Focus

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Maximizing the Outreach of Microenterprise Finance
The Emerging Lessons of Successful Programs

The Focus Series is CGAP's primary vehicle for dissemination to governments, donors, and private and financial institutions on best practices in microenterprise finance.

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The conventional view has held that microenterprise finance helps poor people and therefore is a desirable development activity but that it cannot be financially viable. Small loans, it is said, are simply too costly to administer, and the profits from such lending too meager to permit profitability. However, a study examining some of the best microfinance institutions concludes that this conventional wisdom is quite wrong. Microfinance institutions can and indeed need to be self-sustaining if they are to achieve their outreach potential providing rapid growth in access to financial services by poor people.

Past efforts using subsidized and directed credit have left a distressing legacy of failed programs and created many skeptics. The weaknesses of past efforts to reach small farmers and other priority groups have been in three main areas: lending institutions have not been financially self-sufficient and usually became decapitalized quickly; funds have not reached the intended target group; and programs have distorted financial markets in ways that interfered with the efficient evolution of finance for broad sectors of the economy.

The recent performance of "frontier" microenterprise finance programs demonstrates that some learning has taken place from the mistakes of subsidized directed credit. Programs are increasingly charging interest rates and fees that cover the real cost of delivering financial services and are embracing financial self-sufficiency as a primary organizational goal. More and more institutions have crossed major hurdles in terms of outreach, raising resources on commercial markets, and increasing service to difficult-to-reach populations.

This study looked at recent developments in microenterprise finance from two perspectives, outreach and financial sustainability. Outreach refers to the central purpose of microenterprise finance – to provide large numbers of poor people, including the very poor and women, access to quality financial services. Financial sustainability embodies the institutional capacity to become independent of donor or government subsidies.

The performance of 11 microenterprise finance programs, selected on the basis of outreach and financial viability criteria, was examined in the study.[1] Criteria included loan size (a rough proxy for client income level), number of borrowers (a proxy for scale), and reputation for financial strength. A special effort was made to select at least one institution serving exclusively the very poor in each of the three major geographic regions. Standard accounting practices were used to make two major adjustments to the audited financial information. First, financial accounts were adjusted for inflation in each country. Second, adjustment was made for implicit and explicit subsidies, such as access to funds on a grant or soft-loan basis. These adjustments allowed each institution to be compared as if it operated on a fully commercial basis.

Key Findings:

Outreach to the Poor

Clients were typically very small businesses that would otherwise be excluded from formal financial services. Six of the 11 programs cluster in the range of US$200 to US$400 average outstanding loan balances, with several well below that level. These institutions reach large

numbers of women, either by design or by virtue of the market they serve. Programs offering small loans tend to serve more women.

Achieving significant coverage

Several institutions, notably in Bangladesh and Indonesia, have achieved major coverage on a national scale. The Grameen Bank covers almost half the villages in Bangladesh, reaching more than 2 million very poor clients. In Indonesia, the BRI Unit Desa's system has more than 2 million borrowers and 12 million savers, and the BKD systems cover 20 percent of villages in East Java with small loans. In Bolivia, BancoSol and PRODEM have reached 50,000 clients, about 10 percent of the potential loan market. Most other programs are growing rapidly and may soon be nationally important.

The study demonstrates that among high-performing programs there is no clear trade-off between reaching the very poor and reaching large numbers of people. Several very large programs (BKD, Grameen) have among the smallest loan sizes. Mixed programs, which serve a range of clients, not just those of a given average loan size, have successfully reached very poor clients. It is scale, not exclusive focus, that determines whether significant outreach to the poorest will occur.

Experiencing rapid growth

The large numbers reached by some programs were the result of extremely rapid growth in the client base-rates ranging from 25 percent per year to 100 percent. The BRI program, with its 2 million borrowers and 12 million savers, is only a decade old. CorpoSol in Colombia increased its client base from fewer than 7,000 in 1990 to 32,000 by 1993. The keys to this rapid growth have been the ability to maintain financial viability controlling bad loans, holding administrative costs to manageable levels, and developing a rapidly growing base of financial resources.

Providing high quality services

Dramatic annual growth in the number of borrowers, the loan portfolio, and, in some cases, savings deposits is evidence of strong client demand and overall satisfaction with the services received. Clients were willing to pay interest rates significantly above the rate of inflation and to repay loans on a timely basis, evident in low delinquency.

