

# Secrets of Commercial Success in Microfinance

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# The microfinance business problem

- The market: savings and credit help manage timing mismatches between income and consumption
- The poor suffer most from these mismatches
- Business problem:
  - Building high volume
  - Maintaining high repayment
  - Keeping transaction costs low
  - Requiring little or no “collateral”...all where human capital, rule of law, infrastructure are limited

# Success in providing access to finance determined by:

- Products
- Management
- Environment

# Product design

- There is a spectrum from:
  - village banking: most costs shifted to borrowers, lowest economical loan size; to
  - individual service
- Group lending shifts underwriting, monitoring, and enforcement costs onto borrowers
  - Social capital/shame central, despite trend away from joint liability
  - (Bi)weekly meetings reduce lenders' transaction costs
- Operational advantages of credit over savings:
  - Less prudential oversight needed—easier for a start-up
  - Imposes more discipline, makes transactions regular and predictable, lowering cost for provider
  - Easier for donors to finance

# Solidarity banking in Bangladesh



A centre meeting in progress, summer 2005. The centre manager (dark striped shirt) records transactions, watched by the members in the background, the branch manager on the extreme left, and members of the research team

Source: Stuart Rutherford, *Grameen II: The First Five Years, 2001–2005* (Dhaka: MicroSave, 2006)

