

Summary of the international workshop on microfinance

organised by the Banque de France on 8 July 2011

Paul Loridant
Microfinance observatory

Béatrice Raoult-Textier
Directorate for the General Public

Luc Jacolin and Julien Moulouguet
Economics and International Relations Directorate

In association with the French Treasury and with the support of the Caisse des dépôts et consignations (CDC), the Banque de France organised a workshop on microfinance at the Palais du Luxembourg (home to the French Senate) on 8 July 2011. The event was organised as part of France's presidency of the G20 until November 2011.

The only central bank in the European Union to possess an observatory dedicated to microfinance, the Banque de France decided to entrust the Observatory with the organisation of this workshop. The objective was notably to extend and pursue the work already commenced by the GPF – Global Partnership for Financial Inclusion – created by the G20 at the Seoul summit in December 2010.

This reflection on financial inclusion and in particular on microfinance has more than just symbolic value for G20 leaders, who also recognise a role for the poorest populations in endogenous economic development and for whom an improvement of the social conditions in emerging countries is a priority. In a different context, microfinance is also developing in Northern countries based, in some cases, on best practices in Southern countries. The day was structured around four round tables that were rich in debates animated by approximately forty guest speakers from all over the world and in the presence of Muhammad Yunus, Nobel peace prize laureate, and keynote speaker at the event.

.../...

The discussions were introduced by Jean Arthuis, President of the Senate Finance Commission, Christian Noyer, Governor of the Banque de France, Professor Yunus, Jacques Attali, President of PlaNet Finance and Ramon Fernandez, Director General of the French Treasury. The conclusion was delivered by Jean-Pierre Landau, Deputy Governor of the Banque de France.

All the speakers emphasised the importance of microfinance as a tool for “socially sustainable economic development” and its singularity in the banking and financial sphere that protects it, to a certain extent, from generalised systemic risk.

Key words: microfinance, microcredit, entrepreneurship, fight against poverty, regulation(s), regulation(s)/legislation, financial inclusion, economic development

JEL codes: G21, D10, E20, E21, E50, E60, G28

I| To what extent can microfinance contribute to financial inclusion and poverty reduction?

The different speakers of the first round table all stressed – to various extents – the social and economic utility of microfinance as well as its role in the financial inclusion of the most vulnerable populations and in promoting entrepreneurship. However, they also reminded us of the need for a degree of realism in the defining of the sector's targets since it is ultimately just one of the many poverty reduction instruments that can be implemented.

Thus, giving the poorest populations – who are excluded from the traditional banking system – access to basic financial services, and in particular to small loans intended to finance resource-generating projects under stable financial terms with the potential to create hope and a better future, constitutes a vital factor of economic integration and of social inclusion and cohesion.

The discussion on the utility of microfinance also highlighted the importance of broadening the tool to a diversified range of financial services (microloans, deposits, savings, insurance) in order to satisfy, under appropriate conditions, all the needs of the poorest populations (project financing, life-cycle needs, etc.).

Apart from the offer of financial credit, the speakers also emphasised the importance of the proximity of microfinance institutions to microloan beneficiaries, the establishment of trust-based relationships, the search for a certain flexibility and the utility of loan-accompaniment arrangements.

The discussions focused on the conditions under which microfinance tools should be implemented and notably on the importance of integrating these arrangements into public policy aimed at fighting social and financial exclusion.

From this point of view, the implementation of policies intended to favour the access of poor populations to education in the broadest sense and to financial education in particular as well as to a broader range of public services (health, infrastructures necessary for every-day life, etc.) appeared in the eyes of the speakers to be an essential way of alleviating the vulnerability of poor people to financial risks.

In the same vein, the discussion also pointed to the importance of creating conditions for the development of the offer of microfinance within an

appropriate banking and financial environment capable of promoting the establishment of a sustainable growth model. Thus, the role of government support policies was stressed, not only in the form of direct financial support but also in improving the regulatory and financial environment and in the development of innovative products such as the simplified bank accounts set in place in Brazil.

Lastly the speakers highlighted the place for microfinance in Europe as part of policies to fight against social exclusion and poverty with the introduction of specific programs: Progress (microfinance), Jasmine (program to support microfinance institutions) and Jeremie (program to improve access to finance for small and medium enterprises (SMEs) and microenterprises).

The discussions were concluded by Professor Mohammad Yunus, Nobel Peace Prize Laureate, who stressed the importance of respecting the specificities of the microfinance sector (banking for the poor) compared to the traditional financial system and the special role played by microfinance in the financial and economic inclusion of women who form the bulk of the clientele of the microfinance institutions in Bangladesh.

