MICROFINANCE BAROMETER 2017

CONVERGENCES
ZERO EXCLUSION CARBON POVERTY

8th Edition

IN PARTNERSHIP WITH

CAISSE D'EPARGNE FEDERATION NATIONALE
mastercard foundation
EUROPEAN MICROFINANCE PLATFORM NETWORKING WITH THE SOUTH
OIKO CREDIT investing in people

IS MICROFINANCE STILL WORKING?

CONTENT

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EDITORIAL

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It is not easy to report on the state of microfinance around the world, given that specialised institutions are diverse in their legal nature, size and business model, as well as the services they provide and the context in which they operate.

Convergences' Microfinance Barometer has the great merit of following, year after year, the progress of the sector, identifying trends and fostering debate. We would like to thank all the contributors to this 8th edition.

This new edition points to the sustained growth, by more than 9%, in the overall loan portfolio and the number of active borrowers. However, these figures must be contrasted with those of unmet needs –more than 2 billion adults have no access to a financial institution– and areas insufficiently covered. I think of microinsurance in particular, which can play an effective role in protecting incomes and as a working tool for the poorest people, while contributing to a better quality portfolio of microfinance institutions (MFIs).

This Barometer confirms trends already observed in previous editions: a greater professionalisation of MFIs; dissemination of universal standards for managing social performance; and a tendency to concentrate and transform mature MFIs into banks.

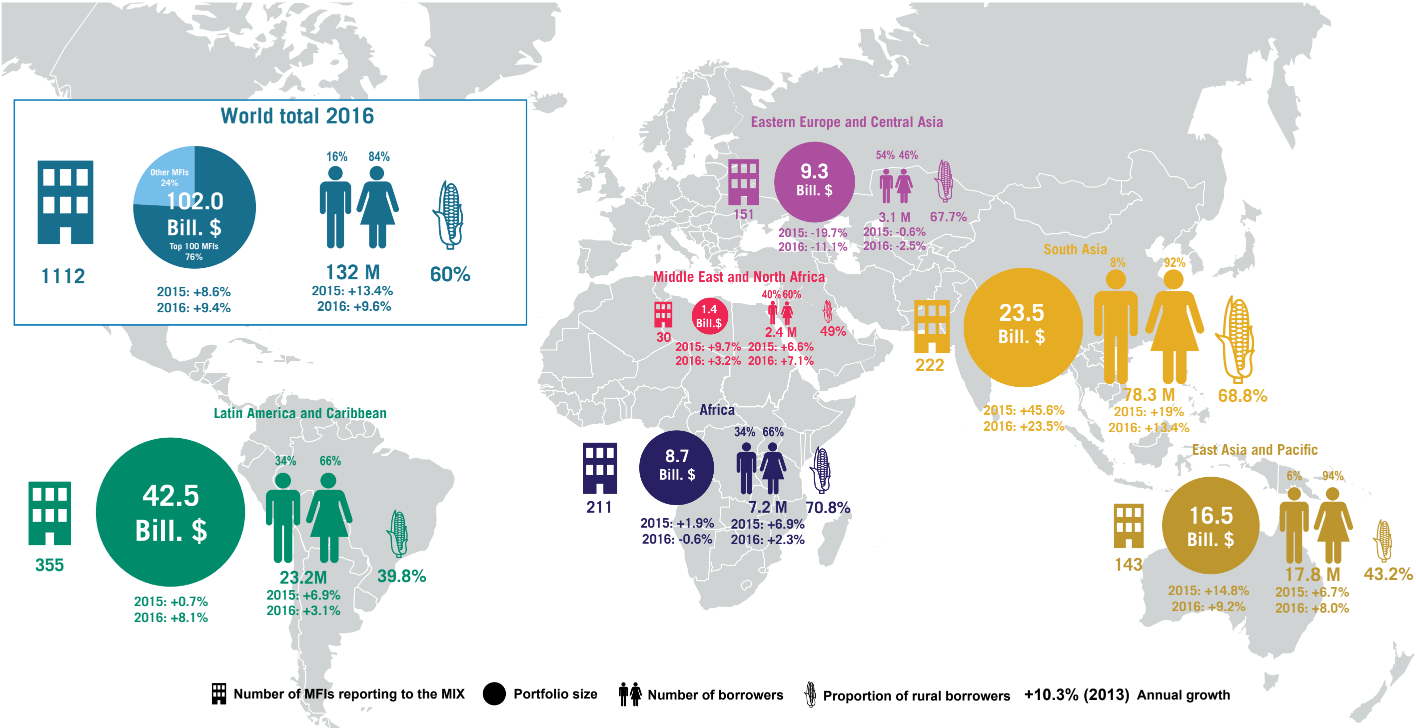
For my part, I would also like to point out two other significant events that the entire microfinance sector should pay attention to :

- The brutal devaluation of the Azerbaijani manat in 2016 and its destructive effects for relatively well-managed MFIs, which are excessively exposed to currency risk, reminded us that local currency financing by international funders, whether public or private, should be part and parcel of any responsible investment policy.
- The Reserve Bank of India's granting of 10 licences to "small financial banks" falls within a strong-willed policy on the part of the country's authorities that aims to achieve universal banking. Financial inclusion of the most vulnerable is not necessarily limited to microfinance.

In light of this observation, this 8th edition of the Barometer highlights the synergies between microfinance and impact investing in a special report devoted to them. The emerging sector of impact investing has much to learn from microfinance, which has played a pioneering role, notably in terms of transparency, social performance management and structuring of the sector. CGAP, MIX Market, SPTF, rating agencies, degree courses, to name but a few, could be a valuable source of inspiration for impact investing.

To sum up, I would like to echo the words of Stefan Harpe of the MasterCard Foundation: "Microfinance gives vulnerable, marginalised clients their dignity back". It should remain faithful to this founding principle, which goes back to its very inception, 40 years ago in the villages of Bangladesh.

KEY FIGURES OF FINANCIAL INCLUSION | WORLD



Microfinance's global figures: the dynamics of a changing sector

In 2016, microfinance institutions (MFIs) reached 132 million low-income clients with a loan portfolio worth 102 billion dollars. At a global level, MFIs recorded an annual growth of +9.4% in the loan portfolio and of +9.6% in the number of borrowers.

The 100 largest institutions (ranked by loan portfolio) represent 76% of the global market with a credit portfolio of 77.1 billion dollars and an outreach of 81.1 million clients in the microfinance sector.

In 2016, Non-Banking Financial Institutions (NBFIs) had the largest concentration of borrowers with 35%, followed by banks which accounted for 33% of global borrowers. NGOs recorded the highest growth in the loan portofolio with +17.7%, but banks continue to have the highest concentration of loans (51%).

Focus on regions

South Asia numbered more borrowers than the rest of the world (59%) and recorded the highest growth in terms of total loans (+23.5%) and clients (+13.4%). Although the region registered a strong growth, it was lower than in 2015 when it recorded a growth of +45.6% and +19% respectively.

LA and the Carribean registered a growth rate of +8% in borrowers and held of loan portofolio (42%) with a growth rate of +9,2%. The region witnessed big mergers of MFIs institutions with different consequences in each country. In Peru for example, the mergers have been positive for the sector, whereas in Mexico they had led to a slower market.

In 2015 and 2016, the MFIs in the Eastern Europe and Central Asia continued to register a decline in the loan portfolio and the number of borrowers (-11.1% and -2.5% respectively) due to ongoing economic crises and currency fluctuation, impacting the operation of the MFIs in the entire region. The most affected country was Azerbaidjan where the number of borrowers and the loan portofolio continued to decline as in 2015 (-42.3% and -19.1% respectively). However, a positive change could be expected for the MFIs thanks to the political measures taken to fight the economical crisis.

In Africa, the MFIs have experienced a slower growth in borrowers (+2.3%) and a decline in the loan portfolio (-0.6%) in comparison to the last two years. The average loan size in the region was 425 dollars (the second lowest after South Asia with 220 dollars). Among all the countries in Africa, Kenya, Tanzania and Nigeria had the highest loan portfolio, while Nigeria, Uganda and Benin registered the largest borrowers base.

Focus on clients

Female borrowers continue to be the primary target in the microfinance sector across the globe, with a coverage of 84% in 2016. East Asia and the Pacific had the highest coverage in female borrowers with 94%, closely followed by South Asia with 92%. Latin America and the Caribbean and Middle East and North Africa regions registered more than 60% of female borrowers, while Eastern Europe and Central Asia had the lowest coverage with 46%.

Rural borrowers in 2016 represented 60% of the global market. NGOs had 81% of rural clients, followed by NBFIs with 63%. Banks, on the other hand, still recorded the lowest concentration of rural clients registering 26% in 2016.