To motivate repayment, the programs examined used one of several approaches: groups, social pressure, or unconventional collateral. They emphasized short-term working-capital loans and graduated lending, whereby initial loans are small, and loans are renewed and increased on the basis of the borrower's repayment record. Turnaround time for loans was significantly less than 2 weeks, and lenders were located close to the borrowers' place of work. These features are all aspects of service quality tailored to the situation of poor entrepreneurs.

Operational Efficiency and Full Self-Sufficiency

Efficient, financially viable institutions can develop the scale and financial leverage to reach large numbers of poor people. These institutions have the potential to multiply contributions from donors by tapping funds from commercial non-donor sources. Donors have an opportunity to reach the very poor through sustainable institutions and to make their investment reach far beyond a dollar-for-dollar effect.

Ten of the 11 institutions examined were operationally efficient. They fully covered the cost of day-to-day operations, including salaries and other administrative costs, with program revenues from interest and fees, while reaching large numbers of poor people. The programs achieved these goals in a variety of settings, ranging from rural Bangladesh to urban Bolivia, and with a range of clientele, with average loan sizes as low as US$38. Five institutions were fully profitable, generating inflation-adjusted positive returns on assets. Program revenues covered both the nonfinancial "operating costs" and the financial costs of obtaining loanable funds on a commercial basis. These programs no longer rely on concessional funds or other subsidies (Table 1). Microenterprise finance institutions can achieve operational efficiency consistently in a range of settings and with diverse levels of clients.

Nearly all these frontier programs decided to be self-sufficient. They brought their cost structures in line with spreads available in local markets, controlling for delinquencies and increasing productivity through client/staff ratios. They adapted credit methodologies to the demands of the market, contributing to efficiency. For 10 of the 11 programs, administrative expenses fell into a narrow range of 9 percent to 21 percent of the average loan portfolio outstanding.

Keys to Financial Viability:

Interest Rates

Fully self-sufficient programs charged an effective real rate of interest high enough to cover all their costs, including the cost of capital fully adjusted for inflation. For instance, a fully self-sufficient program in Colombia, CorpoSol, charged an effective real rate of interest of 52 percent, the highest of the sample. Even in an inflationary environment, it sustained a 4.9 percent real return on total assets.

Salary Costs

The only other statistically significant factor for financial viability was the relationship of the program's average annual salary to GNP per capita. Programs paying lower salaries were more profitable than those that paid more. Programs with lower relative salary expenses, such as BKDs, FINCA, Grameen, and LPDs used local personnel to staff their operations, which gave them a distinct cost advantage.

Recommendations to Donor Agencies

- Assess institutions' commitment to achieving operational efficiency and ultimately full self-sufficiency within a reasonable period. Management commitment should be visible in concrete targets and credible plans. Indicators of effective performance include:

Operational efficiency

The institution should be working to develop an efficient, low-cost credit methodology; to control delinquency; and to rationalize its cost structure, particularly salaries.

Interest rate and fee policy

Costs of services should be adjusted for inflation and priced to support financial viability.

Reporting standards

Financial reporting should meet private sector standards, and management should use such information effectively.

- Invest in institutions with the potential to reach full self-sufficiency and significant outreach. Donors should focus on support that fosters movement to greater financial self-sufficiency. In considering whether support is warranted, donors need to take into account the time needed to achieve both operational and full self-sufficiency. Programs examined in this study typically required 5 to 10 years to become self-sufficient, often with substantial donor support.
- In the early phases of start-up, donor support should concentrate on helping programs achieve operational efficiency, including establishing a lending methodology and operational strategy for service delivery. At this stage, donors are often a key source of start-up capital. However, start-ups should be granted a short time frame, such as one project cycle. If efficiency is not achieved, donors should cease support.
- Donors looking at programs that have already achieved operational efficiency should focus on institutions committed to tapping other sources of funds, with concrete targets and plans. Greater emphasis should be placed on improving financial performance reporting, given the higher standards required by investors, and financial skills, such as spread management and asset and liability management. In addition, attention should be directed at meeting the legal requirements to become a licensed financial intermediary or to tap other commercial funding sources. Also important is mobilizing savings to enhance institutional development and provide valuable deposit services to clients. Within a reasonable period, such as one project cycle, assisted institutions need to demonstrate sustained improvement in financial performance indicators, such as operational efficiency, return on assets, and leverage (total liability versus total equity).
- For top-performing programs, donors should consider helping in the transition to full independence. Donor attention will most likely center on strengthening policy dialogue with the government regarding supervisory standards for microenterprise finance, increasing capitalization through retained earnings or equity investment, and mobilizing deposits.

