisabeth Rhyne****

The answer to the gap between numbers of clients reached and potential demand can be found by focusing on large countries such as Mexico, Brazil, India, Nigeria, and China. The vast numbers of unserved are concentrated in these few countries. And in the large countries, some of the main barriers to microfinance expansion have come from policy

constraints. India's government has long had strong directed credit policies. In some countries, market characteristics could be another factor, in more developed countries. Most of these countries have infrastructures which could be mobilized to deliver financial services to microenterprises.) Urban Brazil may have passed the stage where standard microfinance is relevant due to the availability of financial services from other sources. A wide variety of financial services are available in the large urban centers, but services are very limited outside those centers.

The most optimistic picture for the year 2010: Microfinance as an industry has disappeared. It no longer needs to exist as a separate identity. We hope large financial institutions will increasingly take on microfinance, and hence microfinance will be integrated in the capital markets. We foresee a parallel process to the process in the United States of the creation of the 30 year mortgage. The Federal Housing Administration (FHA), a subsidized, government entity, pioneered the innovation of mortgage insurance. Gradually the mainstream financial system learned it could make mortgages with private mortgage insurance, which meant that the subsidies and special government intervention was no longer central to the mortgage market. FHA gradually turned its attention to the hardest-to-serve pockets. In microfinance we look toward a time when government-supported programs are not needed in order for the poor majority to receive services, leaving such programs available to focus on exploring how to reach the poorest.

We need to look at new models for involving mainstream financial institutions. Claus Peter Zeiting of IPC has proclaimed, "downscaling is dead." ACCION does not believe this. It is using a service company model in Haiti and Ecuador which allows the program to take advantage of the the funding and infrastructure advantages of a commercial bank while providing the microfinance program with the necessary space to operate successfully. We need to create structures within commercial banks which are viable for microfinance and are embedded in the leadership structure of the bank.

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7. How can Wall Street help?

What are the most important financial constraints to the development of microfinance today? Please provide evidence e.g. if equity financing, provide supply and demand. What are the issues in mobilizing international capital markets for microfinance, the difficulties and the potential downside of this engagement e.g. foreign exchange risk for relatively small institutions? How can domestic capital markets? savings, bond issues, domestic equity, commercial borrowings be built, and how could members of the NY financial community help? What are the skill sets and attitudes that a member of the financial community needs to have to make a contribution to microfinance?

****Elisabeth Rhyne****

Several new funds for equity investment in microfinance have been created recently, and this is an important step forward. Regarding debt funding, Ms. Rhyne is not comfortable with microfinance's reliance on first world sources, and would prefer to see most of the attention focused on enabling microfinance institutions to source funding locally. There is a danger that the provision of debt, especially subsidized debt, leads to deemphasizing savings.

An issue that should be addressed is who should own commercial MFIs. Now there are many shareholders who represent multilateral organizations, sponsors and social investors. The logic and strategy of the ownership composition of commercial MFIs needs to be developed.

****Didier Thys****

We need to come up with ways to lower transaction costs and increase transparency. The same barriers that MFIs overcome when lending to Microenterprises must be overcome by investors in MFIs. Investors in MFIs have not figured out the problem of exit strategy. Most multilaterals invest in MFIs at the same time, without coordinating their exit. Having different types of investors for different stages in the development of a commercial MFI would make more sense. Wall St. can help with this, and also with the problem of foreign exchange risk mentioned previously.

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The moderator opened the floor for questions and comments.

Lisa Lindsley: No single model has a monopoly on "worst practices." Much tension is generated between the two groups when Pro-Poor practitioners use serving the poor as an excuse for poor performance or lack of transparency. Financial institutions will see microfinance as a business when local governments and MFIs do, as opposed to seeing microfinance

as part of social policy. Linkages between capital markets and microfinance require a new business model which does not exclude the MFIs but involves them in a different way, to overcome the barriers of scale and transaction costs.

Peter Burgess: A new business model for development is needed. Fundamental changes are taking place. However, we are investing in economic value destruction. Microfinance is a powerful tool. It has to be managed so that business values do not erode the value of microfinance. Transaction costs have to decrease. Technology has the ability to induce massive changes.

Asad Mahmood: How do we expect institutional investors to be involved in microfinance in a significant and systemic way, if there continue to be lack of standardization, transparency, and legal uncertainty. While these are all feature of an industry in its early stages of development, as an industry, in the past 25 years, we have not done a great job of tackling these issues. Multilateral organizations should play a more significant role is serving as catalyst for stimulating the private sector. Their role should be to leverage resource from the private sector by taking on more riskier positions rather than acting as a proxy for the private sector.

The moderator invited the debate participants to summarize and answer questions raised by the audience.

****Elisabeth Rhyne****

The subsidization of microfinance will end eventually. This requires differential pricing schemes reflecting product costs, which MFIs have been afraid to implement. Differential pricing is not the same as mission drift.

In the research conducted at MiBanco, the loan payment size of each individual client was the best proxy for the client's income level. Loan size might be a good indicator of poverty level for an individual client, but average loan size of an MFI is a terrible indicator of the depth of outreach of that MFI. MFIs need to start reporting on the distribution of their loan sizes.

Building local institutions and local capacity was part of the initial philosophy for the microfinance movement, and while some international microfinance organizations are giving up on this idea in favor of indefinite control of their partners, she sees that we should keep the goal of having local institutions run with local human and financial capital.

****Didier Thys****

In terms of a "new business model", there is some useful work being done on understanding the distinction between promoter and provider models for microfinance. Most of the industry is focused on provider models where everyone is toiling to build large institutions that will make loans to poor people and collect their savings. The promoter model is more about linking into semi-formal social groups (often called Self-Help Groups, ASCAS oor ROSCAS) and stimulating these groups to improve the quality and outreach of their financial services. The promoter institution is a catalyst (organizing and training) and not a financial intermediary.

The moderator provided a summary in her own words.

****Nancy Barry****

1. Retail capacity is the single largest constraint; the industry needs both regulated and unregulated MFIs; and funders will seek out different segments of the industry.
2. There is convergence regarding what should be measured: transparency, standardized definitions, and impact data. If Commercialization results in outreach, then commercialization programs should be evaluated based on this. Seek out simple ways (i.e. existing MIS) to see if an MFI is reaching poor people. Some say that the microfinance industry is ahead of the banking industry in performance indicators.
3. Savings are important resources for the loan portfolio.
4. Transaction costs need to be reduced. Look for ways to increase the efficiency of loan officers. Women's World Banking is deploying new combinations of technology and "touch" without losing relationship banking.
5. Mobilization of traditional banks is needed. Commitment of the CEO of banks is the number one factor in the success of a bank microfinance program. Banks will copy other banks, banks will not copy NGOs.
6. North-South issues must be addressed. There is a limited role for international equity. Most significant contributions in scale and innovation have been achieved by leaders from the South. Structures have a life of their own.
7. Policy changes are needed to foster growth of MFIs.