Microfinance in Africa: Rethinking the role of the actors

Currently Africa has been making the headlines again and "hope" is the dominant expectation. The deal to write off more than $40 billion of African debts reopened the hopes for something eventually happen, namely to eradicate the poverty. How to use the massive resources available is under debate in each beneficiary Country. Let's look at the issue from the microfinance angle, which has been ever more seen as a tool to eradicate poverty.

When we started the overseas career in francophone Africa at that time people used to call the issue under review *petit credit*, but since then the experiences on credit matters changed in a way that it is hard to find out any analogy with the current micro credit operations. Here we would like to bear witness on micro finance breakout in the Continent and its perspectives.

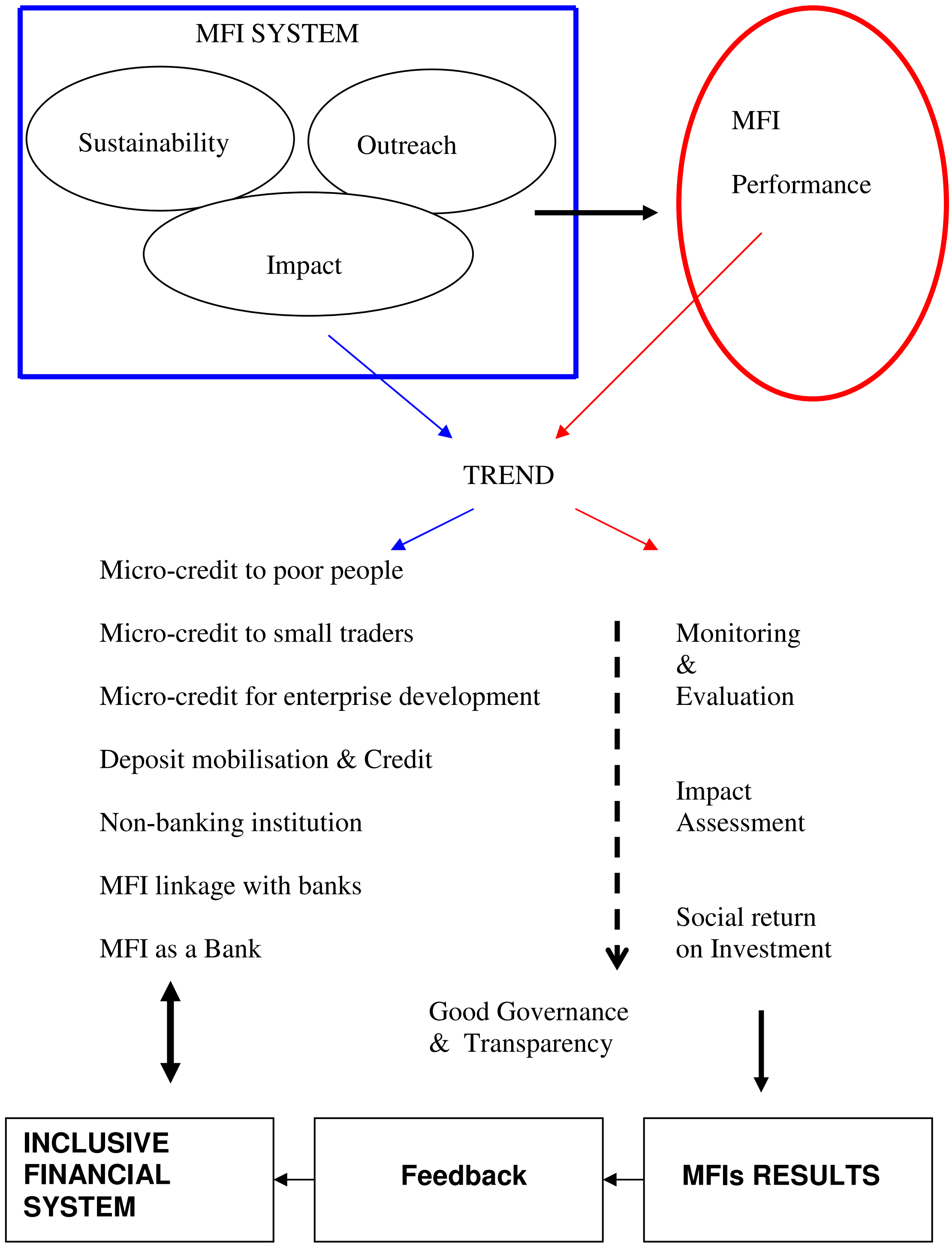
Some time thirty years ago it was thought that the development banks were the best instruments to channel financial resources to the rural areas but for well-known reasons something went wrong and now these banks are under pressure to decide whether change or die. Informal finance came out having group lending techniques as their main asset and it was a flourishing of initiatives. The grass root organisations replaced the reluctant African banking system to provide resources to the dawning entrepreneurship and indeed they did a wonderful job though sometime the price paid by the borrowers has been high. Recent times there has been a booming of micro credit organisations, as a logical sequence of the past events and now the Continent has a casting place in the microfinance worldwide movement.