Top 10 countries by borrowers and loan portfolio outreach

Rank	Country	Borrower FY 2016 & borrower growth since 2015 (%)	GLP (USD) & GLP growth since 2015 (%)
1	India	47.0m (+18.4%)	14.7bn (+24.4%)
2	Vietnam	7.6m (0.0%)	7.4bn (+0.2%)
3	Bangladesh	25.2m (+5.1%)	6.9bn (+19.7%)
4	Peru	4.6m (+12.4%)	10.8bn (+16.3%)
5	Mexico	7.0m (+3.2%)	4.4bn (-6.4%)
6	Cambodia	2.3m (-0.1%)	6.4bn (+20.7%)
7	Colombia	2.8m (+0.4%)	6.0bn (+12.5%)
8	Bolivia	1.3m (+2.4%)	7.4bn (+13.1%)
9	Brazil	3.2m (0.0%)	1.9bn (+11.8%)
10	Ecuador	1.3m (-10.0%)	5.1bn (-7.2%)

The top 10 countries listed are defined based on the loan portfolio and borrowers registered in each country during 2016.

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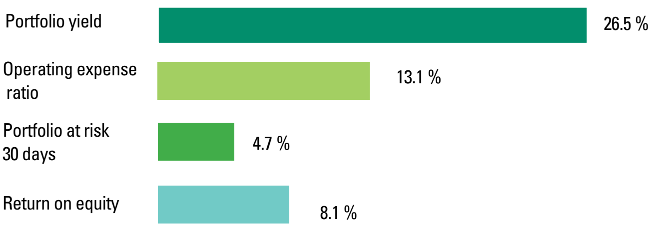
Focus on microfinance institutions

The median value of return on equity for the institutions reporting to MIX was 8.1% in 2016, as compared to 7.9% in 2015 and 9.6% in 2014. NGOs and rural banks were the only group that observed a positive change over 2016. The yield on gross loan portfolio aggregated to 26.5% in 2016, quite similar to 2015. Africa had a yield of 34.3%, i.e. the highest at global level, whereas South Asia had the lowest yield of 22.8% during the year.

The Operational Expense Ratio, a measure of service delivery cost, stood at 13.1% in 2016 at the global level, marginally lower than the previous year at 13.3%. South Asian MFIs continue to deliver the lowest operating expense costs at 9.1% due to an effective delivery model, whereas Africa reported the highest operating cost with 17.7% in 2016. The global portfolio at risk (PAR) exceeding 30 days was 4.7% in 2016, a slightly higher rate from 3.9% in 2015. South Asia's PAR –which was the lowest in 2015– increased and reached 1.9% in 2016, which was the highest change reported by the MFIs. Africa's MFIs witnessed deterioration in its portfolio as they reported a PAR rate of 6.9% in 2016.

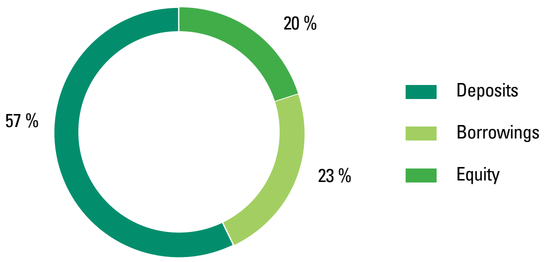
Figure 1: MFIs median performance ratios in 2016



Deposits, main base of MFIs' funding

The funding structure in the microfinance sector is comprised of borrowings, deposits and equity. In 2016, deposits represented the first source of funding with 57%, followed by borrowings and equity (23% and 20%).

Figure 2: Sources of MFIs funding in 2016

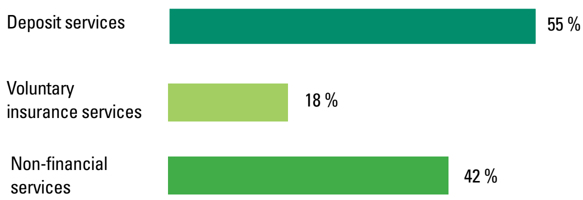


The Latin America and Caribbean region continued to have the highest deposits coverage with 29% whereas Eastern Europe and Central and South Asia had the lowest coverage with 5% each. Regarding the funding within each continent, Africa also had a higher concentration of deposits (71%), followed by equity coverage (17%) and borrowings (11%). South Asia got most of its funding from borrowing (43%), a phenomenon that can be explained by the opportunity given to few Indian institutions to become "small finance banks"(SFBs), a status which allows the institutions to have low-cost structures thanks to deposits and a larger scope of their products and services. Concerning the type of financial providers, credit unions and banks had higher deposits levels with 77% and 67% respectively, whereas NBFIs had deposits and borrowing as their main source of funding with 42% and 37%, respectively. NGOs had a similar combination of borrowings and equity, while deposits remained lower.

Going beyond credits: the MFIs' non-financial services

The most common non-credit products are non-financial services, insurances and deposit services. Globally 42% of MFIs provided at least one non-financial service, concentrating in particular on education, health services, entrepreneurship and women's empowerment. Banks had a better range of products in terms of deposits (92%) and insurances (30%).

Figure 3: MFIs product offer excluding credit in 2016



In the Middle East and North Africa, non-financial services accounted for 56% of MFIs' global offer, while East Asia and the Pacific had the highest number of institutions offering insurance products. Deposits were offered widely in Africa and East Asia and the Pacific regions, as over 85% of MFIs provided at least one deposit product.

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CHIEF OPERATING OFFICER
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Methodology

MIX calculations are based on data provided by financial service providers to MIX that is publicly available at http://www.themix.org/mixmarket. MIX makes every effort to collect the data from the dominant actors of each market to ensure visibility into each market but does not collect data on every actor in every country.

Total figures for borrowers and loan portfolio as of FY 2015 and FY 2016 are based on data provided by 1,036 and 1,112 institutions respectively. For FY 2016 data, globally and regionally, we have considered data for all the institutions that have reported to MIX for an annual period of FY 2016 as of March 31, 2016, July 16, 2016, September 30, 2016, and December 31, 2016. If no annual, year-end figures were available, we took the latest available quarterly figures starting from December 31, 2016 and moving backwards to September 30, 2016, June 30, 2016, or March 31, 2016.

Growth figures for borrower and loan portfolio values for FY 2015 and FY 2016 are based on a balanced panel data from the set of institutions that have provided both data fields to MIX for each of the fiscal years from FY 2014, FY 2015 and FY 2016.

Funding data is provided by microfinance institutions. To fill in any gaps in the funding data, values were assumed provided that enough data was initially reported by the institution. For example, equity was calculated if no value was provided by the institution, but the assets and liabilities were available. Similarly, deposits or borrowings were calculated assuming total liabilities were comprised of either deposits or borrowings and that two of the three values were available from the institution.

KEY FIGURES OF FINANCIAL INCLUSION | EUROPE

In the context of economic crisis and growing inequality that Europe has faced in the last years, microfinance has emerged as an important policy tool to fight against social and financial exclusion, promote self-employment and support microenterprises.

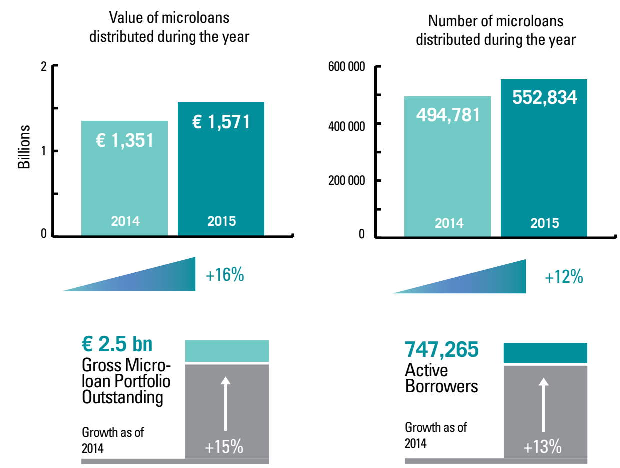
Nonetheless, today in Europe there remains a significant, unmet demand for people and microenterprises who are financially excluded. The European Microfinance Network (EMN) and Microfinance Centre (MFC) Survey Report 2014-2015[1] provides evidence on how the microfinance sector can take on the challenge and fill this financing gap.

European MFIs are supporting an increasing number of financially excluded

According to the Report, which surveyed 149 MFIs from 22 countries[2], the microfinance sector has been steadily growing over recent years. In 2015, the surveyed Microfinance Institutions (MFIs) disbursed a total of 552,834 microloans with a total volume of almost 1.6 billion euros. Overall in 2015, MFIs reported 747,265 total active borrowers, with a gross microloan portfolio outstanding of 2.5 billion euros.

These indicators show a double-digit growth over the 2014-2015 period and reach a growth rate upwards of 50% when considering a 4-year time span (2012-2015).

Figure 1: Trends in microlending activity and outreach



Business microloans as MFIs' core activity (loans below 25.000 euros)

Business microloans support self-entrepreneurs and microenterprises who are financially excluded whereas personal microloans support the needs of vulnerable clients such as rent, education and personal emergencies, as well as employability investments (e.g. financing the purchase of a car).

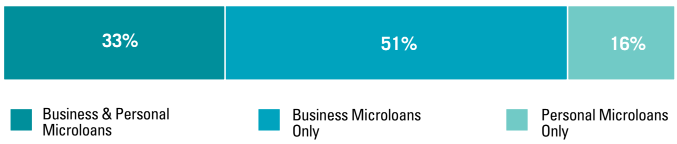
From the MFIs perspective, the combination of business and personal products depends on the specific mission and business model, but could also be the result of the regulatory framework in place at the national level. For instance, in some countries, MFIs are only allowed to provide business microloans.