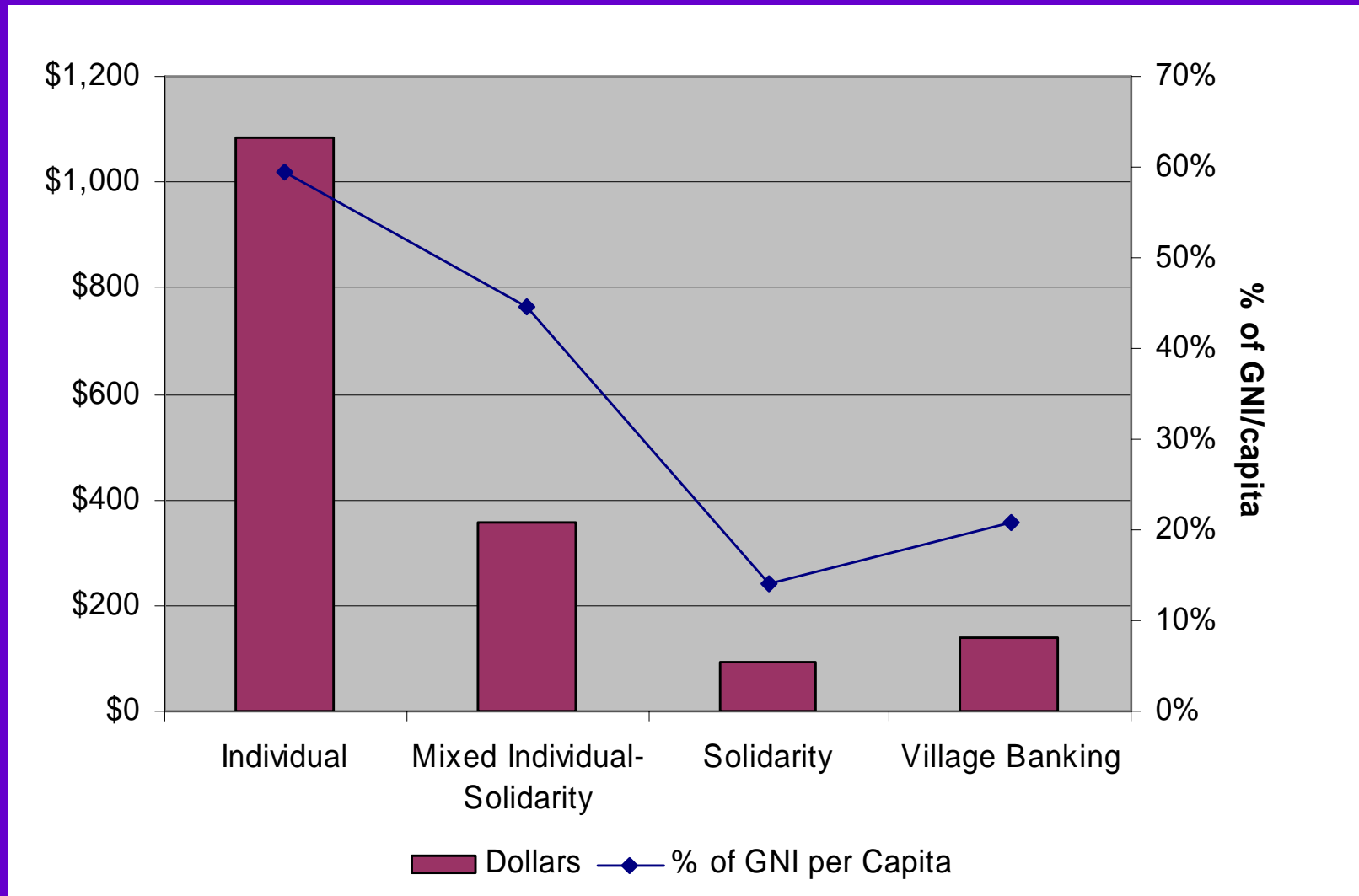
# Village Banking in Uganda



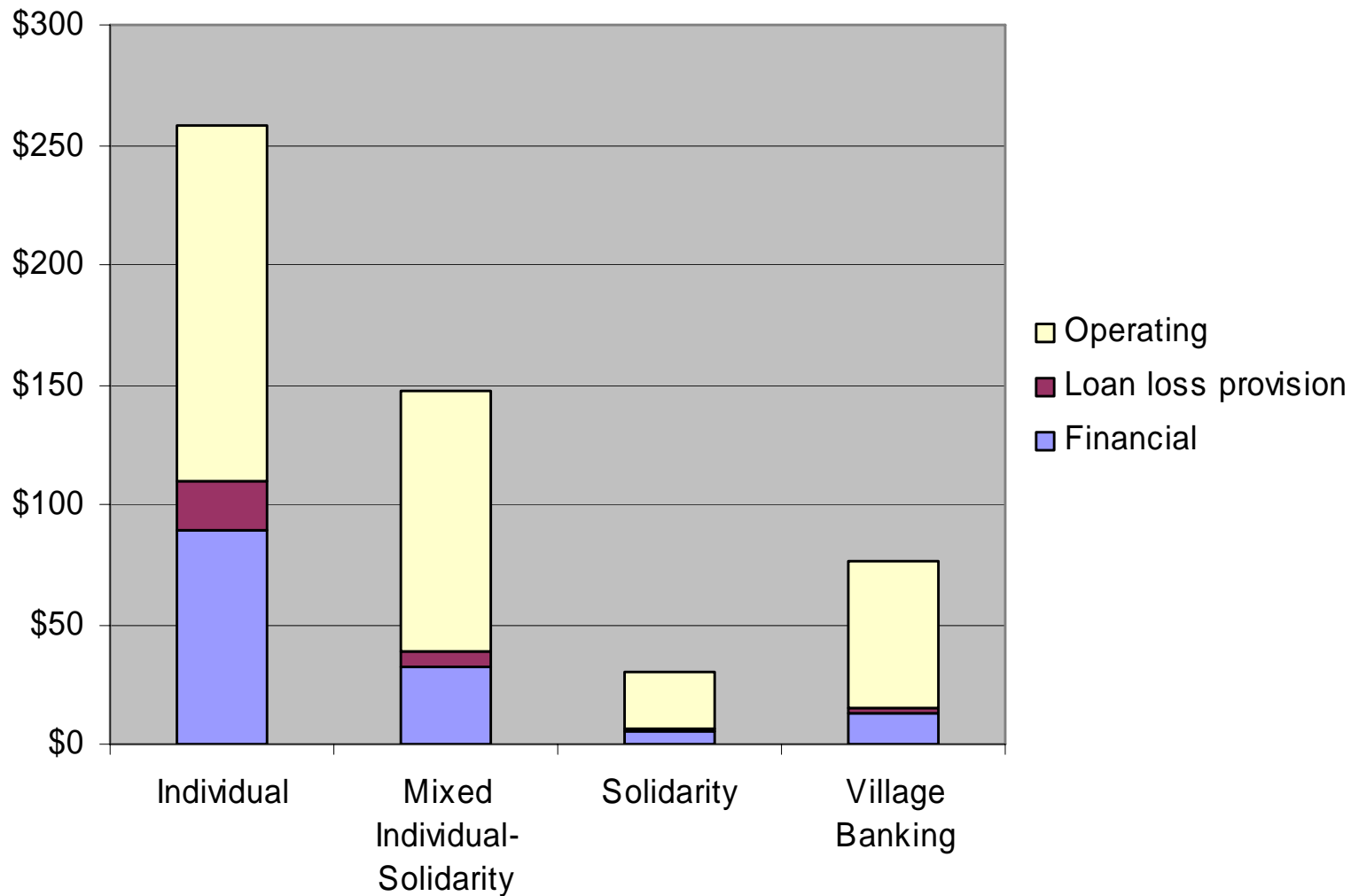
# Individual lending in