To understand the direction of African microfinance movement there is a need to distinguish and categorise MFIs by *drawing up a demarcation line and categorise the interventions according to the declared MFIs' objectives.* An option could be to group MFI into three big categories of providers: a) food aid, b) income generating activities and c) enterprise development. By grouping micro lenders organisations in such a way it will be possible to set out the appropriate management parameters and accordingly to assess their performance referring to different criteria.
One can't assess and evaluate MFIs having as a reference a set of parameters that are supposed to be well founded for everybody. [1]

As elsewhere, in Africa MFIs started focusing on meeting the demand from either poor niches of population, or small traders running a shop round the corner, or small entrepreneurs. Then the importance of capturing savings has been re-evaluated for obvious reasons and microfinance industry has been making a further step and offering a wider range of services (see Figure 1 for the trend). However microfinance movement has been arsing expectations for providing support to diversified segments of population (very poor, HIV/AIDS groups), which need a different and specific approach. This is a crucial point that should draw the attention especially by donors and governments sponsoring such a kind of interventions in order to spell out clear objectives and the expected results.

[1] A report from Microfinance Information Exchange (Nov. 2006) found that microfinance continues to struggle in Africa with unfavourable macroeconomic conditions, high operating costs, increasing competition and little access to commercial funding

Figure 1 - Microfinance trend of marketing financial services



1. Re-thinking the role of the actors

In the past outreach has been a privileged target to the detriment of the sustainability of the operations.

Both Microcredit Summit and Millennium Development Goals provide a new horizon in terms of vision and objectives. The Microfinance institutions (MFIs) are called in cause to adjust the way of doing business and, by and large, shift the course of action from Outreach to Sustainability.

An important outcome of such a trend saw the diminishing importance of the public hand in the micro credit industry. New topics have been dawning and the attention of the insiders of the development will be increasingly drawn on how to make it happen a MFIs durable growth.

It has been widely recognized that in the past social objectives have prevailed; it has been becoming evident that a balance has to be found between economic and social objectives together with a concerted agreement between main actors. This new course call for a new deal among all the actors and the role plaid by the international development agencies (Donors) will be crucial.

In this scenario the interests/objectives/demand/expectations stressed by the actors will find a welding point in a common consensus. As a result at management level the expected performance/results of MFIs will vary in relation to the relative importance (weight) of the interests/positions stressed by the actors.

This concept can be expressed by saying that the expected results of MFI are functions of the interests/positions of the actors (independent variables).

In practice this means that while dealing with MFIs' issues one has to be aware that the bearers of a specific interest can react differently in relation to the market conditions. From the above it is understandable that the collaboration among all the players is a "condition sine qua no" to attain the goals and have an equitable game.

In parallel with above changing goal and objectives a different way of doing business will be adopted in order to adapt and adjust tools and techniques at macro, meso and micro level.