In Europe, the majority of the MFIs offer business microloans only, 1/3 provide a combination of business and personal microloans and a limited number of MFIs offer personal microloans exclusively.

Although personal microloans show remarkable growth in the recent period, the majority of the gross microloan portfolio (71%) is allocated for business microloans. This reflects the large share of MFIs that exclusively offer business products and the fact that European Union (EU) support (e.g. funding) has been traditionally focused on MFIs that finance income generating activities rather than the personal needs of clients. In addition, another important element is the significant average size difference between business and personal microloans.

In fact, business and personal loan products, which are designed to meet different clients' demands, differ greatly with regards to their terms and conditions. On average, personal microloans are much smaller in size, offered on shorter terms and are more expensive than business microloans.

Figure 2: Share of MFIs by type of microloans offered



It is also worth noting that the terms and conditions of microloans are very diverse among European countries. The average annual interest rate on business microloans varies from 3% in Poland, Finland and France to 28% in Serbia. There is also a wide spectrum for personal microloans, ranging from 4% in Italy and France to 41% in the UK. This is mainly due to differences in national legal frameworks, particularly the presence of usury laws (lack thereof, as in the UK) or a regulatory environment that allows for competition, as it is not currently the case in Serbia. Other factors include the business model adopted by the MFI, the level of public support (i.e. high in France), refinancing costs and inflation.

Figure 3: Average terms and conditions of microloans

	Business Microloans	Personal Microloans
Average outstanding loan size	€ 7,947	€ 1,697
Average microloan term	41 months	30 months
Average annual interest rate*	10.7%	19%

**does not include additional fees (Average fee: 2.5%)*

A comparison of the average loan size also provides a contrasted picture. Assuming that the smaller the loan size (as a percentage of the Gross National Income per capita), the poorer the client, the four countries that reported the lowest ratio and therefore where MFIs are targeting the poorest clients, are Germany (6%), France (11%), Switzerland (12%) and the United Kingdom (16%). Conversely, this average loan ratio is more than 100% in Hungary and Poland. These results are an example of the different target groups that the microfinance sector is serving across Europe, ranging from the financially excluded population underserved by banks to potentially successful micro-enterprises that are financially excluded because of the underdeveloped financial sector.

[1] Microfinance in Europe: A Survey of EMN-MFC Members. Report 2014-2015.

[2] This sample covers EMN and MFC members.

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Beyond microloans: the key role of non-financial services

MFIs in Europe are also expanding their range of financial products and services. Beyond microloans, the main financial products and services offered by MFIs are larger business loans (e.g. more than 25,000 euros to microenterprises and small and medium enterprises (SMEs)) and savings (mostly offered by banks and credit unions that are allowed to take deposits). Additional products offered include: insurance, current/checking accounts, mortgages, mobile banking and money transfer services. However, the current percentage of MFIs offering these additional products is still limited.

Non-financial services are also emerging as a key element of microfinance in Europe. In fact, more than half of the MFIs surveyed follow an integrated approach allowing for the provision of financial and non-financial products and services. In 2015, MFIs reached 205,943 clients with their non-financial services, primarily financial education and business development services.

Given the high cost of traditional non-financial services for MFIs, the lack of dedicated funding and the on-going digitalisation process, 40% of the surveyed MFIs are complementing their "in person" offer of non-financial products and services with an online offer. However, the majority of MFIs (56%) are still delivering non-financial services "in person". Only a few MFIs (4%) offer exclusively online services through dedicated platforms.

Institutional diversity of MFIs in Europe

Looking at the main institutional features of MFIs operating in the European market, a clear image of the sector's heterogeneity emerges relating to the institutional model, social mission, size and level of specialisation in microlending.

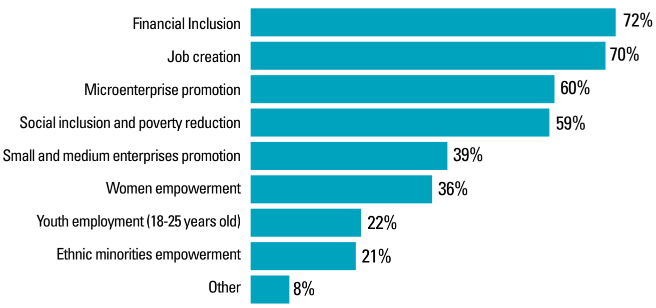
MFIs adopt a variety of institutional models to operate in the diverse national legal and regulatory frameworks. MFIs in Europe are primarily non-bank financial institutions (60%) and NGOs (31%). Nonetheless, other legal forms are also adopted such as cooperatives and credit unions, banks or a government body.

MFIs in Europe are also pursuing a wide spectrum of social goals. However, most MFIs state financial inclusion and job creation as their primary missions. Only a few MFI mission statements emphasize ethnic minorities and/or immigrant empowerment as well as youth employment (18-25 years old) goals.

More than half of MFIs are specialised in microlending, which represents their primary activity and contributes to more than 75% of their overall turnover. Finally, in terms of size, MFIs are still relatively small. This is reflected by the fact that 42% of the institutions have fewer than 10 paid staff. Only 1/5 of the MFIs surveyed have more than 50 employees. Larger MFIs are mostly located in Eastern Europe.

Figure 4: Share of MFIs by mission

Respondents selected at least one option to describe their mission



Some challenges ahead: sustainability and impact measurement

Despite the heterogeneity and various levels of development in the sector, European MFIs will face some common challenges in the coming years. Although financial performance and portfolio quality trends show an increasingly financially viable European microfinance sector, the achievement of sustainability remains a major challenge, especially in Western Europe. Public support remains fundamental to keep the sector going as market players show limited to no appetite in investing. New philanthropic and social investors are being identified and some funds are being channeled to the top-tier MFIs.

The on-going digital transformation of the economy also offers several opportunities for MFIs to develop new delivery channels, to enable the instant transmission of information between clients and financial providers and to increase operational efficiency. Today, MFIs are required to develop innovative business strategies integrating digital solutions that focus on vulnerable clients on a larger scale without compromising their social mission.

Further professionalisation of the sector, including innovation, is required to provide responses to new crucial societal challenges and to prove to funders and supporters (both public and private) the social and economic impact of microfinance.

Obstacles are numerous, but one main remaining challenge is the regulatory constraints that limit the provision of microloans or the entrepreneurial initiative of the microfinance clients. In some countries, better regulation for non-bank MFIs, simplification of micro-enterprise creation and the recognition of self-entrepreneurial status are fundamental to ensure that the sector can fully deliver on its mandate to support financially and socially excluded people.

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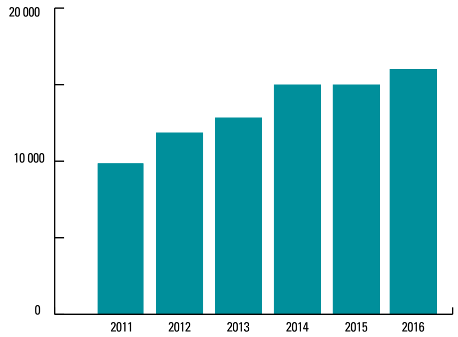
Personal microcredit

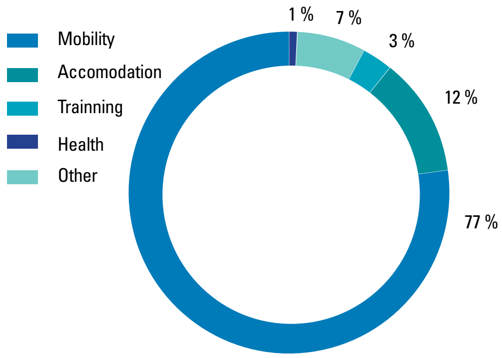
Personal microcredit has existed since 2005, when the Social Cohesion Fund (SCF) was created. 10 years after, the 100,000 loan-mark is passed, even if we have to keep in mind that the demands are six to seven times higher than the loans granted. Microcredit remains above all a process of financial and social inclusion: it is not limited to the simple disbursement of a loan. Indeed, it also offers the construction of a budgetary diagnosis, reorientation or openness to rights, and where possible, instruction of a loan application and monitoring of the borrower. It is estimated that 72% of borrowers who succeeded sustainably in their project were already employed. As for job seekers, they are 55% to carry out their project.

Some figures on personal microcredit at the end of 2016:
- 100,229 personal microcredits granted since 2005
- 233.1 millions euros: nominal amount distributed since 2005
- 2,326 euros: average amount of loans.

