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RESEARCH PROGRAM MISSION

The research program titled Rural Financial Policies for Food Security of the Poor seeks to identify policies and institutional arrangements that help the poor integrate themselves into sustainable savings and credit systems in order to increase capacity to invest, bear risk, and preserve livelihoods.

FOCUS COUNTRIES

- Bangladesh
- Cameroon
- China
- Egypt
- Ghana
- Madagascar
- Malawi
- Nepal
- Pakistan

ABOUT THE AUTHOR

Cécile Lapenu is a member of the Food Consumption and Nutrition Division at IFPRI. Her area of research is household participation in rural financial institutions.

RURAL FINANCIAL POLICIES for FOOD SECURITY of the POOR

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Current State of Development and Prospects for Microfinance Institutions

CÉCILE LAPENU

The database compiled by IFPRI (see policy brief on microfinance institutions [MFIs] in Africa, Asia, and Latin America) counts almost 1,500 microfinance institutions (688 in Indonesia and 790 in other countries) supported by international organizations in 85 developing countries. They reach 54 million members: 44 million of them save, and 23 million of them borrow. The total volume of outstanding credit stands at $18 billion and the total savings volume stands at $13 billion, or 72 percent of the volume of the outstanding loans. MFIs operated out of at least 46,000 branches and employed around 175,000 persons. Analyzing this world of mushrooming MFIs can provide fresh insights on potential service outreach and the overall role of MFIs in developing countries.

Diversity Among MFIs

Lending Technologies

Four main types of lending technologies can be distinguished in terms membership, the role of savings, and the guarantees used for the loans. These are cooperatives, solidarity groups, village banks, and individual client-based institutions.

The IFPRI database shows that when Indonesian MFIs are included, the individual client-based institutions predominate in number, followed by solidarity groups and cooperatives. Cooperatives and solidarity groups have about the same number of members. On the other hand solidarity groups have the largest number of borrowers, which reveals an active policy of lending for solidarity groups. The cooperative model dominates in loans and savings volume, followed by solidarity groups.

Indonesian individual-client based MFIs are numerous but, except for the Bank Rakyat Indonesia, mostly represent small institutions at the village level. If these MFIs are excluded from the sample, then solidarity groups dominate in number and in terms of borrowers, while cooperatives dominate in terms of volume of savings mobilized and loans disbursed. Village banks account for a significant number of MFIs and branches and for 12.5 percent of members but remain small in terms of volume.

Size and Share of Market

MFIs are also quite diverse in terms of size: 49 percent of MFIs have fewer than 2,500 members, 73 percent have 10,000 members or fewer, and only 7.5 percent have more than 100,000 members, which represents an impressive world of tiny institutions. This diversity is due to the fact that competition is uneven; donors and governments subsidize institutions of various sizes (with small MFIs receiving relatively larger shares of subsidies in relation to their costs). Also, market segments in which they operate differ in terms of products and clientele, and small MFIs entering new market segments, such as rural areas or rural poor, have higher startup costs. The combination of these factors results in a financial system with a multitude of institution types but a concentration of activity at the top. According to IFPRI's database (for MFIs in which the number of members is known), 3 percent of the MFIs (the 18 largest ones) account for 80 percent of the clients.

Legal Status

In terms of their legal status, MFIs generally take one of the following forms: projects, nongovernmental organizations, cooperatives, or banks. Table 1 shows that 91.5 percent of MFIs, with more than 100,000 members, are regulated under cooperative law or banking law, while the same is true for only 16 percent of MFIs with fewer than 20,000 members. Although around 60 percent of MFIs are still unregulated, they account for less than 2 percent of the volume of savings mobilized and loans dis-

Table 1. Regulation status of MFIs, by number of members

Status of regulation	Size of MFI, by number of members: 0-20,000	20,000-100,000	>100,000	Total
Regulated—cooperative, bank (percent)	15.8	51.6	91.5	24.6
Unregulated—nongovernmental organization, project (percent)	69.0	35.5	8.5	61.4
Not available (percent)	15.2	12.9	0	14.0
Number total of MFIs	538	62	47	650

Source: IFPRI survey on worldwide MFIs, 1999.

INTERNATIONAL FOOD POLICY RESEARCH INSTITUTE
2033 K STREET, NW, WASHINGTON, DC 20006-1002 USA
Web: www.ifpri.org • Phone: 1-202-862-5600 • Fax: 1-202-467-4439 • Email: ifpri@cgiar.org

bursed. More than 95 percent of the volume of microfinance transactions flows through regulated institutions.

