



CFGS Policy Brief

The Need for A Global Microfinance Facility

Introduction

As one element of a strategy to eradicate poverty, the international community should act to increase the availability of basic financial services in developing countries through the establishment of a Global Microfinance Facility. The Facility would aim to substantially increase the scale, outreach, and financial sustainability of microfinance institutions (MFIs). Through an aggressive program of marketing and capacity development, the Facility would leverage new private sector investment and ODA commitments to the MFI sector. An innovative governance structure emphasizing strong civil society and private sector representation would facilitate linkages to the commercial banking sector, while ensuring a high standard of institutional transparency and accountability.

Microfinance and Poverty Eradication

Microfinance — the provision of small loans and other financial services to poor entrepreneurs who are otherwise excluded from conventional banking services — is a development strategy with significant potential for poverty alleviation and economic empowerment. With thirty years of experience behind it, the industry has spawned a range of innovative models for providing quality savings and loan services to the poor in both urban and the most isolated rural settings. Over time, exemplary programs in Bangladesh, Bolivia, and the Philippines, among others, have proven that the poor, including the poorest, are reliable borrowers and a safe credit risk. They have enabled great numbers of impoverished people — and women in particular — to establish small enterprises, accumulate savings, and secure necessities like running water, food, shelter, and education. In Indonesia, which has the largest financially self-sustaining microfinance industry in the world, microfinance initiatives are recognized as having played a key role in the country's declining poverty rate from 40% of the population in the mid 1970s, to 11% in 1996.

The Gap in Capacity

While not a panacea for the complex issues of underdevelopment, the effectiveness of these grassroots-driven networks for improving the lives of poor people has been too often overlooked in the setting of international reform agendas. As a result, the majority of MFI's remain caught within an outmoded paradigm of dependency, requiring substantial infusions of grants and below-market loans to achieve full cost recovery. Currently, 30 million families are being reached by microfinance services, two-thirds of which are estimated to have been living on less than \$1 per day when they began borrowing. However, only about 1% of these initiatives are financially sustainable. Programs are either starved for capital, or else lacking in the human and institutional capacity necessary to effectively utilize new investments that do become available.

Failed microfinance experiments are common, reinforcing investors' aversion to supporting new or innovative ventures.

If significant new support is provided to institutions that follow generally accepted best practices, expanding global outreach to 100 million families through a diverse network of microfinance institutions that are fully self-sufficient, or on course to reach self-sufficiency, is feasible. Moreover, from the perspective of promoting broad-based economic growth and social justice, it is highly desirable.

In recent years, some MFIs have been able to substantially reduce and in some cases eliminate their reliance on grants and subsidized loans. Bolivia's Bancosol, the Bank Rakyat Indonesia, the Foundation for International Community Assistance (FINCA) in Uganda, and the Philippines' Centre for Agriculture and Rural Development (CARD) are just some examples of MFIs that have made a successful transition to financial sustainability through the adoption of commercial banking techniques. These and other industry leaders have proven – in contrast to conventional wisdom - that flexible savings and loan products can be provided profitably and at a reasonable cost to borrowers, while still maintaining a commitment to the serving the poorest households. These examples are small in numbers compared to the global need for microfinance services, but they are operating at levels of efficiency and growth that were rare if not unheard of even five years ago. They are representative of the new frontier in microfinance, for which a global effort is now required to assist the industry as a whole to achieve similar results.

Existing Institutions

Reaching large numbers of the poor with accessible financial services requires a complete rethinking of global governance institutions. The lead agencies for microfinance promotion within the World Bank, UNDP, and USAID have been encumbered in their abilities to raise the profile and funding base of the industry by the same inertia and crises of accountability that plague their parent organizations. The Consultative Group to Assist the Poorest (CGAP), the World Bank donor coordinating mechanism, has drifted from its original mission of being a smart policy institution to become a competitor with consulting firms providing direct technical assistance at the field level. It is inordinately defensive concerning questions of alternative arrangements that might compromise its own dominant position. Among the donor agencies in general, there are notable problems of transparency in methods of fund distribution, while administrative costs are often unacceptably high, resulting in reduced amounts of monies reaching the poor.

