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WALL STREET MEETS MICROFINANCE

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I must confess that I started out as a skeptic on microfinance – even after I had heard about the Grameen Bank and Bank Rakyat Indonesia (BRI). My skepticism began to fade when I was at the IMF, and we worked with our World Bank colleagues to understand microfinance better and see if we could do anything to promote it. We concluded we could help a bit, on the regulatory front. I finally switched from skeptic to supporter as a result of a personal experience that took me to a remote village in the country in which I was born, Zambia, where I was able to see and talk with women who had benefited from a small microfinance scheme. The poor women in the village had used small loans to buy inputs – cloth and dyes – and machines – a sewing machine – to produce more output, and then to extend the range of their market. They benefited from microfinance and one could not fail to be moved by the stories they told – and also to be impressed by what small amounts of loans could do.

That was one experience. But every day it is repeated around the world. Peasant farmers, traders, and informal sector industrialists – mostly women – use loans and savings to build income and assets. And they repay their loans. Today, about 40 million low income entrepreneurs – mainly in the emerging market countries of Latin America, Africa, and Asia –

have access to microfinance. I find the 40 million number astounding. Over 15 million of these are served by members of the Women's World Banking global network. But there are probably another 500 million who need and warrant financial services.

What I want to do tonight is talk about the change in the way the microfinance industry is viewed. Originally it struck many as a charitable activity. Then the skeptics thought this could never become a viable commercial activity – and I was among the skeptics then too. Now we see the possibility that microfinance can provide bankers with a profitable business opportunity that at the same time gives poor people a stake in the economic future of their countries.

Today, many microfinance institutions are profitable and fully integrated into their domestic financial systems. Representatives of many of these institutions are with us tonight. Almost all WWB network members here meet WWB performance standards. In the WWB network, most affiliates and associates have excellent portfolio quality, with net credit losses as low as 2%. Nancy Barry tells me that in nearly every country in which the WWB network operates, the loss rate on the portfolios of microfinance institutions is below that on the corporate finance portfolios of banks. It is an impressive fact that during the East Asian financial sector crisis of 1997-98, Bank Rakyat Indonesia (BRI) – the largest microfinance institution in the world – had to write off 100% of its corporate portfolio and 50% of its middle market portfolio, while its 6 million microborrowers continued to repay at a rate of 98.5%.

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Commercial banks and finance companies are learning microfinance from the specialized institutions that are at the cutting edge of innovation in this area, and regulated institutions are finding ways to combine technology and personal contacts with the clients in microfinance:

- These organizations have shown how to cut the high transaction costs in making very small loans. With us tonight, we have ASA from Bangladesh, PADME from Benin and the WWB affiliates from Colombia. These institutions have the lowest transaction costs in their countries and regions, even while serving poorer clients with smaller loans.
- Microfinance institutions and banks have found ways to use technology to cut costs and improve services. For example, Equity Building Society in Kenya has introduced virtual branches and a branchless MIS. A villager can now sit under a tree with her loan officer, get a loan or make a deposit, and have the transaction recorded at head office in real time.
- Institutions in Asia and Africa have demonstrated with millions of customers that poor people have the capacity to save. This is something no one should doubt. Having grown up in central Africa, I have seen the emphasis poor people put on the future – on saving and on their children's education. Institutions that mobilize broad based savings from the public find that more people want to save than to borrow. Indeed, this may be one of the less-understood features of many microfinance institutions, that they gather deposits as well as make loans.
- Microfinance institutions are beginning to mobilize foreign remittances, as a service to poor households, and as a stable source to fuel portfolio growth. In this room we have representatives of some of the pioneers in this area: FIE of Bolivia is mobilizing regional remittances flows between Argentina and Bolivia; ICICI, the innovative giant from India has built its Money2India brand of online remittance products – an area I should add in

which Citigroup has played a leading role with larger remittances;[2] Fincomun of Mexico, EBS of Kenya, BRI of Indonesia and the World Council of Credit Unions (WOCCU) too have each developed remittance products.

Microfinance is coming of age.

Ten years ago, it would have been difficult to predict that Mibanco of Peru – a regulated institution specializing in microfinance – would have completed its third successful domestic bond issue. Five years ago, who would have guessed that major companies would be working out how to securitize microfinance loans – a move that could transform the economics of the industry. As you meet the microfinance leaders here tonight, you will see both how well grounded they are in understanding the evolving financial service needs of their clients and how sophisticated they are in understanding the possibilities of integrating into their domestic financial markets.

Is microfinance ready for the financial markets, and are the financial markets ready for microfinance?

If microfinance institutions and the financial markets are to work together to build suitable products and services for the hundreds of millions of unbanked poor in the world, bridges need to be built. WWB's Capital Markets Workshop series is an important part of that process.

Microfinance institutions need to continue building excellent performance, using common definitions, and demonstrating transparency. Women's World Banking has played a leading role

[2] See: http://www.icicibank.com/pfsuser/icicibank/ibank-nri/m2ihom.htm

in building performance standards in the microfinance industry. Bankers who have joined the WWB Global Network for Banking Innovation in Microfinance are surprised that a network so committed to serving poor women has such high credit standards.