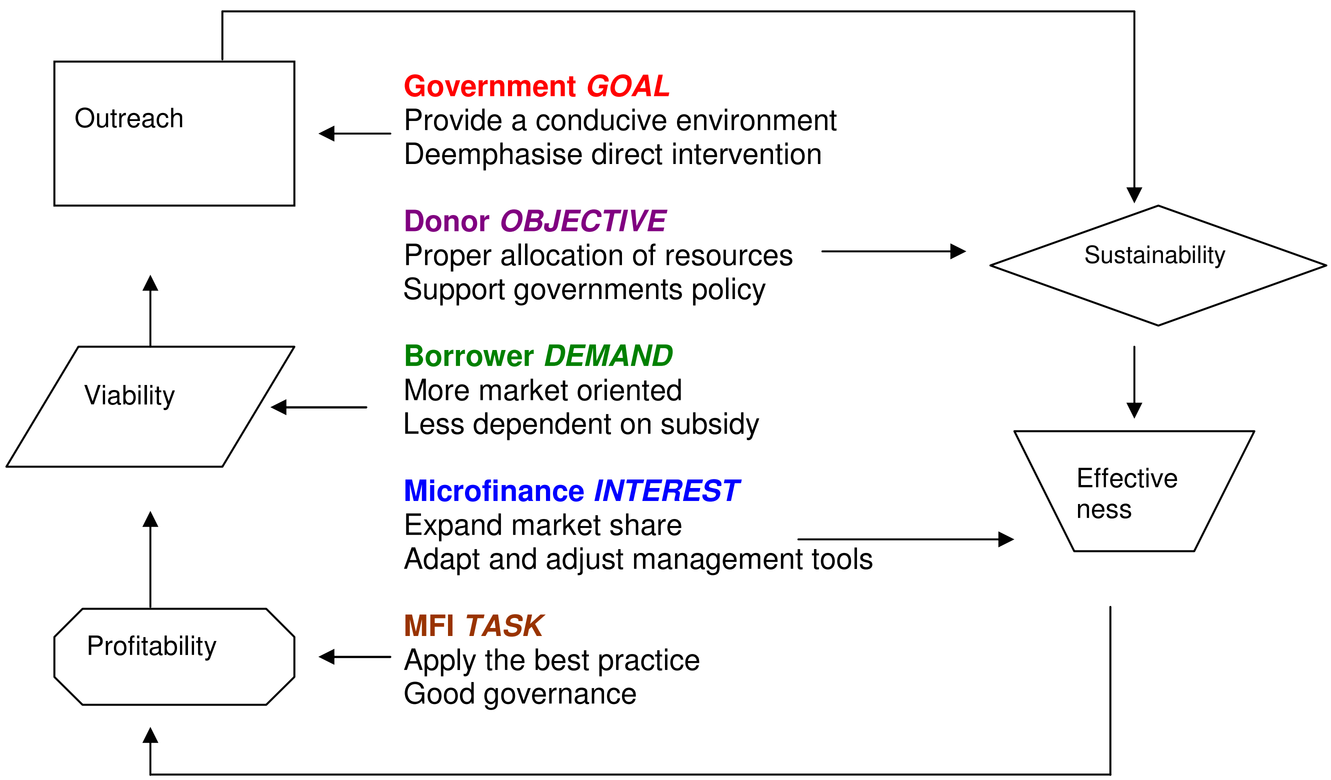
In line with the emerging new orientation aiming at enhancing access to financial services the interventions could be streamlined at the following three levels that are interacting each other:

Macro level: a) Regulatory and supervision framework, **b**) Credit policies for a conducive environment, **c**) Land reform, **d**) Property rights, **e**) Markets liberalisation, **f**) *Sector's* analysis.

Meso level: g) Partnership, **h)** Capacity building & institutional strengthening, **I)** Guarantee schemes, **j)** Credit Bureaux, **k)** Capacity building & Institutional strengthening, **l)** Linkages between banks and MFI, **m)** Chain value.

Micro level: n) Information technology, **o**) Guarantee schemes to back up micro borrowing, **p)** Strategic management and business planning, **q)** Product innovation's, Management best practice, **r)** Reporting and auditing, **s)** Leasing, **t)** Factoring**, u)** Capital restructuring**, v)** Scoring, **z**) Factoring, **w)** Leasing.