The Future of MFIs

Breadth and Depth of Outreach

The extreme concentration of activity among the largest MFIs underscores the current difficulty in significantly and rapidly increasing MFIs' breadth of outreach. MFIs must be supported and innovation must be used so that they can reach a significant scale in terms of the number of clients and the volume of activity.

Efficiency in depth of outreach can come from three main strategies. First, some huge institutions, such as the Bank for Agriculture and Agricultural Cooperatives in Thailand or the Bank Rakyat Indonesia, have an impressive breadth of outreach. They may only have a low percentage of poor among their clients, but on the whole, they can reach more poor households compared with tiny nongovernmental organizations that struggle to target specifically the poorest but that have no means to grow in scale. Second, some solid, self-sufficient institutions, which first concentrate their efforts on institution building and financial autonomy, can develop, in a second step, direct services or links for reaching the poor. Finally, some institutions clearly focus their services on the poor. They target actively and rely on specific organizations to compensate for the specific costs and constraints faced in reaching the poor: e.g., village banks or solidarity groups delegate part of the screening and monitoring process to clients and use new forms of guarantees to lower costs. This last category of MFIs generally grows more slowly and takes more time to reach self-sufficiency.

Regulation

The necessity for regulating microfinance is based on several arguments. The protection of savers is generally the first argument. To implement efficient intermediation, MFIs will also have to leverage capital and mobilize external resources. This requires them to formalize their activities and to follow standard financial rules to gain the confidence of other financial institutions. Finally, MFIs may find that official recognition gives them a competitive edge over informal competitors.

Even if it is generally accepted now that specific regulations can be defined for MFIs, the debate continues on which MFIs should be regulated. All tiny MFIs clearly cannot be regulated and supervised. Moreover, many large MFIs are already regulated. The question of regulation is importantly linked to the change of scale of some nongovernmental organizations that will have to grow larger to serve more clients.

Innovation

The IFPRI worldwide survey underscored the MFI industry's progress in overcoming many constraints. However, innovations are still necessary to further improve outreach, to reach sustainability more rapidly, and to expand the provision of sustainable financial services in areas where little progress has been made. These areas are smallholder agriculture, credit for agribusiness, and insurance (such as old age, disability, unemployment, and health).

Support for MFIs

Given the current structure of the financial systems with a large number of tiny MFIs, and given the need for innovations, two types of MFIs should be supported in the financial landscape: those for profit and those that have a social ambition. Their characteristics are outlined in Table 2.

Of course, the world of microfinance is not strictly divided between these two types; indeed, a range of situations falls between these extremes. Further, a dynamic must be encouraged so that small MFIs can grow and serve more clients. However, both types should be encouraged, as each fulfills a specific role in the outreach and innovation generation. In particular, they nourish each other in terms of innovation: small organizations can benefit from the information on regulation and best practices to improve their performance and governance; large organizations can draw on the pool of innovations bearing on breadth and depth of outreach tested by smaller nongovernmental organizations. The diversity of the world of MFIs must be seen as an asset and not necessarily the result of inefficient support. ■

Table 2. Main characteristics of the two types of MFIs

MFI characteristic	For-profit MFIs	Nonprofit MFIs
Size	Large	Small
Regulation	Formal financial institution (bank, cooperative)	Unregulated status (project, nongovernmental organization)
Main objective	Financial self-sufficiency, breadth of outreach	Impact on the poor, innovation, depth of outreach
Main means	Application of well-known best practices	Search and test of innovations
	Professional and efficient functioning	Professional and efficient functioning
	Incentive structures for staff and clients	Incentive structures for staff and clients
Lending technology	Mainly individual approach and cooperative	Solidarity groups, village banks, linkage, innovative technologies
Financial activities	Full-fledged financial services (credit, savings, insurance)	Most begin with credit, some with savings
Complementary services	None, or minimalist approach	Possible (training, social services)
Sources of funds	Savings, interbank loans	Concessionary loans
Dependence on subsidies	Maybe in the short run, rapidly declining	In the medium term, slowly declining
Self-sufficiency	Rapidly reached (few years)	Slowly reached (can be 5 to 10 years or more)
Incentive	Profit	Donor or sponsor-driven: national or international recognition, concessionary funding, evolution towards more autonomy

ABOUT IFPRI

IFPRI's mission is to identify and analyze strategies for meeting food needs of the developing world, with particular emphasis on low-income countries and the poor.

IFPRI is a member of the Consultative Group on International Agricultural Research (CGIAR).

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CONTACT
Bonnie McClafferty
Communications Specialist
B.McClafferty@CGIAR.ORG