Let me note incidentally that as the industry grows, it becomes even more essential to pay attention to issues of governance. I have recently been briefed on the highlights of a report commissioned by the Council of Microfinance Equity Funds. The report concludes that few microfinance institutions have independent directors, and that they should make better use of board committees. And it calls for the active participation of all board members and senior management in adopting corporate governance policies and implementing them in their institutions.

Rating agencies and regulators need to understand how to evaluate risk differently to take into account the unique nature of microfinance. Specialized rating agencies – such as Microrate, Planet Finance, and MCRIL – have played important roles in bridging the gap between global capital markets and microfinance. Microrate reported in October 2002 that 12 of the 29 rated microfinance institutions in Latin America had a higher return on equity than Citigroup – and this is quite remarkable.[3] The mainstream rating agencies – Moody's, Fitch and S&P – have each begun evaluating bond issues and other financial transactions in microfinance. They are beginning to understand that the risks in microfinance are not the same as in traditional corporate finance:

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and also "ICICI Bank helps Indian Americans do charity back home", Silicon India News, Tuesday, August 19, 2003, http://www.siliconindia.com/shownewsdata.asp?newsno=20489&newscat=Business

[3] See: Microrate, "The Finance of Microfinance", Washington: November 2002, p. 10. http://www.microrate.com/PDF/Finance%20of%20Microfinance.pdf

- **Country risk:** The emerging markets in which most microfinance institutions operate are challenging. But we have seen in several countries that microfinance has done well in good times and much better than corporate finance in bad times. The microfinance leaders in Colombia, Indonesia, and the Dominican Republic have shown a great capacity to keep portfolio quality and growth high even in very tough times.
- **Credit risk** needs to be treated differently as well. Most poor people do not have conventional collateral. Microfinance institutions have used small loans, short maturities, and credit discipline to achieve outstanding portfolio quality – in this regard microfinance is closer to standard consumer lending than to corporate lending. In several countries, including Colombia and the Dominican Republic, central bank regulators and bank superintendents have created microlending as a separate loan class.
- **Foreign exchange risk** needs to be addressed. Most MFIs are solid but relatively small institutions with outstanding portfolios of US$10 to US$20 million. These institutions are wise to integrate first into domestic financial markets—mobilizing savings, borrowing commercially, issuing bonds, and mobilizing international remittances. They would not be well served by foreign exchange loans.

Microfinance has now caught the attention of some of the world's leading financial institutions. Citigroup, Deutsche Bank, Santander, ABN Amro, Credit Suisse are beginning to see microfinance both as a potentially profitable business opportunity and as a way of changing the way the world works.

Investment Opportunities. Of the 40 million low income households receiving microlending services today, one third are supplied by specialized microfinance institutions, one third by credit unions and cooperatives, and one third by converted banks and finance companies. Banks have their own resource mobilizing strategies, cooperatives mobilize more savings than they lend out. It is mainly specialized MFIs that will be looking for external investors and lenders. WWB estimates that there are 125 to 150 specialized microfinance institutions around the world that are profitable. While these institutions will be fueling most of their growth with domestic savings and borrowings, international investors may also be able to contribute.

Some banks that emphasize social goals, and some funds, have targeted this market. Oiko Credit, a regulated cooperative development finance institution based in the Netherlands, now provides 20% of its $100 million loan pool in local currency loans to high performing microfinance institutions around the world. Shore Bank, based in Chicago, is a community bank that has recently created an equity fund to invest in small and microfinance banks around the world.

And the big institutions are looking for ways to enter this new market as well. Calvert has a product that enables investors to back loans to microfinance institutions. Deutsche Bank is about to launch a $50 million commercial microfinance facility, mobilizing funds from their clients.

At Citigroup, we have been active in supporting microfinance at a number of levels. Our Foundation provides major support to microfinance networks such as Women's World Banking, Accion, and the Grameen Trust. We also support initiatives of their network members around the world. We are collaborating with WWB on a management development program geared to build middle managers in microfinance institutions in Africa, Asia and Latin America. We are exploring the possibility of mobilizing equity funding to invest in strong MFIs around the world. We supported MiBanco's bond issues in Peru, and a Banamex subsidiary, Accival, underwrote a bond issue in Mexico for Compartamos, a successful and growing microfinance institution. And we hope also to work on securitization.

Conclusion

Microfinance has proven that it helps people help themselves. Today, microfinance institutions, banks and credit unions provide lending services to over 40 million low-income entrepreneurs and savings services to millions more. These low-income clients – particularly women – have demonstrated that they are among the world's most reliable customers. Microfinance institutions, some of them represented here tonight, have led the way in reducing the high transaction costs of making small loans. An increasing number of banks are exploring microfinance both as a profitable business opportunity and a way of contributing in a positive way to development. More and more finance ministers and central bank governors are making the needed changes in financial sector policies and regulations to accommodate microfinance. And major global financial institutions are finding ways to build wholesale operations for microfinance.

Microfinance is moving into the capital markets. Together we can ensure that future collaborations between those of us in the financial sector and those in the microfinance industry can be profitable and productive – and more importantly, that they truly benefit poor women and men around the world who need access to financial services.

As Women’s World Banking says, together we can change the way the world works. Indeed, we already are. But there is much more that can be done.

Thank you.