Bolivia



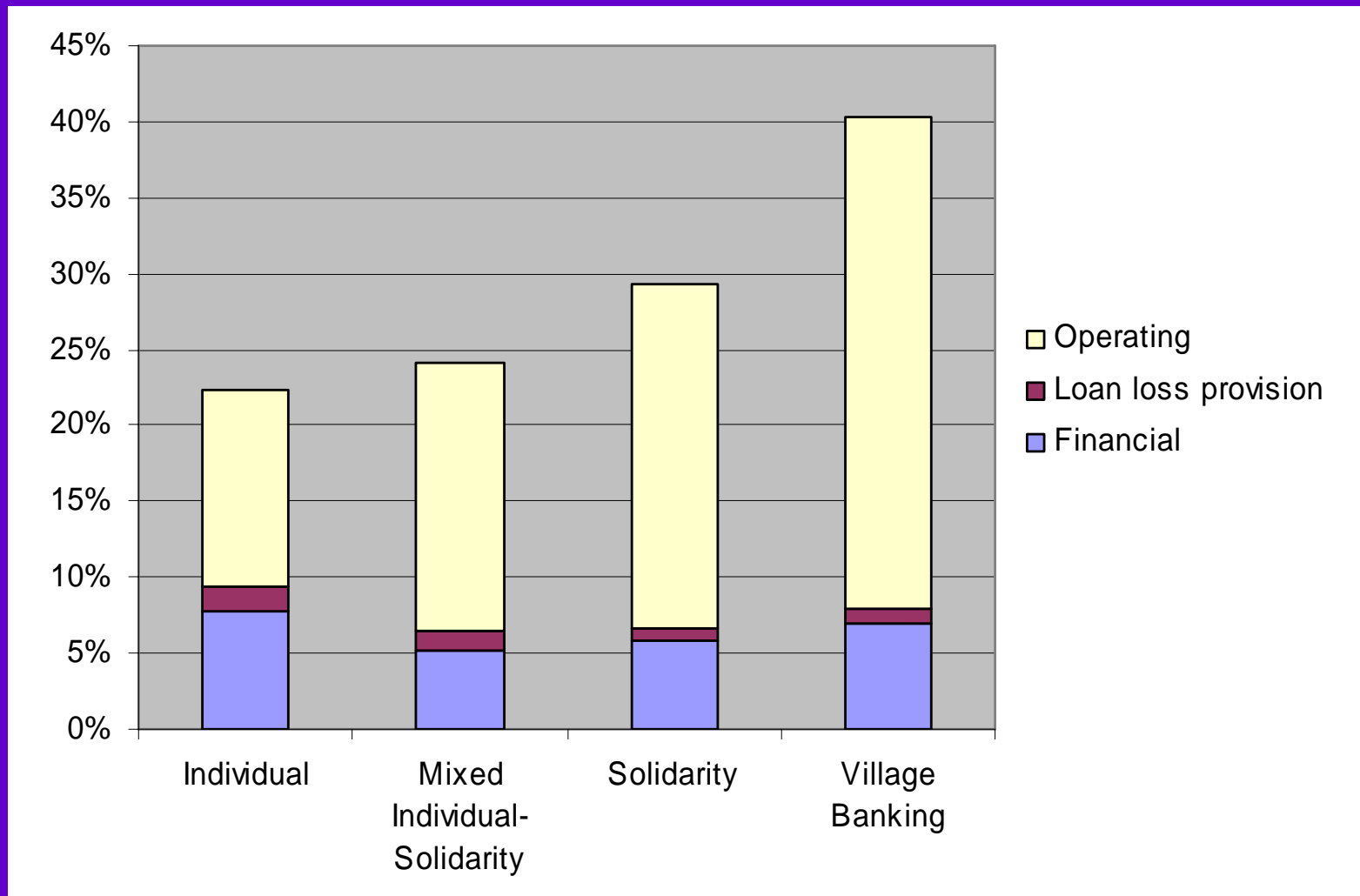
# Loan sizes in dollars and fraction of GNI/capita by lender type (median), 2004