2| How can advanced economies learn from the development of microfinance activities in developing countries?

Introducing the discussions of the second round table on the lessons to be learnt from microfinance activities in the South, it should be remembered that while much remains to be done, the system has proved its capacity to function in these countries. After roughly thirty years of development, microfinance today impacts the lives of nearly 200 million borrowers and is characterised by a very low default rate.

This development, which has been accompanied by a very substantial broadening of the offer of financial products and services conceived and adapted for poor people (loans, deposits, savings, means of payment, insurance), illustrates the system's capacity to reconcile profitability with social objectives.

Microfinance in developed countries operates in an economic and financial environment that is very different from that which exists in emerging and developing countries. The lower levels of financial exclusion and of poverty and the relatively smaller informal sectors in developed economies typically prompt microfinance institutions to offer substantially different products and services (micro-lending, basic banking services).

It was therefore emphasised that the objective of experiencing-sharing should not be to simply replicate the experience of developing countries, but rather to adapt to the local economic and social conditions.

The spread of microfinance in developing countries has, nevertheless, undoubtedly been a major source of inspiration for developed countries, both at the conceptual level (the [re]discovery of the central role that financial inclusion can play in the economic integration of the most vulnerable populations and hence as a factor of social cohesion) and in terms of organisation and the adoption of specific types of financial products.

The discussion on experience-sharing showed that such exercises can be particularly effective in the domains of governance, consumer protection, technological innovation (mobile banking) and public support schemes, the objective being to facilitate the overall development of the sector in order to maximise the economies of scale.

3| The funding of microfinance: using local resources, transfers of savings from the North to the South, international financing

The first part of the discussion in the third round table focused on ways of insuring the sustainable development of microfinance institutions (MFIs) on the back of long-term resources. Although still marginal operators within the global financial system, the MFIs represent a dynamic financial activity, whose aggregate balance sheet assets – negligible thirty years ago – represent a total outstandings of approximately 60 billion dollars today. Although public funds used to represent the bulk of microfinance institutions' resources (one sixth of total resources today), MFIs resources are increasingly derived from local savings (half of total resources today) and from private international institutions (banks or international investment funds). In addition there is the still very marginal but nevertheless highly dynamic segment of savings transfers from the North to the South, facilitated by the development of peer-to-peer international money transfer websites and migrant remittances to home countries.

According to certain speakers, the mobilisation of local resources seems a priority in order to limit the financial dependence of MFIs and ensure their financing at a reasonable cost, for example, by allowing MFIs to collect public savings in countries where it is prohibited or by the development of fund transfer activities. To stabilise their resources, MFIs have also decided to accompany the needs of their traditional microfinance clientele

as the latter's projects develop (bottom up approach) by diversifying the financial products they offer (consumer loans, insurance products, etc.). Technological and financial innovations can also allow developing countries to benefit from technological shortcuts in the development of their financial systems and therefore from financial inclusion (mobile banking, transfers of migrant funds).¹ Peer-to-peer internet platforms that serve as intermediaries between individual investors and MFIs have experienced strong development. Although still very small, the collected resources are growing very rapidly and according to their promoters, should represent 5 to 10% of the microcredit loans by the year 2020, and at a very low cost since investor loans are by nature solidarity-based.

International investors, for their part, are playing an increasing role in financing MFIs. Apart from bilateral and multilateral public investors and NGOs, private investment funds are playing a fundamental role in the development of microfinance. The discussion on their investment strategies – which of course are different from one institution to the next – gave rise to the following questions: to what extent do financial performance criteria undermine the social objectives of MFIs or, alternatively, do they in fact guarantee their sustainability? What risk exposure strategies do investment funds adopt and do these strategies foster an expansion in size of MFIs and the “professionalisation” of the sector (i.e. bank-type structures and operating methods)?

Lastly, the speakers underscored the complementary role played by public funding and NGO initiatives – notably in the riskiest sectors of microfinance – in the form of a broad range of financial support tools (guarantees, acquisitions of stakes, loans). These initiatives continue to provide significant leverage for their MFI beneficiaries.

At the end, the discussion on MFI financing focused on the question of the responsibilities of lenders, whether public or private: what requirements in terms of governance quality and social responsibility can investors reasonably and legitimately make? Investors – both public and private – can play an essential role in the diffusion of sound practices, for example, by ensuring high levels of transparency in their pricing, internal controls, accounting and risk management systems, or via the adoption of codes of good conduct aimed notably at ensuring better consumer protection. Lastly, public investors can play a specific role vis-à-vis national authorities in promoting better business environments, enhanced administrative capacities and better regulatory frameworks via the provision of technical assistance.