Figure 2 – Actors' role and responsibility



1.1 Macro level

A suitable law is an indispensable step in a Country with economic stability, inflation under control, interest rates liberalization, currencies exchange rates relatively stable, which are as many as positive factors to map out the road for a concrete intervention at both market and policy level.

The experiences from Africa's micro finance movement have demonstrated that the access to the financial circuits for SME and micro business is facilitated when above factors are a reality and the following pre-conditions are in place:

1) Collateral alternatives (mortgage land, group lending, etc);
2) Free and transferable property rights;
3) Land reform;
4) Well functioning marketing system that make it possible to formalize contracts between participants and the formation of reasonable prices.

Above factors make it functioning both a credit market and a micro credit policy.

Historically donors and governments have been the main providers of resources to MFI. Currently the strong growth of the portfolio and the increasing exposure to the potentially borrowers ask for additional resources coming from diversified sources: private capital, commercial borrowing, savings mobilisation and capital markets. In the context capital restructuring has been coming along as a necessary MFI step.

1.1.1 Regulation & Supervision. *The definition of rules of the game in the Africa microfinance industry is by now a requirement* and **in** the last couple of years regulation and supervision have been emerging as a dominant issue in the microfinance industry in Africa.

There is a wide consensus that MFIs have to give account of what they are doing and how they do it. It is not possible here to go into details and we can spend a few lines only on the subject. We would like to notice that the big question: sustainability versus outreach? Has come to a solution by agreeing that the two objectives are complementary and not opposite. It is worthwhile to notice that microfinance is no more seen as a distinct sector but as a component of the overall financial system. In relation of the size and the sophistication of the market some countries are at debate stage on how to regulate and supervise, others have been matching the benchmarks and in a third group the regulatory framework is running at full speed. Obviously, each country has been mapping out the road referring to its own environment within the agreed institutional and legal framework. Transformation from donor ship to ownership, the role of NGO as well as governance are as many as leading questions which have been given an answer or the discussions are at drafting process. Last but not least all regulatory systems foresee that deposit taking from the public must be carefully regulated and supervised.

The trend has marked a turning point in the microfinance industry in Africa and since then nothing will be as before. All around the Continent we witnessed the promulgation of new regulatory frameworks sponsored or at least not hampered by governments. We have to recognise that the insiders have already been discussing on the suitable way to monitor activities carried out by MFIs (supervise) and set up clear rules governing the intermediation activities (regulate). The systems have been set up range from a rigid control to a more flexible intervention. The first option has been prevailing in West Africa, mainly in the Francophone regions where the disasters caused by the past failure of big financial institutions and recently some disappointed performance of credit programmes are still burning wounds. In some Anglophone Countries MFIs major functions the interventions of monetary and credit authorities hasn't been so direct in ruling MFIs' functions and activities.

In a word it can be said that there is a "continuing" process in relation of the sophistication of the market.
Some Countries have been debating how to regulate, others have been matching the benchmarks and in a third group a bill has been running at full speed.
It is worthwhile to notice that microfinance is no more seen as a distinct sector but as a component of the overall financial system.

Obviously, each country has been mapping out the road referring to its own environment within the existing institutional and legal framework together with the market reality.

Transformation from donor ship to ownership, the role of NGO as well as governance is as many as questions that have been given an answer or are at drafting process. All regulatory systems foresee that MFI-deposit-taking from the public must be carefully regulated and supervised.

From our direct experience there is evidence that in West Africa, mainly in the *Francophone Countries* tight regulatory and supervision laws have been promulgated because of the disasters caused by the past failure of big financial institutions (mainly development banks under government control) and recently because of some disappointed performance of micro credit programmes.

In some *Anglophone Countries*, initially the commercial code rather than the monetary and credit authorities regulated the activities of MFIs.

Recently in *Kenya* a draft bill proposed that the Central Bank would regulate all microfinance institutions collecting deposits from the public. A key proposal in the Microfinance Bill 2005 is a requirement that institution seeking to operate as a microfinance must have a core capital of Sh 60 million.

In *Nigeria* all licensed Universal Banks currently engaged in microfinance services have to set up a subsidiary to effectively carry out that function by obtaining a microfinance banking licence or setting up a department for such services**.**
The microfinance activities of such units shall be subjected to the provisions of the Microfinance Banks (MFB) regulatory and supervisory guidelines.

