

P E R S P E C T I V E

Emerging Trends in the
Microfinance Industry



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Introduction

A laymen's dictionary would describe microfinance as the provision of financial services such as loan, savings, remittance, insurance etc. to the economically deprived, with the necessary guidance in order to raise their standard of living. A global consensus and concerted effort towards appreciating it as an industry led to the United Nations identifying microfinance as one of the means to reduce extreme poverty as envisaged in the Millennium Development Goal 2015. Apparently financial inclusion (financial exclusion in some countries) is identified as one of the key challenges

microfinance sector that would play a vital role in shaping its future.

Commercialization

The rising popularity of MFI has been geo-specific. Africa, Latin America and Asia are witnessing the increasing concentration of MFI. This can be attributed to the presence of below poverty line population in the region as well as the concentration of the urban poor. Savings of the clientele and funding from venture capitalists have been the prime source of funds for the MFIs. However the scenario is changing gradually.

Table 1 - Banks and MFI – A Comparison

Features	Conventional Banks	Microfinance Institutions
Products	Wide gamut of loans, deposits and allied services	Small ticket loans, deposits, insurance, investment and remittance
Size of the loans	USD 1000+	USD10 – USD300
Duration of the loan	6 months +	Intra day to 1 year
Guarantee	Collateral required	Group guarantee
Interest Rate	10 -20 percent (general)	20 -30 percent (general)
Technology	Electronic Core Banking Solution	Evolving from paper based system to software solution
Motive	Profit	Social cause + Profit

in achieving equitable economic progress throughout the world. Central banks across the globe are taking initiatives to ensure that the benefits of financial services reach the underprivileged to help reduce the gap between the have and the have-nots.

In retrospect, ever since Dr. Muhammed Yunus gave his first USD 27 loans to women in Chittagong, Bangladesh, three decades ago, the microfinance industry has come a long way. Today MFIs serve 75 millions borrowers with a loan outstanding of more than USD 38 billion¹.

Hundreds of microfinance institutions (MFIs) have matured and become profitable over the years. The commercial banks are beginning to see opportunities at the low end of their retail market. Even mobile-telephone operators are innovating with mobile phone-based banking services. All these, along with the insatiable appetite of the market valued at USD 300 billion have made the playground exciting and innovative.

This paper explores the emerging trends in the

Banco Compartamos, the largest MFI in Mexico has divested 30 percent of its stake for USD 458 million. Interestingly the return on equity is a whopping 45 percent and profit margin is 33 percent. The bank has issued 1,000 million pesos in the local debt capital markets. Tanzania National Microfinance Bank sold 21 percent of its stake to public in a bid to raise capital. In India too a couple of leading MFIs are planning to go public in near future. Forbes recently published the Forbes 50 list of top MFIs acknowledging the industry and its impact². It clearly indicates that there is a huge market opportunity and potential for business growth for the MFI industry. The commercialization of the MFI is a trend which is here to stay. It is very important for the MFI to retain its social objective of empowering the poor amidst the structural adaptation.

Merger and Acquisition – The merger and acquisition activities in the MFI industry are expected to gather momentum. Spain's Fundación BBVA acquired several MFIs in Colombia and Peru in recent past. Several small MFIs would still exist but may be shadowed by the consolidation anticipated in the segment.

Downstream focuses from banks have been another impetus fueling the spurt in MFI growth. High street banks have realized the importance of the MFI segment, its impact and prospects. Banks are opening microfinance departments to cater to this segment. Banco Caja Social and Bancolombia of Colombia are few examples. At the same time some large MFIs have up-scaled to become full-fledged banks as in the case of Banco Sol, Bolivia and Finansol (now Finamerica) in Colombia.