Number of guaranteed personal microcredit distributed in France per year



Distribution of personal microcredit by object



Professional microcredit

In the professional microloan sector, the SCF works to provide contributions in favor of:

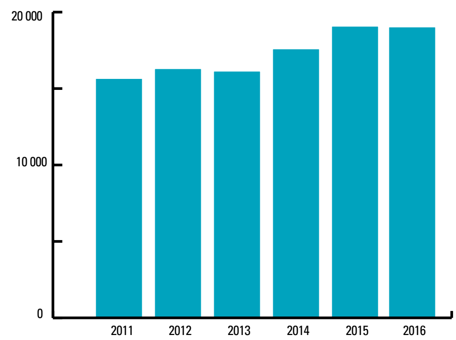
- allocating state funds pooled under the Guarantee Solidarity Fund for Female Entrepreneurship and Inclusion (FOGEFI)
- supporting guarantees of “Galland Law” territorial funds, managed by France Active
- New support for Enterprise Creation and Recovery (Nacre)
- supporting accompanying enterprise creation networks.

The SCF contributed 17.3 million euros in 2016 in these fields, including 7.74 million euros on traditional guarantee schemes and 8 million euros in guarantee of the “Nacre” loan resource, the balance being allocated to the financing of supporting networks.

This support enabled FOGEFI to set up 15,189 cases (a steady number compared to 2015) for a guaranteed amount of 75 million euros, reflecting the increase in the average guarantee amount. Thanks to FOGEFI, the amount of loans granted to women entrepreneurs, microcredit, mainly to Adie, or to integration enterprises and solidarity structures came to more than 120 million euros.

The “Galland Law” territorial funds, financed joinly by the State and the local communities, granted very small

Number of professional microcredits distributed in France per year



businesses (VSBs) a total of 3,900 guarantees, representing 63 million euros.

The SCF guaranteed Nacre zero-rated loans for a total of 42 million euros. More than 35,400 jobs were created or consolidated by the action of the SCF (except Nacre) in the sector of solidarity-based professional credit, mainly in VSBs.

ECONOMIC DEVELOPMENT & SOCIAL COHESION DEPARTMENT
CAISSE DES DÉPÔTS GROUP

MICROFINANCE IN FAVOUR OF EMPLOYMENT

Personal microcredit in detail

In France, according to the law, personal microcredit must finance projects for professional or social integration.
However, it is the first objective that has overtaken since 2005, as three out of four microcredits have been used to finance job access or retention projects.

Professional microcredit in detail

In 2016, the impact of the professional microcredit (which finances business creation) guaranteed by the SCF totaled 35,432 jobs: 19,468 generated in the VSB sector and 15,964 in the Social and solidarity economy sector.
Furthermore, 9,511 businesses were financed by “Nacre” loans in 2016, which according to borrowers’ declarations could generate 13,856 jobs in France.

Microfinance in France: a success story?

Across the world, microfinance has often been portrayed as a success story given its ability to contribute to economic development and poverty reduction on the basis of sustainable financial results. The impact studies carried out in recent years and the gradual clarification of microfinance institutions' economic models have resulted in a more realistic vision of the sector, which is positive yet nuanced.

Besides the professional microinsurance activity, most microfinance in France is in the form of microcredits.

What is our assessment of this particular activity in France? Besides the professional microinsurance activity, carried out by the Entrepreneurs de la Cité Foundation, most microfinance in France is in the form of microcredits. Microcredits were developed in the 1980s specifically for professional purposes. From 2005 onwards, personal microcredits began to appear, coinciding with the creation of the Social Cohesion Fund[1] (SCF).

If we look first at the volume of activity, we are happy to report that its annual growth has been positive since the very beginning, with total outstandings[2] having increased by an average of an annual 10% in recent years. If we look at the number of microcredits granted, we can see that the sum of personal microcredits, combined with the activity of France Active, Initiative France and Adie, represents a total of 56,000 microcredit or similar loans, of which 3/4 were issued by cooperative banks[3]. This is admittedly a significant amount and yet –and here is the nuance– it is still less than half the need estimated by the General Inspectorate of Finance[4].

60% of professional borrowers consider the income they make from their activities to be insufficient and merely over 1/3 of individual borrowers have seen their fiscal situation improve.

The reference studies, carried out by France Stratégie[5] for professional microcredit loans and by Caisse des Dépôts[6] for personal microcredit loans, support the social and economic utility of microcredit in France. This is shown by the high employability rate of the borrowers: 91% for entrepreneurs and 65% for individuals. However, these figures should not obscure the fact that 60% of professional borrowers consider the income they make from their activities to be insufficient and merely over 1/3 of individual borrowers have seen their fiscal situation improve. A stocktaking exercise that is linked to the macroeconomic context and the situation of the labour market in France, which does not detract from the effectiveness of microcredit loans at the microeconomic level.

French microcredit players have all tried in a realistic and decided manner, each in their own way, to expand their range of services, and make them better and more targeted, in order to increase their impact.

French microcredit players have all tried in a realistic and decided manner, each in their own way, to expand their range of services, and make them better and more targeted, in order to increase their impact. Without claiming to be exhaustive, we can cite France Active's "Cap'Jeunes" programme, Initiative France's "initiatives remarquables" or Adie's "micro-franchise solidaire". In terms of personal microcredit loans, the Caisses d'Épargne and Renault, in partnership with Action Tank Entreprise et Pauvreté, have developed a car rental offer financed through microcredit to enable borrowers to gain access to a new vehicle, thus avoiding the difficulties caused by second-hand vehicles in poor condition.

A myriad of examples from an innovative and dynamic sector, whose progress continues sheltered from the classic media spotlight of the early years.

[1] A guarantee fund managed by the Caisse des Dépôts.
[2] Source: Observatoire de l'inclusion bancaire (former Observatoire de la microfinance).
[3] Cooperative bank: Institution in which the customers are owners, and are both business partners and users
[4] Source: Le microcrédit, IGF Report No. 2009-M-085-03, 2009.
[5] Source: Microcrédit professionnel, a BIT study, France Stratégie and CSA, 2014.
[6] Source: Étude d'impact du microcrédit personnel, Caisse des Dépôts, 2010.

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Microcredit enhances professional integration by financing job access and retention projects.

Making microfinance work better with the Universal Standards and CERISE-SPI4

Does microfinance still work? The theme of this year's Microfinance Barometer is undoubtedly provocative. The question assumes that microfinance used to "work", and begs another question: work in what way, exactly?

The question is not new. A lot of efforts (and money) have gone into trying to prove the impact of microfinance over the last two decades, with relatively little success. Methodological issues, high costs and lack of applicable results have led many to abandon efforts to "prove" impact, and focus instead on how to "improve". This approach is known as social performance, based on the idea that for microfinance to "work", you need to define what it means (i.e. your social goals) and measure your progress.

For many years, most of what was measured in microfinance was related to financial performance: levels of operational self-sufficiency, returns, operating expenses, yields… By early 2000, a group of socially-driven institutions[1] started voicing concerns. While committed to financial sustainability, they were worried that focusing only on financial performance could overshadow—even undermine—their social mission. This working group set out to define indicators to measure the effective translation of an institution's social mission into practice. In other words, making sure microfinance was "working".

In 2003, the task of defining social performance was still dismissed as unreasonable by leading donors—too subjective, too hard to define, impossible to measure. And yet, from several field initiatives[2] emerged in 2005 the Social Performance Task Force, a multi-stakeholder membership organisation that has grown to over 3,000 global members and that has facilitated the "bottom-up" development of social performance standards.

Launched in 2012, the Universal Standards for Social Performance Management are a set of collectively-defined, practitioner-driven management practices to help financial service providers achieve their social goals. The 2015 Universal Standards Implementation Survey demonstrated that the standards were largely adopted in the microfinance sector[3].

Providers can measure themselves against the Universal Standards with the CERISE-SPI4, a free social audit tool. The uptake of this tool, as well as the increasingly common function of "Social Performance Manager" in both microfinance institutions and investment funds demonstrates not only that social performance can be measured, but moreover is being embedded into operations. While this alone is not enough to confirm microfinance is meeting its social goals, it definitely indicates a sector concerned by its impact.

Today, the microfinance sector has an objective framework to assess and benchmark social performance. By May 2017, the audit tool had been used by more than 300 institutions in nearly 90 countries, creating a database of social performance scores that can be used for benchmarking.

Benchmarks have been used by individual MFIs to compare themselves to peers, by investors to analyse their portfolio of partners and fine tune responsible investment policies, and by networks to guide members and inform regulatory authorities[4].

At regional level, these benchmarks offer insights into sector trends and gaps, making it possible to pinpoint the support needed from networks, investors or donors. The benchmarks reveal the challenges facing Sub-Saharan Africa (the lowest scoring region across the 6 dimensions of the Universal Standards). Regional analyses intimate the positive effects of consumer protection regulation in Latin America (highest scoring region in Dimension 4), and testify to the importance of regulation when it comes to protecting clients. SPI4 benchmark reports have helped the Responsible Microfinance Facility (funded by AFD), Opportunity International, ACEP, and investors like REGMIFA, FEFISOL, GCAMF and I&P identify social risks and define targeted technical assistance.

Source: The Universal Standards for Social Performance Management Implementation Guide, SPTF, Leah Wardle

The benchmarks are imminently useful combined with hundreds of individual audits, which have resulted in action plans to address social performance gaps. They are evidence of a genuine commitment not just to make microfinance work, but to make it work better.