1.1.2 Government presence & micro credit policy.

By and large, the orientation is that government direct involvement in credit provision would be progressively phasing out.

In this perspective it has been foreseen integration of microfinance institutions into the mainstream of the financial market. This will be achieved through fostering linkages between banks, specialised institutions and microfinance banks to enable the latter source for wholesale funds and refinancing facilities.

All the development actors do have a role to play and the best a government can do is to operate by paving the way for a sound start-up of the business in a favourable legislative framework with suitable infrastructures and leave financial providers and borrowers to run in a free market.[2]

By ignoring these basic understandings the practitioners will expose themselves to a risk as it happened to their colleagues in the seventies amid the wave of the development banks movement in Africa. At that time a huge amount of financial resources have been distributed without having the expected return. As it is well known those institutions failed

[2] As a part of its aid effectiveness programme, CGAP was asked to do an in-depth portfolio review of the micro credit projects of two of the largest donor agencies, the World Bank and the United Nations Development Programme. The results of the evaluation revealed a disappointing picture: in both agencies, less than a quarter of the projects that funded micro lending were judged successful. The rest failed, or appeared unlike to produce lasting results. CGAP, Focus Notes. Aid effectiveness: evaluating micro credit projects of the WB and UNDP, 04/2006.

the mission to finance development projects. By and large banks and financial providers channelled resources within the frame of a country economic policy with all the negative implications of having social and economic matters wrongly mixed up.

Here it is a question on how to deal with these sensitive issues. As we know, MFIs to be successful should operate by referring to the following management triangle: **a)** meeting both running and financial costs in a long term perspective (sustainability), **b)** expanding interventions, namely reach as much population as possible (outreach), **c)** having a positive impact on the communities served by ameliorating the people's quality of life, improve income, etc. So, MFIs have to be free to apply a coherent and consistent policy to comply with above management requirements.

Why government presence has been so huge? An answer could be provided by the fact that agriculture is the backbone of the gross domestic product. More important is the fact that millions of smallholder's farmers need credit for sustainable basis and a few lenders can meet their demand. When we match these figures with the fact that micro credit has a multifaceted impact on the communities, the political implications can be found having in mind the fact that microfinance movement: a) has been seen, among others, an appropriate tool for alleviating poverty and allowing everybody to participate the communities development, b) a jobs creating instrument, c) a tool to subsidy poor people.[3]

1.2 Meso level

1.2.1 Integration between financial circuits. In our opinion the best way to expand business is to link with the banking system. The entry into the market of the traditional bankers should be welcome and nowadays this what has been happening not only in the Continent but all around the world, in the light of the fact that the big names of the financial world have been moving to this direction.

The benefits of such entry will be for all main stakeholders: banks, MFI, final beneficiaries along with the financial market. On one hand, banks can expand the areas of intervention and, most important in our view, they can borrow on how to market financial services; indeed it seems to us that MFI's market oriented approach is without any doubt a casting asset they can spend out. On the other hand MFIs can improve skills and be more acquainted with the banker profession. In a word we can say that management and marketing expertise will be dynamically combined.

The dividends of the partnership will be for the borrowers who will have additional chances to get what they need at competitive price. How to achieve that? *MFIs could operate as driving belt between sources of capital and final beneficiaries. In doing so the two finance engines will pool resources and share risks.* The implementation of credit guarantee schemes in all their multifaceted forms is an area where both parties are actively committed along with advisory services and venture capital. In proportion of the sophistication of the local financial market, focus of attention shall be devoted to innovative non-credit products such as: current accounts, trade products, pension plans, credit card schemes, cash management, staff loans, foreign fund transfers.