Innovative Functioning Models

The functioning models of MFI would undergo changes considerably. The current structure of MFI is mostly three-tiered with Field Officer (Correspondents), Branch and Head Office. Some of the innovative methods being conceptualized from the functioning perspective are as follows:

- Corner shop banking - In Mexico, it has been proposed that retail shops be licensed to offer plain vanilla banking services (cash deposits, transfer and bill payments). Another notable development would be in the mobile device. Mobile money transfer is being widely accepted in LATAM and African countries as an entry to microfinance services. MTN tie up with mobile fund transfer Fundamo in South Africa is one such example.
- Islamic microfinance represents the confluence of two rapidly growing industries: microfinance and Islamic finance. A recent CGAP survey reveals that there is a total of 380000 customers for Islamic microfinance with increasing popularity in South Asia, Middle East and African countries. Various types of new Shariah based products in addition to the most popular Murabaha (cost plus mark up). The small but prospective market is dominated by Islamic microfinance banks with a huge demand to be met with.
- Type of organization – Different legal entities would assume the role of MFI irrespective of their industry and legal status leading onto Insurance companies, money exchanges, mobile phone operators, property developers, retail shops in addition to the NGOs, banks and NBFC offering microfinance services.

Changing Face of Regulation

Gone are the days when MFIs were viewed as a loss making charitable institutional exercise. More and more countries are enabling, empowering and supporting the MFIs with regulations and legislations. Exclusive central regulatory bodies, specific legislations, effective support and grievance redressal mechanism are gradually being put in place by governments worldwide. South Africa has formed a Microfinance Regulatory Council to monitor the MFIs. In Kenya the Microfinance Unit of Ministry of Finance regulates the MFIs. The National Commission of Banks and Securities supervises the operations of MFI in Mexico. In almost all the other countries the respective central banks are the regulatory authority for the MFIs. Islamic MFIs follow the Shariah Supervisory Board (SSB) in the respective region. Different countries have passed or are proposing to pass exclusive regulations pertaining to the MFIs. The trend reiterates the significance attached to the industry and the future being perceived by each country. In future, we may see the MFI Industry emerging as an equally strong industry akin to the mainstream banking.

In the light of the current turmoil in the finance sector emanating from subprime lending, going forward, regulators might impose stringent norms for disclosure. The MFI would be required to furnish the features of the product on the brochure with warning notes like 'if the servicing of this loan is absorbing more than 20 percent of your disposable income, do not sign'. Increased focus on financial literacy would be put in place to create awareness among the people.

The emergence of rating agencies and apex bodies indicate northward growth of the industry. International agencies like the UN, IFC, World Bank and CGAP are doing commendable work in the area of spreading awareness about MFI activities across the world. The future beckons social rating and impact analysis to assume greater importance in judging MFI performance.

Technology Thrust

The initial cost of investment and the subsequent maintenance fee charged by technology vendors have kept MFI away from the adoption of technology solutions in their operations. However with passage of the time and the increasing

volumes of business-vendors, and MFIs have realized that technology is indispensable for long term growth strategy. Vendors have accordingly come up with exclusive software/hardware solutions for the MFIs. Software as a service (SaaS) model is expected to go down well with the MFIs. The cloud computing platform is expected to gain popularity as it can reduce the cost and efforts required substantially. MFIs need not lock in resources in massive hardware infrastructure or in a full-fledged core banking solution.

Delivery channels - The importance of delivery channels like ATM, IVR, laptops, palmtops, biometric, smart cards and mobile phones will be realized by all players. The marriage of mobile phone operators with the financial services providers would present an indomitable combination. This comes on the backdrop of an amazing rate at which mobile phones are catching up at different parts of the world. Developing African countries such as Morocco, Ghana and Nigeria have 59 percent, 33 percent and 30 percent mobile penetration respectively³. Banks would be keen on forging alliance with mobile operators to reach out to the last mile.

Shared branching – It is another trend that could emerge as an alternative operations model. It helps MFI in reducing the costs in a large way once they expand. Different MFIs who are part of an association can use the branch set up of any one its members located at a different location. It would enable the MFIs to circumvent the challenges in spreading their operations across geographies. Germany's ProCredit Holding opened new institutions in Colombia, Honduras and Mexico in 2007 to expand their Latin American operations.

Tip of the Iceberg – Funding

Bankers, venture capitalists, technology solution providers, governments and public at large have realized the mammoth potential of microfinance.