A New Direction

The chief function of a new Global Microfinance Facility would be to provide the vision and the global coordination necessary for substantially increasing the quantity and improving the performance of MFIs in every region of the world. In doing so, the Facility can draw upon a rich base of knowledge located in the NGOs, international organizations, national governments, and front-line providers that together have pioneered the growth of this movement over the past three decades. The Global Microfinance Facility mandate should include:

Capital Mobilization

Currently, contributions from bilateral and multilateral organizations purportedly totaling approximately US\$500-600 million over the past ten years comprise the main source of funding to MFIs. This estimate represents about 5% of total ODA. Most of this is funneled to local institutions through large NGO intermediaries like ACCION International, Grameen, and Women's World Banking. However, with a first step toward world wide unmet demand for microfinance requiring between US\$2 and \$4 billion in new investment to meet the needs of 100 million poor households, it is clear that dramatic steps are needed for the leveraging of new resources.

A focal point is needed to engage commercial banks and private investors. Historically, commercial banks have avoided targeting poor people and the vast informal economies they support. The microfinance industry has now achieved sufficient momentum to establish viable partnerships with the banking sector, but it is a direction that remains, for the most part, uncharted. A Global Microfinance Facility could provide the thrust needed to bridge this gap by building private sector interests into its institutional structure, and by proactively marketing the commercial potential of microfinance, as well as its value for enhancing the social responsibility profile of corporations and citizens.

Strategic Capacity-building

Significant initiatives are in place for microfinance capacity building, but further inputs are still required in the areas of training, management systems, best practices research, and the reform of legal and regulatory environments. One particularly notable gap is the dearth of resources for assisting institutions to access information and communications technologies. Computerized management and accounting systems have dramatic cost-reducing benefits, yet many agencies are still reliant upon outdated manual techniques. The Global Microfinance Facility can play a powerful role in raising new funds for custom-tailored information and communications technology (ICT) development, brokering corporate partnerships for the mobilization of specialized equipment and software, and coordinating the expertise and technical support required for implementation.

Marketing and Promotion

Raising awareness of the microfinance concept with private donors and the public will have considerable returns. The possibilities for large-scale promotional activities coordinated through a global information clearinghouse are significant. A Global Microfinance Facility could unite the industry under a trademark name that the public will come to recognize and trust. It could coordinate media and education campaigns, publish microfinance "success stories," or promote regions threatened by conflict or natural disasters.

Good Governance

A new Facility offers the opportunity to implement an alternative model of governance — one in which policy and decision-making reflect the balanced participation of business, civil society, and governments, and in which the poor and their advocates have a voice from the outset in the framing of new mandates. A consortium of private,

nonprofit, and civil society organizations should be charged to organize, house, and manage the new Facility. Canada could initiate the process by providing core funding for the consortium and championing the concept.

The initiative need not be a traditional bricks-and-mortar approach. A virtual configuration could be effected, enabling the best aspects of a centralized coordination function to coexist with the evolution of strong and autonomous regional decision-points. Alternative voting methods, and an innovative joint arrangement emphasizing NGOs and traditional finance interests, will enable a much quicker and more equitable response to the demands of this growing industry than the conventional donor-driven system.

Global Security for All

Amid all of the drama of current world events, the industrialized nations must not lose sight of the opportunity at hand for challenging the widening gap between rich and poor. Undoubtedly, the best prospect for decreasing the gap will lie in the ability of the west to act definitively and in good faith toward a restructuring of the global economic regimes that enable the impoverishment of millions of people in the less developed countries. Bold strategies and strong multilateral commitments are needed for tackling poverty. The Global Microfinance Facility would represent a substantive contribution toward the goal of greater global justice and security for all.

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