---

[3] A. Graziosi "Microfinance and politic", May, 2005
http://topics.developmentgateway.org/microfinance/rc/ItemDetail.do~1037941

Besides the above-mentioned stakeholders, the financial market, as a whole will benefit from the foreseeable collaboration between banking system and microfinance industry. *The ultimate goal of such a partnership will be to enhance the efficiency and the effectiveness of the financial market.* What's the situation now? Banks, non-bank financial providers and NGO in all their well-known *facettes* have their own niche of market and as a matter of fact they do not communicate each other and operate in a monopolistic competition. Under the circumstances non-communication means market's lack of effectiveness and efficiency and, what's more important, higher transaction costs. The market niches are like closed circuits and micro financial providers fix up a (monopolistic) lending rate in relation of the cost of capital, the in-house running cost and their own perception of the risk. On the contrary, in an open market the costs will level down.

The implementation of credit guarantee schemes in all their multifaceted forms could be an area where both parties could be actively committed along with advisory services and venture capital. From the banks side, managing retail operations, providing commercial loans, providing infrastructure and systems are as many as indirect approaches to enter the microfinance market; direct approaches could be: setting up a finance unit, a specialized institution, a microfinance service.

Presenting a paper on "Poverty Challenge and the Practice of Microfinance Banking in Africa", Dr. Kpakol said poverty had become a major challenge facing Africa, as many people continue to suffer pronounced deprivation even as reforms continue across the continent.
He said robust economic growth could not be achieved without putting in place well focused programmes that enhances the access of the poor to the factors of productions, especially credit.
Stating that the provision of microfinance services improves the latent capacity of the poor for entrepreneurship, the national coordinator of NAPEP said this would enable them to become more self-reliant, increase employment opportunities, enhance household income and create wealth. He said most bankers have **not** regarded microfinance as a genuine option because they believed, albeit erroneously, that it is unprofitable.

As far as banks are concerned the CGAP has identified[4] the following direct and indirect approaches to enter the microfinance market, respectively: - An internal microfinance unit, - A specialized financial institution, - A microfinance service company.
* Outsourcing retail operations, * providing commercial loans to MFI * Providing infrastructure and systems.

1.3 Micro Level

1.3.1 Management & Governance. *Microfinance movement in Africa is something like "gold rush*". However, MFIs have a lot to compete for the confidence of the public. The growth has been very remarkable in terms of either number of new MFIs or amount of resources allocated. The industry has been successful in terms of outreach leaving in the shadow the sustainability factor. So, before any further step like to have MFIs as a full services provider MFIs have to take stock in the light of the fact that for not a few of them the break-even point is far away. This is what usually happens at the dawn of any industry when the development is achieved at any cost. We do believe that from now on a phase of sustainable development should be in the agenda.

---

[4] Commercial banks and microfinance. CGAP, Focus Note, June 2005.

The behaviour of the people responsible for is an important factor affecting the overall project's performance. By understanding it the relevant management criteria or recommendations can be better tailored to the situation. We are sure that on this issue any insider can prove that.

The MFIs in lack of productivity and competitiveness are left agonising till their natural exit from the market, with understandable damages in terms of mistrust and, not to mention, the waste of money.
A not negligible result of such way of dealing with above situations is that the responsible people for the Programme in loss enjoy *de facto* the immunity from any action. Simply, after some time we see the same people running an other project with the same players. Usually the general public is told that the borrowers have been responsible for the failure because they didn't pay back the money; the role plaid by those who granted and sponsored the credit distribution seems to be of secondary importance; but it is not.

Practitioners, researchers, representatives of finance agencies and policy decision-makers are kindly invited to think over the current microfinance trend *to avoid the risk that in a ten years time Africa microfinance movement could be compared to the bad experience of the African development banks in the eighties years when the resources have been distributed without having any expected return*.

1.3.2 New technologies. Visionary finance in Africa is well backed up by ICT people and there isn't any doubt on the fact that the success of microfinance industry would have been unthinkable without the new technologies. Thanks to that, the proliferation of the microfinance industry has been happening without pause. Currently there is a need to balance the development.

Although the symbiosis between new technologies and micro credit looks like a natural union between bride and groom a word of caution is needed. Honestly we have to notice that African websites have been doing a wonderful job. However the Providers should be aware of the risk to arise expectations.

In other words, the output of the exercises should be closely connected to the field reality because here the risk is to wide the *gap between laboratory research and field practice*. Indeed we haven't to forget that both final beneficiaries of the MFIs interventions and front line staff are newcomers in the market. So, the web pages shouldn't be built-up to communicate each other but to be an accessible service for everybody. The risk to rely too much on the outcome of the computer technologies to a detriment of a comprehensive judgement is more real than one could think.

