



The Consultative Group to Assist the Poorest

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HELPING TO BUILD A MICROFINANCE INDUSTRY

The Demand for Microfinance Services

What does it take to build an industry? This question has become the focal point for CGAP, the Consultative Group to Assist the Poorest.

Microfinance practitioners estimate that over 500 million poor people worldwide demand financial services, but microfinance serves only a fraction—about 16 million. The task of building a viable microfinance industry to meet this massive demand poses an exciting yet daunting challenge.

The Story So Far

Early efforts to provide financial services to the poor tied those services to specific economic activities. Between the 1950s and 1970s, governments and donors focused on providing subsidized agricultural credit to small and marginal farmers, in hopes of raising productivity and incomes. During the 1980s, microenterprise credit concentrated on providing loans to poor women to invest in tiny businesses, enabling them to generate and accumulate assets and raise household income and welfare.

The success of some microenterprise credit programs led to bold experiments with product designs, delivery methods, and institutional structures, performed mainly by practitioners in developing countries. These experiments resulted in the emergence of microfinance institutions (MFIs), specialized financial institutions that serve the poor.

MFIs exist in various legal forms, including non-governmental organizations (NGOs), credit unions, non-bank financial intermediaries and commercial banks. Their success has shown that poor people are valuable clients of specially designed financial services—and that serving this niche *can* be financially viable.

The New Challenges

However, among the 10,000 + MFIs around the world, very few are currently viable—by some estimates only one percent. And many remain heavily donor-dependent. To meet the enormous demand for services, MFIs can no longer rely solely on the limited pool of donor funds. Instead they must become part of the financial landscape, attracting funding from more abundant commercial sources.

In short, microfinance must complete the metamorphosis from a mostly donor-dependent collection of programs to a mature industry capable of growing sustainably.

But what are the constraints to building a microfinance industry? First and foremost, to carry the industry moniker the microfinance community must develop and adhere to sound financial standards to gain credibility from commercial investors.

Second, microfinance practitioners must offer a wider range of financial services beyond microenterprise credit. MFIs have traditionally offered relatively rigid loans to cover working capital requirements of microenterprises, principally among mar-

ket vendors. But many MFIs increasingly recognize that the poor are not a homogeneous group and they demand varied loan products, safe savings, insurance, and other financial products. Developing client-responsive, flexible financial services for the poor is a top priority.

Third, the microfinance industry needs to answer some basic questions: Who are microfinance clients? How poor are they? And how do they use financial services? Answers to these questions will help ascertain how to reach poorer clients than are currently being served and determine which flexible financial products can fully meet the needs of the very poor.

Enter CGAP

In 1995 a group of donor agencies including the World Bank launched CGAP, initially oriented primarily to improve the quality of microfinance programming. During the early years, CGAP played a pivotal role in developing a common language about microfinance, catalyzing the move toward best practice performance standards, and building consensus among its many and varied stakeholders.

As CGAP's membership grew to the current 27 bilateral and multilateral donors, and its small investment fund became more visible, many in the microfinance community initially thought of CGAP as another donor in the fray.

As microfinance continues to transform into a cohesive industry, CGAP has undergone a metamorphosis itself: from a donor-type organization to a service center to the fledgling industry.

Principles to Live By

Recognizing the challenges facing the industry, CGAP has formulated a set of guiding principles to focus on over the coming years:

- *Build institutional capacity on the ground:* As long as demand far outstrips supply, increasing the number of competent MFIs providing services at the retail level remains the number one priority.
- *Put clients at the center:* CGAP believes that listening to the poor is key to knowing who they are and understanding their financial services needs and preferences.
- *Move from microcredit to flexible, pro-poor financial services:* Not all poor people want credit or can use it effectively. Voices from the field tell us that the poor require financial services that allow them to address a range of needs, from investment to death ceremonies to education and health expenses.
- *Extend the poverty-sustainability frontier:* The twin pillars of reaching the very poor and achieving financial sustainability may involve tradeoffs, but both can be improved.
- *Improve transparency:* Transparency promotes accountability and is a powerful tool for improving the quality of MFIs and

their services to clients. Transparency should be promoted both on financial matters as well as on the poverty profile of clients.

- *Appreciate the critical role still remaining for donors:* Donors will continue to play an important role in the development of the microfinance industry, particularly in supporting early-stage pioneering MFIs that show commitment to sustainability and promise to reach significant numbers of very poor people.

CGAP as a Service Center for the Industry

If CGAP is a service center for the microfinance industry, to whom exactly does it offer services? And what are these services anyway?