There are now 80 investment funds that specialize in microfinance, 30 of which were established in the last three years globally. These funds are still small and highly concentrated in the leading institutions in Latin America and Eastern Europe, but their pool of capital available is growing fast. World Bank's IFC, the German KfW or the

European Investment Bank, are currently the largest investors in microfinance. IFC, for example, currently has USD 640 million in outstanding commitments to microfinance and plans to double this amount over the next three years. Accion International, Ford Foundation, Bill and Melinda Gates Foundation, Grameen Foundation, Sequoia Capital, Lok Capital are few of the high profile venture funds who have already invested millions into microfinance initiatives. It is estimated that the microfinance industry receives USD 500 million to USD 1 billion a year as funding.

Another innovative avenue of MFI funding has taken shape online. MYC4, a peer-to-peer lending facility with 15,643 registered investors from 94 countries, has reported investments in online microfinance amounting to 9.3 million Euros in 4,865 businesses in seven African countries so far. Micro Place, an e-Bay company, has provided 40,005 loans enabled by investments made online since its inception in 2007. Kiva, another major US-based not-for-profit company which has pioneered the idea of online lending, is distributing one loan in every 14 seconds, lending more than USD 1 million a week. Kiva has explored the potential of internet to connect retail investors to microfinance borrowers and entrepreneurs across the world. Rang De and Dhanna-X in India have also adopted the online model.

Urbanization

Microfinance Industry was visualized to cater to the financial requirements of the poorest of the poor. However the ground reality is not close to the original thought. The MFIs driven by various factors such as risk, return and convenience are more skewed towards the urban poor than the real rural poor population. In future the regulators could come up with specific percentage allocation in the portfolio of MFIs towards the rural poor. With the advent of innovative delivery model like mobile phones, the inclination towards rural population will also rise. As per the UN is around 35 percent of the world population, with daily income of less than USD 1. Therefore the indication is that people migrating to urban areas from rural hub would avail the microfinance services easily. However, as the industry matures, the rural poor and unbanked would have choices to make in terms of selecting the financial service provider.

Table No 2 The Regional Highlights

Region	Market Size (projection for 2012)	Unbanked Populace
LATAM & Caribbean	USD 22 billion	175 million
Africa	USD 25 billion	230 million
South Asia	USD 15 billion	264 million

Source: Various sources

Table No 3 Country Specific Highlights

Country	Region	*Conventional Banking Penetration	GDP rate ('08-'09)	Microfinance Market Size
India	South Asia	8	7.1 percent	USD 6 billion
Kenya	Africa	10	2.008 percent	USD 2 billion
Mexico	LATAM	10.1	1.3 percent	USD 4 billion

*No of branches per 100 thousand population

Sources: Various sources

The Road Ahead

The journey so far has never been a bed of roses for the MFIs. The usurious interest rates, limited products, lack of accessibility have always won them brickbats from the critics and skeptics. The emergence of regulatory body for MFIs, enactment of legislation, performance rating by industry bodies, increased funding, increasing spends on technology and innovative products indemnify the potential of MFI industry. Only 28 percent of the total demand for microfinance services would be covered by the MFI globally by 2010 with the World Bank estimation of microfinance requirement at USD 300 billion.

The world leaders at UN Summit 2005 have set the goal of reducing the extreme poverty in the world by half by the year 2015, as one of the Millennium Development Goals. In that all-encompassing journey undoubtedly MFIs play a pivotal role. The producers of software, hardware and associated infrastructure required by the MFIs should by then acknowledge the undeniable prospects of MFIs and prepare themselves accordingly. And by doing so they are also contributing to a larger social cause; of course with business objective!

Glossary

UN	United Nations
MFI	Microfinance Institutions
CGAP	Consultative Group for Assisting Poor
IVR	Interactive Voice Response
ATM	Automated Teller Machine
IFC	International Finance Corporation

Research Utilities

Microfinance Gateway – microfinancegateway.org
mixmarket.org
Sa-Dhan.org
Cgap.org
UNCDF - unCDF.org
Trends in Microfinance 2010-2015 - www.micro-ned.nl

Details of Tables

SI No	Name of the Table	Page No
1	Banks and MFI – A Comparison	1
2	The Regional Highlights	5
3	Country Specific Highlights	5

References

SI No	Reference Points	Page No
1	A leading portal on Microfinance	1
2	http://www.forbes.com/2007/12/20/top-philanthropy-microfinance-biz-cz_1220land.html	2
3	Leading portals on telephone penetration and usage	4

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