# MFI expenses by lender type (median, \$ per loan), 2004



# MFI expenses by lender type (median, % of assets), 2004

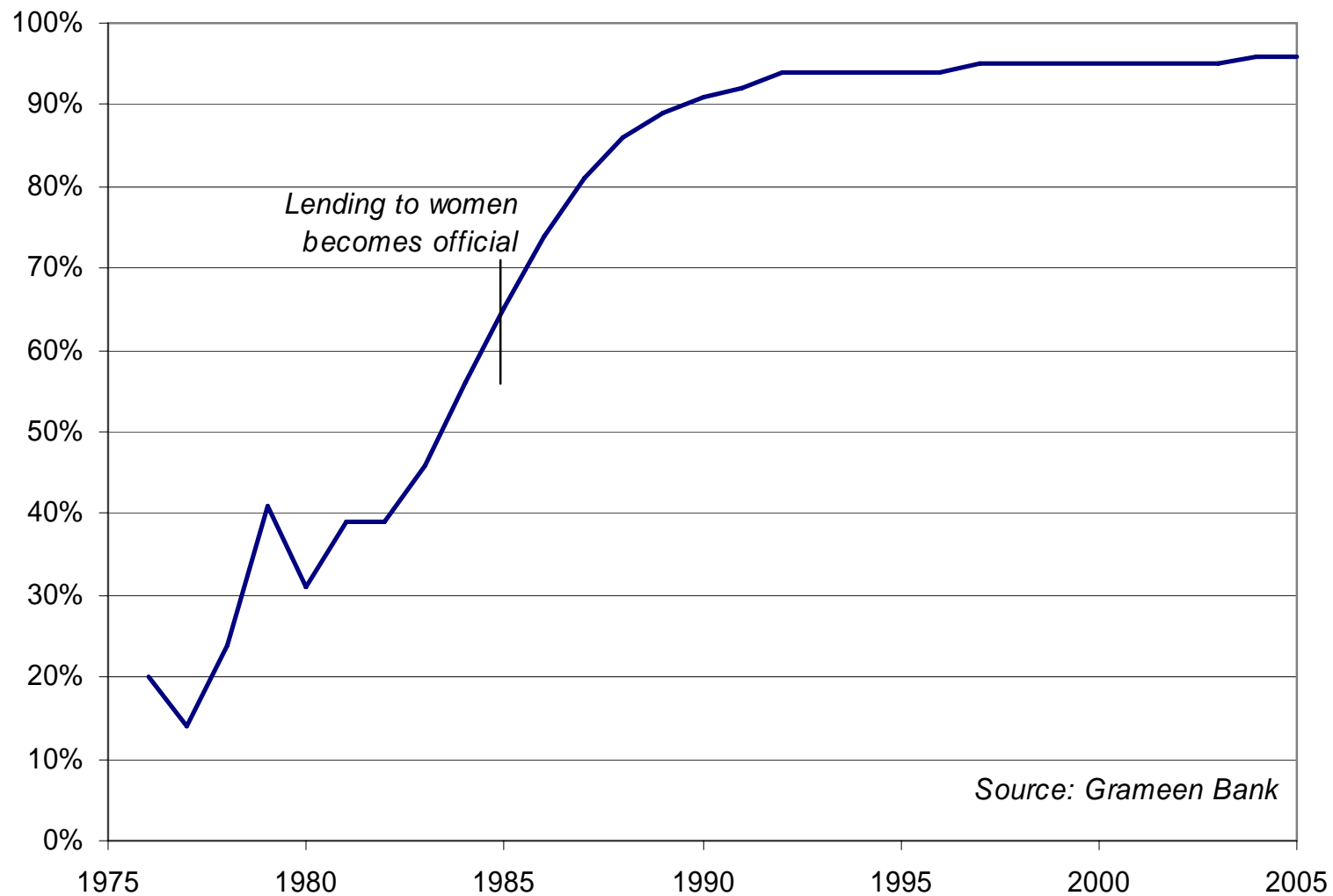


Type	Number in sample	Expenses (% of assets)				Average loan balance	
		Financial	Loan loss provision	Operating	Total <sup>1</sup>	Dollars	% of GNI per Capita
Individual	104	7.8	1.7	12.9	24.6	1,084	59.5
Mixed Individual-Solidarity	132	5.2	1.2	17.8	25.9	359	44.6
Solidarity	32	5.8	0.9	22.7	30.3	92	14.0
Village Banking	34	7.0	1.0	32.4	39.8	139	20.8

<sup>1</sup>Previous columns do not sum to totals because median totals differ from total medians.

Source: MicroBanking Bulletin: 2004 Benchmarks, available at [http://www.mixmarket.org/medialibrary/mixmarket/2004\\_MFI\\_Benchmarks\[2\].xls](http://www.mixmarket.org/medialibrary/mixmarket/2004_MFI_Benchmarks[2].xls).