Outstanding Issues

The importance of financial information

Even the frontier programs examined in this study had less than adequate standards for reporting on financial performance and outreach. Accurate financial information, based on generally accepted accounting principles, is critical for two reasons. First, such information contributes to better decision-making and greater efficiency. Second, external sources, such as commercial lenders, depositors, supervisory authorities, and even other donors, rely on accurate financial reporting to decide whether an institution is creditworthy or financially sound. This information determines whether the institution will gain access to additional sources of funds for expansion. Donors should promote the use of standard accounting practices, including transparent treatment of subsidy and portfolio quality (delinquency).

The challenge of mobilizing savings

Possibly the greatest challenge in microenterprise finance is to expand the provision of savings services to the poor. Access to credit by the poor has been emphasized, but research has established that the poor can also benefit from access to secure and liquid savings with adequate returns. BRI's highly successful voluntary savings program demonstrates that many poor clients will save through deposits at financial institutions.

Table One: Analysis of 11 Microfinance Institutions

SUMMARY DATA 1993	BKDs	LPDs	GRAMEEN	KREP	BRK	ADOPEM	FINCA	CORPOSOL	BRI	BANCOSOL	ACEP
COUNTRY DATA											
GNP PER CAPITA	$610	$610	$210	$340	$163	$940	$1,898	$1,558	$610	$650	$753
CURRENT INFLATION RATE	9.5%	9.5%	7.8	47.1%	0.4%	5.3%	9.0%	19.2%	9.5%	9.3%	6.0%
BASIC INSTITUTIONAL PROFILE											
NUMBER OF BRANCH OFFICES	5.345	651	1,030	6	14	6	1	0	3,267	21	19
NUMBER OF EMPLOYEES	16,035	4,913	10,452	60	34	47	19	355	16,067	335	31
TOTAL ASSETS	$62,591,331	$25,597,601	$238,697,436	$1,946,000	$1,586,000	$1,799,000	$1,708,853	$15,681,210	$2,288,743,000	$34,100,296	$1,087,013
AVERAGE ANNUAL GROWTH TOTAL ASSETS	2%	34%	30%	116%	69%	99%	39%	131%	15%	190%	25%
CLIENTS-WOMEN	50%	40%	94%	60%	45%	100%	26%	50%	24%	71%	20%
PROFILE OF CREDIT SERVICE (*)											
TOTAL VALUE OF ALL LOANS OUTSTANDING	$34,196,927	$18,807,632	$159,480,769	$1,149,000	$1,500,000	$1,079,000	$1,586,656	$11,732,836	$937,626,000	$24,830,644	$2,143,184
NUMBER OF LOAN CLIENTS	907,451	145,183	1,586,710	5,303	6,787	3,500	5,121	32,022	1,897,265	46,428	2,109
AVERAGE OUTSTANDING BALANCE	$38	$130	$101	$217	$221	$308	$310	$366	$494	$535	$1,016
ANNUAL GROWTH RATE, LOAN PORTFOLIO	0%	25%	35%	213%	65%	92%	36%	134%	8%	182%	41%
AVERAGE LOAN TERM	4 mos.	10 mos.	12 mos.	12 mos.	10-13 mos.	4-12 mos.	12 mos.	5-12mos.	24 mos.	4-6 mos.	12 mos.
EFFECTIVE RATE OF INTEREST	55%	36%	20%	38%	18%	72%	32%	71%	34%	55%	20%
CREDIT METHODOLOGY - Groups	0%	0%	100%	100%	80%	40%	100%	90%	0%	100%	2%
CREDIT METHODOLOGY - Individual Loans	100%	100%	0%	0%	20%	60%	0%	10%	100%	0%	98%
AVERAGE LOAN BALANCE/GNP PER CAPITA	6%	8%	48%	64%	136%	33%	16%	24%	81%	82%	135%
CAMEL ANALYSIS - CAPITAL ADEQUACY (*)											
EQUITY AS PERCENT OF TOTAL ASSETS	82%	20%	31%	89%	100%	18%	29%	16%	5%	16%	93%
CAMEL ANALYSIS - ASSET QUALITY (*)											
DELINQUENCY - Balance Loans Overdue > 90 days	10.3%	3.9%	2.0%	2.3%	20.0%	4.0%	1.7%	1.3%	6.5%	1.5%	3.0%
EFFECTIVE YIELD ON LOAN PORTFOLIO	37%	36%	20%	22%	9%	49%	24%	50%	28%	45%	27%
CAMEL ANALYSIS - STAFF MANAGEMENT AND PERFORMANCE (*)											
NUMBER LOANS/TOTAL STAFF	57	30	152	88	200	74	270	90	118	139	68
SALARIES/TOTAL ADMINISTRATIVE EXPENSE	69%	65%	64%	68%	69%	48%	65%	75%	53%	60%	55%
SALARIES/AVERAGE PORTFOLIO	11.5%	6.6%	9.3%	12.9%	10.1%	16.8%	8.7%	16.2%	4.5%	12.5%	10.6%
SALARIES/AVERAGE TOTAL ASSETS	6.3%	5.0%	6.1%	6.9%	9.7%	10.2%	8.2%	12.0%	1.9%	9.2%	6.9%
AVERAGE SALARY FIELDWORKER	$1,100	$1,150	$687	$6,000	$3,354	$5,750	$6,192	$8,573	$2,567	$3,300	$4,367
AS MULTIPLE OF GNP PER CAPITA	1.8	1.9	3.3	17.6	20.6	6.8	3.3	5.5	4.2	5.1	5.8
CAMEL ANALYSIS - EFFICIENCY AND PROFITABILITY (*)											
OPERATIONAL SELF-SUFFICIENCY (**)	197%	148%	105%	106%	44%	94%	98%	124%	113%	107%	142%
FINANCIAL SELF-SUFFICIENCY (***)	118%	137%	79%	38%	43%	89%	75%	104%	110%	103%	100%
ADJUSTED RETURN ON AVERAGE TOTAL ASSET	3.2%	7.4%	-3.3%	-18.5%	-11.5%	-0.8%	-6.3%	4.9%	1.6%	1.0%	0.1%
ADMIN. EXPENSE/AVERAGE LOAN PORTFOLIO	16.7%	10.1%	14.5%	19.0%	14.8%	35.1%	13.4%	21.5%	8.5%	21.0%	19.1%
ADMIN. EXPENSE/AVERAGE TOTAL ASSETS	9.2%	7.7%	9.5%	10.1%	14.1%	21.3%	12.5%	16.0%	3.6%	15.4%	12.5%