[1] MFIs such as Promujer and Crecer in Bolivia, Buusaa Gonofaa in Ethiopia, Vola Mahasoa in Madagascar, Kashf Foundation in Pakistan, Bina Swadaya in Indonesia, etc. supported by a Foundation (Charles Leopold Mayer) and the Alliance for a Responsible, Plural and United World - http://www.alliance21.org/ came together under the Social Performance Indicators Initiative led by CERISE.

[2] Cerise, Imp-Act Consortium, rating agencies, etc. with the support of Ford Foundation, CGAP and Argidius foundation

[3] See 7th edition of the Barometer "Sustainable Development Goals : what are the stakes for microfinance?" p.4, 2016.

[4] See examples from Jaida Morocco, Grameen Credit Agricole Microfinance Foundation, Finrural Bolivia or Copeme Peru on CERISE SPI4 website: http://www.cerise-spi4.org/#/benchmarking/

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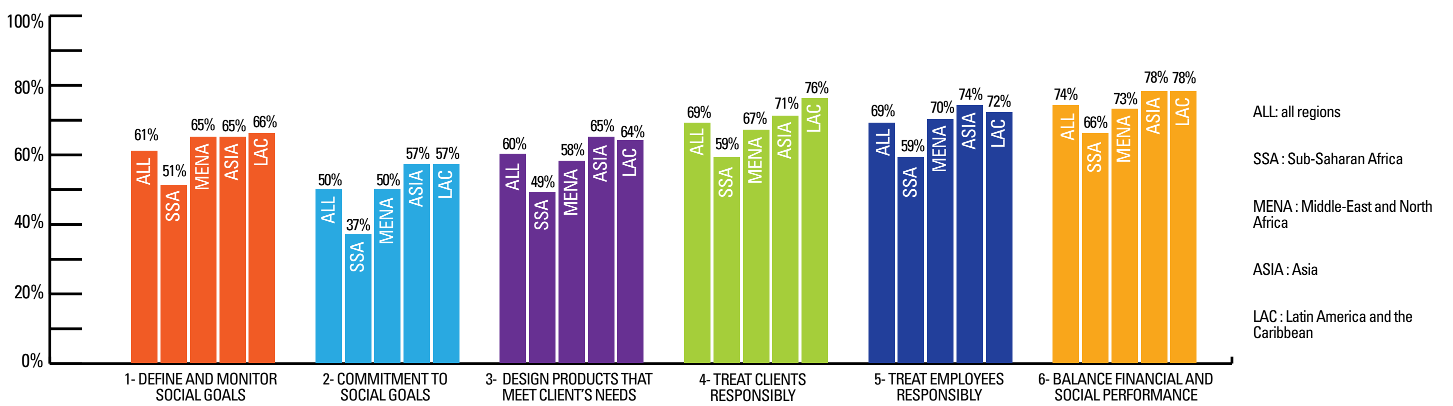

USSPM average scores by region (from SPI4 version 2.0)
Source : CERISE database - May 2017

Impact assessment in microfinance: feedback on one social investor's experience

2 years ago in this Barometer, Ging Ledesma, Investor Relations and Social Performance Director of Oikocredit, commented the results of the 2014 Implementation Survey of the Universal Standards for Social Performance Management (USSPM), pointing out that considerable sector-wide awareness had not yet translated into rigour when it came to collecting and reporting client-level data relevant to most microfinance institutions' (MFIs) social goals[1].

She then briefly introduced a capacity building initiative developed by Oikocredit with partner MFIs in Asia and Latin America: the Client Outcomes Programme. The programme consists of two pillars: the first one provides training support for partner MFIs to define indicators, to improve client data collection, analysis and reporting, and to adapt management information systems; the second pillar involves in-depth research on the effects on microfinance borrowers' lives.

The aim of the programme is clear: through sustained management of consistent data – using, for instance tools such as the Progress out of Poverty Index (PPI), we analyse changes at MFI client level. Several years into the Client Outcomes Programme, it is possible to draw careful but positive conclusions from the experience.

From four partner MFIs initially involved, the programme has expanded to include 17 MFIs by early 2017, covering more than 2.2 million poverty and employment records from over 1.4 million end-clients. The Oikocredit social performance management team has conducted econometric analysis of data from several partner institutions, including ASKI in the Philippines[2]. One of the findings was that the percentage of ASKI borrowers below the international poverty lines (those living under 1.25/2.5/3.75 dollars per day) had slightly decreased from 2010 to 2014.

Can we now boldly state that microcredit has a positive effect on poverty reduction everywhere? Of course not, but we can say that microcredit has had a small but positive significant effect based on the panel data of 600,000 clients. More analysis is desirable, as well as more data collection. Still, the Client Outcomes Programme has taught us that an MFI's commitment to better collect, analyse, and use client data has in itself a positive effect on its operations. In the case of ASKI, putting up a permanent poverty dashboard has further increased the level of awareness and client-centred practices at different levels throughout the organisation, from management to internal audit and local branches.

Monitoring and analysing not only outputs but also outcomes is a patient transformational process which should involve all players, investors and operators in the microfinance sector. And for the sake of the low-income beneficiaries, we should all remain humble and keep trying harder.

[1] Social Performance Task Force, The Universal Standards for Social Performance Management, http://www.sptf.info/spmstandards/universal-standards, Standard 1.B.

[2] 'Effects of microcredit on the poverty of borrowers using the PPI: Evidence from two Asian MFIs' (Jain, Gravesteijn, Hoepner, 2015) https://www.oikocredit.coop/l/library/download/urn:uuid:4503cd8f-8e75-4037-8828-f3253581251d/clientoutcomesppt11-12-2015.pdf

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Assessing SPI4's implementation: the case of KOMIDA

Since 2012, the Universal Standards for Social Performance aim at promoting best and more responsible practices in the microfinance sector. By adopting the Universal Standards, microfinance institutions (MFIs) put clients at the center of their strategic and operational decisions. This was the main purpose of KOMIDA, the second largest MFI in Indonesia, when it implemented the SPI4 (the Universal Standards assessment tool). Here is the story of the implementation of a client-centered approach.

KOMIDA grants six types of products: general loans, micro-business loans, education loans, sanitary loans, household loans and agriculture loans. It serves 374,259 clients, all women. In 2015, KOMIDA understood that loans did not only affect clients' living standards, but had also social impact on their lives. Therefore, KOMIDA has committed to take into account social indicators in operational and management activities. The use of Universal Standards for Social Performance allow KOMIDA to better target clients. It also help them to understand their needs and the social effects of loans.

Implementing SPI4

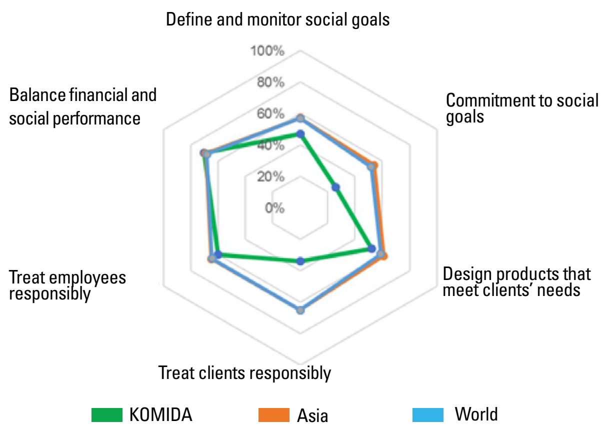
In a year, SPI4 has improved KOMIDA's management, and especially for reaching a proper target, knowing accurately the variety of products meant for clients, and grasping the institution growth. It has even increased some social indicators for tracing the program's effects, such as: the percentages of clients in rural area and the percentages of poverty ending amongst clients. The institution has also become attentive to social effects such as clients' ability to pay child school fees or to access to health care.

KOMIDA's commitment to the Universal Standards has placed the MFI at upper levels than the Asian and global scores, as shown below.

KOMIDA's impact on clients

In 2015, KOMIDA designed three social goals with support from the NGO Opportunity International. First, the institution wants to reach women from poor and financially excluded households. In addition, it ambitions to provide a range of quality financial and non-financial services, and to improve clients incomes, health, and education.

KOMIDA SPI4 Scores: December 2016



KOMIDA reaches the poorest people. Indeed, 66.6% of their clients are living with 2.25 dollars a day, and 62% are financially excluded. Thus, among KOMIDA's clients:

- 89% have access to their own drinking water
- 71% have access to a toilet
- 97% have access to health treatment
- 74.4% of children in school age (6-18 years old) attend school regularly

Facilitated by SPI-4, KOMIDA's client-centered approach has proved to be successful for improving the institutions financial products efficiency. The institution has understood that it must manage its social performances as judiciously as it manages its financial performance if it is to reach its social goals.

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From microfinance to impact investing: opportunities and challenges

An ever increasing amount of mainstream investors are showing interest in impact investing, but this article focuses on the group of 200+ specialised investors reporting to the Global Impact Investing Network (GIIN)[1]. Of particular interest are the 90 active in emerging economies (where microfinance is thriving). They manage almost 30 billion dollars in assets. These actors are primarily market-rate specialised fund managers but also development finance institutions (DFIs), banks, or below-market-rate foundations operating from Europe and North America.