CGAP has three sets of clients: MFIs, donors and the microfinance industry as a whole. It offers technical assistance and strategic advice, the development and dissemination of technical tools and services, training, and action research on innovations. CGAP also has a small grant facility that provides funding for these activities and for strategic investments in MFIs.

Microfinance institutions. Despite the enormous success of a few celebrated MFIs, most remain small and weak in terms of outreach and financial performance. These institutions require exposure to best practices and greater technical capacity and financial resources.

- *Technical advice and exchange:* CGAP's strategic advice and technical assistance includes in-depth appraisals of MFI performance, facilitation of business planning and financial projections, and specialized advice on such areas as setting interest rates, managing delinquency, implementing appropriate staff incentives, introducing new products, and responding to external crises.
- *Training and capacity-building:* CGAP's global capacity-building initiative aims to develop local markets for training and technical assistance that can replace the current over-reliance on international expertise. CGAP firmly believes that these support services are integral to any industry, including microfinance. CGAP's six capacity-building hubs and partners worldwide serve more than 40 countries in Africa, Asia, and Eastern Europe. These hubs have trained more than 500 practitioners, and demand remains high.
- *Tools:* Based on expressed demand from the field, CGAP has produced several tools for microfinance practitioners, including the *Handbook for Management Information Systems for Microfinance Institutions*, *Business Planning and Financial Modeling for Microfinance Institutions: A Handbook*, and a series of Occasional Papers. CGAP and other partners use these very popular tools to complement their technical assistance efforts.
- *Funding:* CGAP uses its small grant facility to support a small number of promising MFIs directly or through networks. Since its inception, CGAP has invested nearly \$21 million in 35 MFIs of all kinds. As a group, these MFIs serve about 2 million poor clients. Perhaps more important than the direct reach of these investments, however, CGAP's investments demonstrate to donors and others a new institutional approach to funding anchored on performance-based contracts, mutual accountability, institutional performance, and shared risks.

Member donors. CGAP services to its member donors are designed to mitigate factors that can undermine donor support for building a microfinance industry. Examples include limited staff experience or bad donor practices propelled by disbursement pressures that can impede development of sound local institutions.

- *Technical advice and exchange:* CGAP provides portfolio review and joint due-diligence services to member donors, and responds continually to donor requests for information on project reviews, funding ideas, and opportunities.
- *Training and capacity building:* Since their introduction, training courses for donor staff have been CGAP's most sought-after service. CGAP currently offers two courses, one on basic concepts of microfinance and one on the use of CGAP's Appraisal Format.
- *Tools:* CGAP has created several tools for donors active in microfinance. Examples include the *Appraisal Format* and spreadsheet that helps them to evaluate an MFI's operations, a *Poverty Assessment Tool* that enables them to assess the poverty level of microfinance clients, the *Handbook on External Audits of Microfinance Institutions* that guides them in commissioning audits of MFI partners.

Microfinance industry. CGAP holds a distinct comparative advantage in addressing issues that affect the entire industry, like regulation and supervision. CGAP can lay the groundwork for building the industry by investing in crucial financial infrastructure that promotes transparency and performance standards and sends the correct policy messages. CGAP's activities focus specifically in those cross-cutting areas that many of its member donors find difficult to support.

- *Technical advice and exchange:* CGAP participates in and sometimes organizes selected high-impact conferences and seminars to disseminate information on best practices.
- *Training, capacity building and tools:* CGAP has invested in products that increase transparency and accuracy of financial information—key building-blocks for any mature industry. These products include the *MicroBanking Bulletin*, an industry journal that provides benchmark financial data on MFIs worldwide; and an External Audit capacity-building program to provide MFIs, donors, and bank supervisors with procedural guidance for high-quality audits.

Other core industry services include the newly launched Microfinance Gateway, a web-based bibliographic database of about 7,000 on-line documents (www.microfinancegateway.org); an Information Systems consumer reports service, another on-line service that will compare financial software for MFIs; and a short Focus Note series published in English, Spanish, and French.

The Way Forward

Microfinance holds the promise of developing into a thriving and powerful global industry that provides relevant financial services to the poor on a sustainable basis. As part of its efforts to help build this fledgling microfinance industry, CGAP itself has transformed into a service center. CGAP offers tools, training, and services to its many clients—microfinance institutions, member donors, practitioner networks, local service providers, government policymakers, and others in the microfinance community—and maintains a deep commitment to ensuring that its services remain fresh and relevant for the evolving and dynamic microfinance industry.