(*) 0: BASIS OF 1993 DOLLAR, ADJUSTED ACCOUNTS (**) Operational self-sufficiency - operating Income/Operating Expenses (***)Financial self-sufficiency - Operating Income/Total Adjusted Cost

However, most institutions lack the capacity to meet the technical requirements of offering attractive financial services and the stringent criteria of bank regulators. Donors should be cautious in promoting efforts at savings mobilization to ensure that institutions have the financial capability to manage resources of their clients prudently.

Programs examined were Agence de Credit pour L'Enterprise Privee (ACEP) of Senegal, La Asociacion Dominica para el Desarrollo de la Mujer (ADOPEM) of the Dominican Republic, Banco Solidario S.A. (BancoSol) of Bolivia, Badan Kredit Desa (BKD) of Indonesia, the Unit Desa System of the Bank Rakyat Indonesia (BRI), Bankin Raya Karkara of CARE (BRK) of Niger, Corporacion de Accion Solidaria (CorpoSol, formerly Actuar/Bogota) of Colombia, Fundacion Integral Campesina (FINCA) of Costa Rica, the Grameen Bank of Bangladesh, Kenya Rural Enterprise Programme (K-REP) and Lembaga Perkreditan Desas (LPDs) of Indonesia.

This Note was extracted by Mohini Malhotra, Operations Manager, CGAP Secretariat, from a summary prepared by James Fox of USAID's Center for Development Information and Evaluation of USAID Program and Operations Asessment Report No. 10, Maximizing the Outreach of Microenterprise Finance: An Analysis of Successful Microfinance Programs (PNABS-519) by Robert Peck Christen, Elisabeth Rhyne, Robert C. Vogel, and Cressida McKean. The full study is available from USAID/CDIE at 1500 Wilson Blvd, Suite 1010 Arlington, VA 22209-2404; telephone (703) 351-4006; fax (703) 351-4093. Internet: docorder@disc.mhs.compuserv.com

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