Looking back at their investments in the last decade, microfinance and other financial services have consistently been the most significant Impact investing sectors with almost 60% of assets (respectively 40% and 17% in 2016). Agriculture, energy and healthcare remaining far behind (respectively 9%, 8% and 6%). Other sectors are marginal in comparison.

Many impact investors are now re-aligning their strategies with the broader Sustainable Development Goals (SDGs), targeting the set of 17 aspirational goals aimed at ending poverty, protecting the planet, and ensuring prosperity for all.

This may change however, for three reasons. First of all, many impact investors are now re-aligning their strategies with the broader Sustainable Development Goals (SDGs), targeting the set of 17 aspirational goals aimed at ending poverty, protecting the planet, and ensuring prosperity for all. Each goal has targets that require some form of financial investment, and the UN estimates that developing countries alone face a 2.5 trillion dollars gap in financing. Impact investment plays a pivotal role as it has unlocked private capital that can contribute to addressing a wide array of societal issues. In particular, job creation, climate change, renewable energy and agriculture, receive a lot of attention.

Secondly, the microfinance market is maturing. Coupled with this is higher financial account penetration[2], bigger institutions with more deposits and more focus on SME banking, as well as increased competition among lenders, including local investors, with stricter regulations. The combination of all these elements is encouraging microfinance investment vehicles to broaden their scope, also in light of decreasing rates and slower growth[3].

There is a third trend which revolves around leapfrogging (i.e. developing economies skipping less efficient technologies and moving directly to more advanced ones such as mobile phones or solar energy). Impact investors pay a lot of attention to innovations like these; but regardless of whether leapfrogging takes place or not, it is undeniable that the widespread use of digital innovation will strongly influence the impact investing space. Microfinance investors becoming broader impact investors of course makes sense as most of them have been operating in emerging economies for the past 10 to 20 years. They have developed a unique expertise which covers areas such as: understanding operational and financial risks, familiarity with the local market, knowledge of the financial sector, partnerships with public funders, and impact funds available.

It is important for investors to realise that this new wave of excitement around impact investing needs to be carefully considered before diving in. It may take time before the market at the base of the pyramid can absorb these innovative services.

It is however important for investors to realise that this new wave of excitement around impact investing and product diversification needs to be carefully considered before diving in. At grassroots level, it may take time before the market at the base of the pyramid[4] can absorb these innovative services. It may also take time for social entrepreneurs to find the right business models, demand, and scale to thrive.

Larger investments in infrastructure, fast-moving consumer goods or large-scale agriculture projects may remain the norm in emerging markets. But even if they largely contribute to the development of these economies, they don't always address the basic needs of the poor (e.g. improving small clinics, improving productivity of small-scale farmers, developing off-grid access to energy, etc.).

As a consequence, we still believe there is more pipeline for microfinance investors in general financial inclusion (e.g. SME finance, but also fintech, leasing, insurance, pension, factoring, etc.) and thematic financial products (e.g. supporting financial institutions for education, healthcare, housing, green finance products) than direct investments in new themes[5].

In order to build this new generation of early and growth stage social enterprises in new sectors, we propose the following recommendations: updating the capacity, knowledge and funding at investor level; building more supportive and fluid ecosystems for social entrepreneurs and impact investors; re-thinking and re-launching private-public partnerships and technical assistance; keep promoting patient capital; reducing transaction costs (which some consider relatively high in the impact investing space) through standardization and scale; and finally, promoting standardized definitions as well as social and environmental metrics to prevent mission drifting.

Applying all the lessons learned in microfinance over the past three decades to these impact sectors will help chart the course for a successful journey towards attaining the SDGs, and attracting more capital to impact investing overall.

[1] GIIN's 2017 Annual Impact Investor Survey, GIIN, 2017

[2] The Global Findex Database 2014: Measuring Financial Inclusion around the World, World Bank, 2015

[3] Microfinance Funds: 10 Years of Research and Practice, Symbiotics & CGAP, 2016

[4] The Fortune at the Bottom of the Pyramid: Eradicating Poverty Through Profits, C.K. Prahalad, 2004

[5] https://triodosimpactinvesting.com/sustainable-development-requires-inclusive-finance/

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Impact investing helps microfinance break into the big leagues

The visibility of financial management practices with environmental and social objectives varies according to media cycles. Microfinance and fair trade made their mark in the early 2000s, which greatly contributed to their growth. It is to be hoped that the recent advent of impact investing and the Sustainable Development Goals (SDGs) will enable them to scale up.

Impact investing is no longer a niche sector. It is the fastest growing investment strategy in Europe.

Impact investing is no longer a niche sector. It is the fastest growing investment strategy in Europe, as Eurosif –the leading European association for the promotion and advancement of sustainable and responsible investment across Europe– explains in its latest study. It shows an increase of 385% between 2013 and 2015. According to the Global Impact investing Network (GIIN[1]), by late 2016, nearly 114 billion dollars were invested this way.

Impact investing is defined as a series of investments in companies, organisations or funds that intend to produce social and environmental impacts and generate financial benefits in various sectors (microfinance, financial services, energy, housing, health, food, agriculture, education, etc.). One of the main features of these types of investments is the implementation of ways to measure their concrete impacts. Large investors that are committed to this approach make it a prerequisite.

The movement recently regained momentum with the SDGs coming to the fore.

The movement recently regained momentum with the SDGs coming to the fore. In September 2016, the most active players, based in Sweden and the Netherlands, issued a declaration of commitment[2] to invest in the SDGs, and two major Dutch pension funds, ABP and PFZW[3], have already announced their intention to spend 58 billion euros by 2020 for their implementation. They also contributed to the report addressed to the Dutch government in December 2016 which recommended the creation of appropriate financial instruments to attract large investors to projects with a very positive impact. This momentum is further bolstered by the development of Sustainability Bonds, targeting environmental and social projects. According to HSBC, they have accounted for 15.6 billion dollars over their first four years of existence (2010-2016).

In order to better identify the players involved in impact investing, those that promote the Principles for Positive Impact Finance should also be looked into. Launched by the United Nations Environment Programme Finance Initiative (UNEP Fi) in January 2017, they were signed by nearly 20 banks managing 6.6 trillion dollars in assets. They provide guidelines for analysing, monitoring and publishing data on the environmental, social and economic impact of financial products and services. Their aim is to be nothing less than the guidelines that will put hundreds of billions of dollars managed by banks and investors into a low-carbon, inclusive economy.

Although it seems that the widespread implementation of positive-impact finance that promotes social development has been given the green light, we must remain vigilant.

Although it seems that the widespread implementation of positive-impact finance that promotes social development has been given the green light, we must remain vigilant. The question of how to measure the real social impacts produced by all these actions and all the dollars invested in social projects remains crucial. To this day, essential elements to ensure that the financing of the fight against poverty and inequality is given the necessary resources are still missing.

The lack of quality projects that combine social benefits with economic success, the lack of a common and shared definition of impact investing on a global scale, and the limited know-how when it comes to evaluating the concrete benefits of these approaches remain major drawbacks. Yet if all major investors join hands to develop robust and credible impact measurement methods, it is to be hoped that the risk of "social washing" can be avoided. The signatories of the various recent initiatives are very much aware of it, which undoubtedly makes it the most effective prevention asset.

[1] https://thegiin.org/

[2] https://www.pggm.nl/wie-zijn-we/pers/Documents/Institutional-investment-into-the-Sustainable-Development-Goals-statement.pdf

[3] https://www.pggm.nl/wie-zijn-we/pers/Documents/Building-Highways-to-SDG-Investing.pdf

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Can microfinance be an inspiration for impact investing?

Microfinance and impact investing are two forms of financial innovation to reach social innovation. It is no coincidence that one of the first Social Impact Bonds (SIBs) approved by the French government was presented by Adie, a microcredit institution.

A broad definition of impact investing includes microfinance. The 2017 Global Impact Investing Network (GIIN) Survey reported that out of the 114 billion managed assets in 2017, 12% representing about 13 billion had been poured into microfinance. In France, the Association Française des Investisseurs pour la Croissance (AFIC –translated as French Association of Investors for Growth) estimates social impact funds excluding microfinance at 1.26 billion euros.

In France, the Consultative Committee has provided a constrictive definition of Social Impact Investment (SII) as "Investment that expressly combines returns on investment that are both social and financial in nature. As a result, social impact investment involves setting priority and specific social objectives, the impact of which can be measured via a continuous evaluation process. These investments can be made in all legally established organisations that have a sustainable business model, and target pay levels ranging from no remuneration to near-market returns."

> Social impact investment can learn from microfinance both in terms of its successes and failures, as well as its positive and negative impacts.

While the SII thus defined is burgeoning (74 SIBs worldwide for 250 euros million), microfinance is a (relatively) mature investment sector worth billions. The fact that microfinance developed sooner may lead us to think that it could be a useful source of observation for SII. We say “observation” rather than “inspiration”, as SII can learn from microfinance both in terms of its successes and failures, as well as its positive and negative impacts.