When we are asked to give an advice on project management matters, we provide the interviewer with the following: a) do surf web sites and mind the high wave of literature; b) do not forget that men and women are behind any management exercise. At the end of the day, a management decision is always a compromise among various interests of a given group of players: project's managers, final beneficiaries, shareholders, stakeholders, influential persons, etc. So, while analysing a situation one should elaborates the data of the computer printout with his own judgement on players' behaviour.

Failures could be avoided by setting in place the right intervention's design and using the required risk analysis tools.

However the provision of financial resources should come along with required expertise to fulfil the sound development of MFI so that finance providers should be supported on the capacity building.

Both banks and micro lenders have to improve the quantity and quality of tools to minimise the risks for loans and introduction of credit bureaux, crop insurance and credit scoring are as many as services to put in place.

The main purpose of a Credit Bureaux Service is to gather information on potential borrowers so that any member of the Credit Bureau Service could have more knowledge about both borrowers and lines of business. In some ways the function of the Credit Bureau will institutionalise the informal exchange of information that lenders used to have.
In line with the above, among the tools to improve information on borrowers, "scoring" should have an important position.

Credit scoring is a technique used to assess the credit risk loans. The necessary data on loan applicants are passed through an analytical model embedded in software. The model delivers a number—the score—that indicates the applicant's level of credit risk. Effective use of this technique can sharply reduce the number of applications that need manual review. The model enables lenders to: (i) reduce their cost of making loans; (ii) make more loans to customers; (iii) control risk more effectively; (iv) remove human bias from the lending decision; and (v) focus on assessing questionable loans. Moreover, loan decisions can be rendered in a very short time or hours because credit-scoring procedures are automated.

1.3.3 New products. Sometimes, the search of new products/services doesn't require much imagination but could be only a matter of looking at what is going on in the market. In theme of finding out new avenues to finance food trade, micro finance practitioners could take on board the tradesmen. Why not? We do think that the financial providers could take advantage of the tradesmen's expertise and experience in financing food trade enterprises in urban areas. This is not a provocative statement; on the contrary it does emerge from the field reality. The tradesmen are very familiar with the local environment and this make them suitable businessmen to get them involved in the financing process. In so doing the lending providers can take advantages of the way tradesmen do business and indeed they have a word to say: they know very well the business community as well as enterprises' production and marketing costs; moreover, their reputation is such that it would be difficult to default on payments[5].

The research of new products and innovative management tools as well shall be appreciated not for itself, but for its capability to meet the real demand from the potential borrowers and be easily handled by the staff. Retail banking, downscale operations and facilitate operational linkages are the main avenues to build up an inclusive financial system.

[5] A. Graziosi. Financing food trade - a cost-effective approach for financial providers, 10/04
http://www.eldis.org/cf/search/disp/docdisplay.cfm?doc=DOC15211&resource=f1poverty

1.3.3.1 Finance for food trade business. The report of the Commission for Africa described the conditions of Continent at the present time and suggested the main elements that are necessary to turn Africa around. Among them, it has been stressed out that without economic growth, Africa would not have the chance to earn and trade itself out of poverty which would be the key to changing the lives of people in Africa in the long term. In order to facilitate this, there was a need to get rid of export subsidies, harmful tariff barriers and to increase market access to allow developing countries in Africa and elsewhere the time and space to adapt to a more open and fairer world trade system.

We do believe that in this context the Microfinance movement could play a role. In our view how to provide food to people living in the big cities of poor African Countries is an issue whose importance is in inverse relation to the poor attention by the policy decision makers and researchers.

In 1997 FAO started the Program "Food Supply and Distribution to Cities" in support of the World Food Summit held at Rome in late 1996. The long-term objective is to improve food security of the poorest sectors of urban consumers in developing countries and countries in transition by more dynamic and efficient food supply and distribution systems. The Program addresses the relationship between urbanisation, urban growth and food security[6].