¹ A study currently being conducted into migrant remittance channels, focused on North African and Franc zone countries and financed by the French Treasury, the French Development agency (AFD) and the African Development Bank (BAfD), was also cited.

4| The regulation of microfinance

Observing the broad diversity of MFIs, of their resources and of the financial services they provide in different countries, the speakers in the fourth round table started by highlighting the difficulty of defining a set of universal regulations for microfinance. Regulations in this sector – when they exist – mostly reflect the existing characteristics of local banking and financial markets and particularly the degree of maturity of the microfinance market, its dynamism and, in certain cases, the appearance of saturation effects that can lead to borrower over-indebtedness. Some speakers also pointed out that the very success of microfinance has actually led an increasing diversification of the sector and to the associated governance and risk management difficulties encountered, prompting regulatory authorities to adopt regulations specifically designed to link certain MFIs to banking groups, to consolidate overly fragmented sectors or to restrict the debt collection practices of MFIs in certain situations of over-indebtedness.

The discussion also focused on the applicability of traditional banking sector regulations to the microfinance sector. According to some speakers, the sector's regulations need to be adapted to its development model, characterised by high unit transaction costs, which, in developing countries, should also be assessed in the light of the specific objective of promoting the financial inclusion of vulnerable populations. One important theme of the discussion concerned adequate access for MFIs to financial infrastructures, and notably to payment systems, whilst maintaining respect of the security rules governing payment and settlement systems.

According to certain speakers, the regulatory framework should be sufficiently flexible to encourage private initiative (via the creation of MFIs) and the broadening of their activity scopes as they grow. At the same time, the framework needs to be sufficiently strict to ensure the financial stability of the sector, adequate risk control and adequate protection for depositors and, more broadly, of consumers, thereby limiting the risk of crises.

These regulations should also go hand in hand with an effective supervision of MFIs. This supervision would of course have to be adapted to the different countries and different structures to be supervised (associations, cooperatives, banks with micro-lending activities, etc.). Central banks have a predominant role to play in the conduct and oversight of this supervision that should notably allow an improvement in the governance of the microfinance sector and in the transparency of the costs of its services that is sometimes inadequate

given the level of financial education of the populations concerned. In some developing countries, a strengthening of the supervisory capacity will be essential if the objectives are to be met effectively.

In sum, the theme of microfinance regulation has substantially evolved over recent years mainly because its field of application has been grown much broader from “microloans” to “microfinance” and then to “financial inclusion” which covers a whole range of financial products typically offered by MFIs. The regulatory questions that developing and emerging countries particularly need to resolve cover a broad range of areas including standard banking regulations, insurance products, means of payment, consumer protection and anti-money laundering as well as the governance and internal control of MFIs.

At the international level, the Global Partnership for Financial Inclusion (GPFI), created in December 2010 by the G20 in Seoul, intends notably to disseminate a set of harmonised regulatory principles, based on best practices, allowing the maintenance of financial stability and the inclusion of the most vulnerable populations particularly in emerging and developing countries. The GPFI has established principles for financial inclusion aimed at facilitating the implementation of regulatory and strategic frameworks in the domain of technological and financial innovation. The GPFI notably works in coordination with international standardisation bodies such as the Basel Committee on Banking Supervision (BCBS) that published a report on microfinance regulations in August 2010, the Financial Action Task Force (FATF) and the Committee on Payment and Settlement Systems (CPSS) with the aim of promoting a better integration of the objectives of financial inclusion into these organisations’ fundamental objectives of financial stability.

At the conclusion of the workshop, the speakers reiterated the importance of the microfinance sector for the social and financial inclusion of the most vulnerable populations. They look forward to a time when the sector has access to appropriate and sustainable resources that guarantee the security of clients, borrowers and savers alike.

Three major challenges have been identified for the development of microfinance:

• **the financial stability challenge:** *the financial security of the microfinance sector could be strengthened by an appropriate regulatory framework and supervision that would bolster the financial soundness of the institutions, promote the professionalisation of the operators in the field and improve the quality of the information available to lending structures;*

.../...

• **the resources challenge:** to grow, microfinance needs greater private sector financing, particularly from local resources. One option could be to develop financial support structures for experimental microfinance projects, for hedging exchange rate risk and for providing technological, financial and regulatory support for migrant remittances;

• **the social and financial inclusion challenge:** the social aspect of microfinance being of primary importance, the sector should take the diversity of client needs more into consideration and make its primary objectives the reduction of poverty, the support of the most fragile regions and the development of entrepreneurial culture, whilst continuing to pursue social and financial innovation.