Economic models are the first subject of observation: microfinance has been structured since inception, particularly in the South, to achieve sufficient levels of profitability, while ensuring sustainability and serving as a source of inspiration for SII. MFIs are very often social businesses themselves. On the basis of this principle, the Committee specified that organisations facilitating social impact investments should have a sustainable business model. Microfinance costs are stable – around 2.2% of managed assets. Yet higher thresholds must also be set. Some MFIs have sought excessive levels of profitability, sometimes resulting in unjustified personal gain, which should prompt two reflections on the part of SII. The first, mentioned in our survey, is that it should attempt to reduce the scope of the risk associated with the investment, hence also reducing the scope of the gains for social impact investors. The second is that it should encourage investors, in an attempt to mitigate the risk of straying from social purposes in order to seek profit, to establish close relations with social businesses so as to ensure that the social objective is both genuine and a priority.

A second observation refers to the origin of the resources. The Sustainable Development Goals are expensive. New institutional/private funding platforms must be created which is something microfinance has already done: institutional funders account for 47% of microfinance financing across the world. Therefore, MFIs have a leveraging effect.

> Social impact investment has to make progress on its impact indicators, even though it is a bigger challenge compared to microfinance, because of more complex problematics.

A third observation points to the fact that the shared performance indicators (social and financial) have enabled the microfinance sector to develop (Microfinance Information Exchange, MIX). Efforts were made to identify standard indicators and rating tools, which made it easier to attract investors. SII has to make progress on its impact indicators, even though it is a bigger challenge compared to microfinance, because of more complex problematics (social reintegration of ex-offenders, curbing academic failure, etc.).

> Social fracture in our societies as seen during Brexit or the French elections should foster financial innovation in order to bring more inclusive solutions.

Finally, microfinance can be an inspiration to SII through its North-to-South capital mobilisation model using equity financing, quasi-equity financing and debt instruments. If inspired by microfinance, SII tools could come to play an investment role in "development impact".

We are witnessing the early stages of SII. Discussions in this regard are lively indeed. Drawing lessons from microfinance could help to make arguments more objective and save time. Social fracture in our societies as seen during Brexit or the French elections should foster financial innovation in order to bring more inclusive solutions. During his campaign, Emmanuel Macron pledged that "social impact bonds with a view to financing innovative social prevention programmes through private partners would continue to be implemented"[1]. Let's get cracking then!

[1] https://en-marche.fr/emmanuel-macron/le-programme/economie-sociale-et-solidaire

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Measuring client outcomes: The frontier of social performance management

Social performance measurement tools make financial inclusion stronger in the long term and more enduring in the responsible investing marathon. The Universal Standards of the Social Performance Task Force (SPTF) and the Client Protection principles of the SMART Campaign are examples of the remarkable toolkit created by and for the financial inclusion sector to do good and protect its reputation. Impact investing can benefit from adopting similar checks and balances and in doing so, grow healthy and possibly avoid a few mistakes.

That being said, one has to recognize that while inputs (e.g. the design of an SME loan product) and outputs (e.g. number of SMEs financed) are well covered by financial inclusion toolkits; outcomes (e.g. number of jobs created after getting the SME loan) are a more recent story. Actually, when it comes to outcomes, financial inclusion can find some inspiration in younger impact investing. The link between the investee company and the end client outcomes in sectors such as energy, education and agriculture is more direct, tangible and short-term than in finance, and systems to measure outcomes have been developing quite rapidly in impact investing.

Outcomes and impact can be easily confused. Outcome is the change for clients that is plausibly associated with the organisation's services received. Unlike impact, measuring change in outcomes does not have to be scientifically attributed to the organisation. Even so, the term "impact" is often used in ways that are misleading. For example, using the % of female clients as an indicator of an MFI's impact simply (and incorrectly) assumes that any loan to any woman always represents positive social change. Using "impact" is sexy, but misusing the term is not fair. Asset managers deserve a level playing field as much as asset owners deserve to be able to compare apples with apples. Outcome is probably the closest we can get to the concept of social return on a decent scale.

Measuring outcome is not easy, but it is not impossible. Several pioneering organisations have been exploring ways to measure outcomes. The Guidelines on Outcomes Management for Investors[1] map their experience. Some asset managers find ways to extract the clients' total revenue loan after loan from their investees' Management and Information System. Some take seriously the poverty alleviation promise and measure the clients' progress out of poverty. Other equity funds manage the seemingly impossible: full coverage of their investees with comparable outcome indicators. Mixed funds find creative solutions to balance the interests of their investors/board of directors/investees and final clients. They may go digital, or may sit under a tree and do a focus group discussion. There is no one size fitting all. The Guidelines identify a 10-step process for each investor to design a tailored outcome management strategy.

Does microfinance still work? It is hard to know yet. We will have a better idea once we have added the tools for measuring change in clients' lives to our general performance management toolkit.

[1] *Lucia Spaggiari & e-MFP (2016). "Guidelines on Outcomes Management for Investors", Number 10 - October 2016. MicroFinanza Rating & e-MFP/SPTF Social Performance Outcomes Action Group: http://www.e-mfp.eu/resources/european-dialogue-no10*

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Microfinance can work: Banco Da Familia's success story

From a responsible lender point of view, a social assessment including both social performance and social impact is part of the full analysis to conduct for the on boarding of new Microfinance institution (MFI) and the follow-up of the microfinance portfolio. As an example, BNP Paribas sponsored a social impact study performed in Brazil by (IM)PROVE[1] in 2017. Aiming at assessing the social impact of the MFI Banco Da Famila (BDF)'s actions, the survey focused on customers who have reached at least their second cycle of microcredit.

It is worth highlighting that 63% of the customers had been financed only by BDF in the course of their lives. The recourse to sources of funding other than MFIs for micro entrepreneurs is fairly limited: only 30% of customers obtained a loan from a bank.

© Banco da Familia 2017

The sample consisted of 120 clients but only 100 interviews were kept to constitute a representative sample. The results are striking.

In terms of financial activity, 79% of clients have increased their revenues between their first and their latest loan. It represents an average increase in revenue of 273 euros per year for the client. For instance, the debt repayment proportion in revenues decreased. The development of their incomes enabled Banco Da Familia's clients to develop saving practices. On average, clients save 104 euros each month. However, loans have had a low impact on employment practices. The average number of employees per customer went up from 1.24 for the first loan to 1.26 for the latest.

In terms of life impact, 87% declared their quality of life had increased since they took their first microcredit. Clients explained they could invest in their business, in their housing, endure less financial stress and improve their health. Families do not balk at paying school fees, but the customers' financial situation remains precarious. 50% had to face a major unexpected event that put them in a seriously difficult financial situation. Half of those had health problems but 76% of them have decided not to buy any health insurance, considered too expensive by 63% of clients.

Finally, microcredits enabled women to gain greater financial independence. The improvement of their self-confidence has a real impact on the relationship with their husbands. 44% of women consider they are more involved in the household's decisions. On top of this, 25% think their husbands ask for their advice more than they used to.

[1] *(IM)prove is a French volunteering students-based association of support to social entrepreneurs around the world.*

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The “pay-as-you-go” microcredit loans

© M-KOPA Kenya™

Paying 0.50 shillings a day for a year to acquire a solar panel is what M-Kopa Solar proposes in Kenya. No, M-Kopa is not a new microfinance institution (MFI), but a social enterprise whose economic model is based on a “pay-as-you-go” system: the customer pays small amounts over the phone to use an item which they come to own on maturity. A kind of micro-lease 2.0. “Unlike traditional microcredit loans, we do not require collaterals or bonds, just proof of ID and a valid mobile money account. Our security is ensured by integrating SIM cards into each of our solar power systems”, says Chad Larson, co-founder and M-Kopa Credit Manager. A box is delivered together with the solar panel, three lamps, a phone charger and a radio, which communicates remotely with M-Kopa. The system automatically switches off if the customer has not paid the required 50 cents and restarts immediately as soon as payment is made. No need for field staff to collect repayments and follow up on customers, as would be the case for an MFI. Everything goes through M-Pesa, Kenya’s ubiquitous e-money purse.

MFIs sometimes offer microcredit loans to help purchase solar panels but do not necessarily have control over the quality of the product purchased or the after-sales service in the event of malfunction. M-Kopa, whose business is first and foremost selling solar panels and then granting credit loans, has instead made the finding of quality products, the setting up of a vast network of mobile sellers and customer care centres in the main Kenyan towns, and the marketing know-how of several M-Pesa defectors its top priorities.

Although not a financial institution, M-Kopa declares the credit scores of 250,000 loans from its portfolio to the CIS, the central credit register recently created in Kenya. “92% of these are in a good situation, with the loans having been either repaid or recording no incidents. This enables customers to access new ways of financing, to acquire other goods or services, whether from M-Kopa or not”, says Chad Larson. An additional 120,000 credit loans were granted on the same principle by the enterprise to buy more lamps, a television, a smartphone, a water tank, an eco-efficient stove... all thanks to the energy supplied through its solar panels. The social enterprise reckons that its current 500,000 customers are saving more than 60 million hours of kerosene lamp lighting each month, which accounts for more than 300 million dollars over four years.