Within the above Program as a Co-ordinator of a Study Group we were asked to prepare a Call for Paper within the section Finance, to define scope and contents for requested contributions so that consultants and experts have been invited to contribute borrowing from their direct experience in the field. We had the opportunity to discuss the matter with colleagues. Although the interviewed persons expressed their interest, they frankly admitted that their contribution couldn't be original and as a result the response was well below the expectations.

Taking into account the importance of the market which provide hundreds thousands on people with food, day by day, here we wish to reiterate the message.

Our question is: why the proposed thematic "*finance for small trade business"* has been less explored? As a member of the network, since the very beginning of the Program we were fully aware of the obstacles and checking meetings/discussions we drew some conclusions and recently we integrated the reasoning in a more comprehensive picture.

First, as it can be understood the magnitude of the subject Food Supply and Distribution System (FSDSs) asks for an intersectional and interdisciplinary approach and it is for nothing that some twenty main technical aspects relating urban dynamics have been identified, at that time.

Secondly, while there could be a good answer for investigating on SME/SMI and agribusiness industry, because here one can refer to a wide range of experiences, there are very few cases specially referred to retail food shops and open-air vendors. What's more, this segment of the market seems has never been investigated alone but its knowledge comes, as a marginal factor, from field experiences on the private sector of the economy focused on small and medium size business.

---

[6] Food for Cities, http://www.fao.org/AGS/sada.htm

Thirdly, food trade business is a very important share of the so-called underground economy, which, as it is well known, is a shadow segment of the economy. So, above all, there is a gap of statistical information to bridge.

Fourthly, if we look at the problem from the angle of the concrete doing for upgrading this segment of the market, first there is a gap of knowledge to bridge. This means that any action addressing food trader should be advanced by an "ad hoc" research looking into the food trade market.

Finally, focusing on finance for small food trade business the main research's objective should be the identification of the sociocultural aspects that can affect a durable development of viable small business. In a nutshell, the preliminary study should include the underground economy to design a program that shall address the constraints of SME in the food sector including agro-industry. The analysis shall be integrated with ad-hoc field surveys.

Summing up, we would like to conclude this necessarily rapid excursus on microfinance in Africa with a common sense statement: the perspectives of the industry are in the hands of the MFIs themselves and the future will be shaped according to the way the practitioners will be capable to face the above problems & challenges. Microfinance is a right tool to unlock the potentials of the African poor people; however it should be less an instrument of economic policy and more and more an industry relying in its own forces. Africa has a well-rooted tradition in tiny loans matters and the practitioners have a lot to capitalise from the financial practices and accordingly they are in a good position to design MFI best practice.

Ascanio Graziosi, Senior Banking Consultant & Microfinance Specialist
http://www.cambridgedata.com/GraziosiAscanio

Summary

The microfinance movement in Africa is something like “gold rush”. Besides an explosion of initiatives the micro credit experiences changed in a way that it is hard to find out analogy with the tiny lending of twenty years ago. Indeed the movement is nowadays called microfinance. In the last couple of years regulations and supervision have been emerging as a dominant issue in the microfinance industry in the Continent. An every increasing number of Countries have been issuing law to regulate the activity of the micro lenders. This trend has marked a turning point and since then nothing will be as before.

The definition of the rules of the game will make it necessary to categorize and distinguish the interventions according the declared objectives of the micro financial providers. This is a very important step not only for evaluation purposes. In this new process the role of the actors have to be adapted because in the past outreach has been a privileged target to the detriment of the sustainability of the operations.

The author has highlighted the new orientations aiming at enhancing the access to the financial services. The analysis streamlines the new topics of microfinance industry referring to three levels of intervention: macro, meso and micro. In this context the revision of the micro credit policy and the role of both donors and governments have to be reviewed and revised.

The approach to the market and the integration of the financial circuits along an appropriate use of the technology are challenging areas for the microfinance industry. However credit alone can’t solve the problem of a sound development of the industry. The new emerging tasks should be accompanied with and sustained by the existence of pre-conditions such as land reform, collateral alternatives, strong value chain, well functioning marketing system for the entrepreneurs. Macro economic and political stability are a condition to make the development happen.