A quantified impact that is highly appealing to impact investment funds, such as the Gates Foundation or ResponsAbility. Some of M-Kopa’s debt financing is secured by the micropayments from its clients, a form of “securisation” that enabled it to raise 7 million dollars between 2015 and 2016 alone. A French social enterprise, Sunna Design, which also developed a “pay-as-you-go” scheme around solar street lamps in West Africa, tried its hand at crowdfunding to raise funds: 500,000 euros were collected from individual funds providers via the platform Lendosphère in November 2015, in exchange for an annual interest rate of 6% over three years. But these “cash flows” are not everything when it comes to raising funds, says Chad Larson: “investors love enterprises that have activity and impact objectives and can clearly show they are meeting them”. MFIs can also showcase this type of know-how.

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Peering into the future of microfinance

Asking what role microfinance can play in the poverty reduction agenda means evaluating the achievements of the past 20-30 years in the context of former expectations and current realities.

The potential of commercially sustainable microfinance institutions, evolving from donor-funded micro-credit projects, emerged in the early 1990s as a significant correction to subsidised, directed-credit programmes or integrated development projects. Subsidies often were not reaching the poorest or weakest populations. As credit components began to show good repayment or revenue potential, the appeal of market-based solutions to development challenges looked to be overwhelming.

Prevailing economic development models would not have to be questioned, free-market fundamentals could continue to rule, and the complexity of socio-economic challenges in poor countries could be overlooked. Microfinance was championed as an effective method to mobilise commercial capital for the poor. It was seen as displacing donor funds, enabling millions of micro-enterprises to flourish and end poverty for millions, if not billions, of households worldwide.

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Microfinance has indeed reached hundreds of millions of micro-entrepreneurs around the world. People previously "unbanked"and marginalised have been empowered as clients to seize opportunity: using saved or borrowed funds to grow a micro or small enterprise, or to provide a cash buffer for consumption in times of need. In addition, the industry has developed with regulation, training, patient social capital, and benchmarks/standards. MFIs have broadened the range of services offered to people at the bottom of the pyramid, effectively intermediating local capital.

And yet… the outcome is mixed. Certain areas of the world have demonstrated an optimal mix of prudent regulation, sound institutional governance, product development, and integration with the broader financial markets. Elsewhere, the story is of continued high operating expenses and high interest rates, excess profits, even systemic failure, and deepening poverty.

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What are we learning from this varied experience across the emerging markets?

First, microfinance does provide marginalised poor clients with dignity and opportunity. Access to finance can mean the difference between resilience and collapse.

Second, viable commercial microfinance sectors, particularly in Latin America, have been able to grow based on local savings or wholesale capital, thus diminishing the need for further donor funds.

Third, despite these attributes, microfinance cannot solve all development challenges. There will still be a need to invest in drinking water and sanitation, education, public health, and social capital.

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Current realities suggest two potential paths forward in the fight to reduce poverty. First, we know that development is complex, with project implementation containing multiple pathways toward success or failure. No longer can we expect to fund, for instance, a micro-credit project and automatically expect sustainable or quick outcomes at the other end. Commercial microfinance services, therefore, need to be seen as part of an entire "eco-system" of financial market development, along with various public infrastructure elements, to drive capital markets more broadly to directly and indirectly provide benefits to the poor.

Second, instead of counting the number of "unbanked" or those now with bank accounts, we need to understand how useful those accounts really are. Putting a "client-centric" focus at the core of MFIs will ensure that the services provided will address client needs for proximity, low cost, reliability, and flexibility. MFIs today are confronted with market pressures from larger commercial banks seeking new markets, from financial technology firms (fintech) who are disrupting conventional business models, and with institutional capacity constraints to anticipate and respond to changing conditions.

With all this in mind, it is not difficult to see how MFIs can – and should – be strong actors in developing sustainable economies that reduce poverty and enable all people to attain their full potential in life.

Microfinance, yes, but microfinance that builds upon the strengths of the past and embraces changes that ensure long-term value to those who need it most.

But this is only possible if they take a true measure of their current role and of the value they bring to the lives of poor people and other underserved populations. In summary, they will need to concentrate on doing three things: strengthen management/governance capacity, leverage technology, and become more client-centric. Microfinance, yes, but microfinance that builds upon the strengths of the past and embraces changes that ensure long-term value to those who need it most.

STEFAN HARPE
DEPUTY DIRECTOR, FINANCIAL INCLUSION
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Interview with Jean-Michel Servet : microfinance, impact investing...what's next?

Jean-Michel Servet is Honorary Professor, Graduate Institute of International and Development Studies

What synergies can you see between microfinance and impact investing?

Microfinance investments can now be considered to fall within impact investing. This includes a much more diversified range of investments in the production of goods and services that have direct or indirect effects on the well-being and living conditions of people (i.e. energy, water, housing, healthcare, etc.). The sources of financing within microfinance are themselves diversified, and microfinance itself demonstrated social responsibility before impact investing did. The fact that microcredit leaders or specialists have turned to impact investing in recent years goes to show how close both actors are. They provided their experience towards its development. This can be understood as a desire to eliminate what has been denounced as a deviation from microcredit, particularly as it has been made commonplace by some listed companies.

Impact investing refers to the belief that it is possible to do "good" and that this action can not only cover basic costs but can also generate a profit. This compatibility corresponds to a recognition of social and solidarity economy as having transformed how social economy has traditionally been understood. It is the action taken which must be considered, and not its legal status on its own. And so the area goes from so-called "capitalist" structures to those with "social" statuses and purposes.

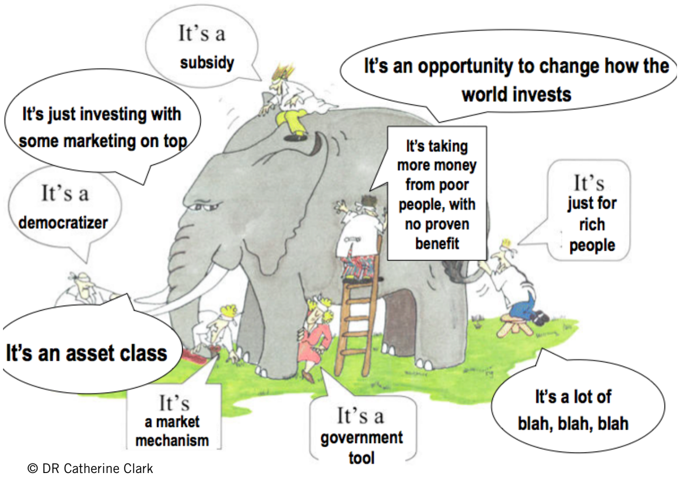
The development of impact investing can be related to niche investment in a time of declining interest rates and 2008 post-crisis, which has forced diversification of investment risks and therefore the need to find new opportunities.

2. What is your assessment of microfinance and impact investing?

With respect to microcredit, we have become increasingly aware of its limitations in terms of its ability to achieve economic takeoff on its own. Following an unbridled growth, we have also seen an unexpected drop in the number of clients, especially poor clients. The focus has been placed on the financial inclusion of people through an expanded range of tailored services. The intentions displayed had been taken for actual effects, and many believed that, by nature, microfinance institutions always act for the greater good of their clients. Looking at the impact of an investment makes it easier to separate the wheat from the chaff.

However, the limitations of impact investing are, as is the case of philanthropy, that those who have the means to engage in it make choices, whether via their investments or their gifts, which are certainly useful, but whose good intentions do not address the most essential or urgent needs. Certain sectors of activity or parts of the planet, which have a lower profile and are less profitable, can end up being neglected because of this free play whereby a strictly private logic escapes any democratically made choice. Crowdfunding presents the same danger given the much larger audience it addresses, with the risk of selecting only the most appealing projects instead of the most useful ones. As long as their contribution towards the bulk of development finance remains limited, there is no danger. However, this mismatch can be dangerous, especially in a context of restricting public budgets, which are able to offset these biases.

Impact investing is a strange elephant as well



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3. In your opinion, what are the challenges for these two sectors?

For impact investing and for microfinance, it is necessary to realise that the way the impact of a certain action is measured is generally based on a limited and localised assessment of an organisation. Moreover, it tends to be on the basis of its own accounts rather than on extensive, multi-disciplinary research, the cost of which is considerable.

More importantly, this way of measuring impact can hardly take account of all the systemic effects of the action that was carried out, especially on all the local stakeholders. While some effects are positive, others are highly negative. An organisation can hardly perform equally simultaneously in all areas. There are choices to be made: for example, to what extent can job creation and environmental conservation be compatible?

4. In which direction should microfinance and more broadly inclusive finance be directed?

The opportunities for financial development and the needs are considerable. Let us mention three aspects: hedging of risks by insurance companies, guarantee funds to raise local financial resources, and –one which is much too often overlooked– the introduction of a system of inter-company loans (such as complementary currencies WIR in Switzerland or Sardex in Italy).

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