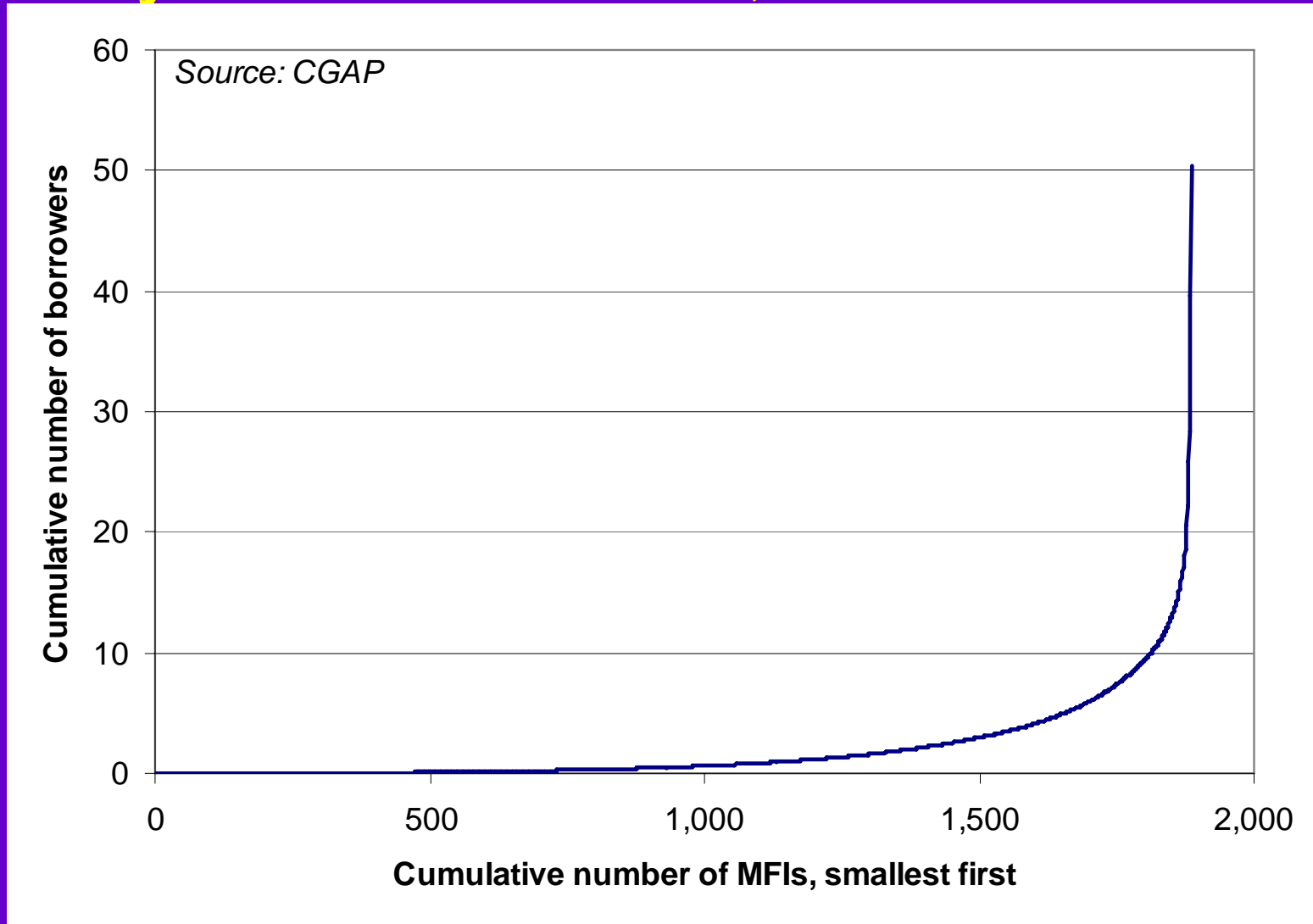
# Share of members who are women, Grameen Bank, 1976–2005



# Share of borrowers who are women by lender type (median), 2004



# Cumulative number of borrowers by size of lender, circa 2000



# Management: the challenge of scaling up

- Going to the customer
- Esprit de corps/sense of mission
- In downscaling banks, top-level commitment
- Charging rates that cover costs
- HR strategy: hiring, training, retention
- Standardization of products and jobs
- Decentralization
- Pay incentives: significant, relevant, clear
- Monitoring/good MIS
- Separate accounting for subsidies

Active loan  
accounts per  
capita,  
countries with  
at least 1  
percent, circa  
2000

Country	Loan accounts (thousands)	Population	Loan accounts/ capita (%)
Bangladesh	17,300	130,407	13.3
Indonesia	15,159	224,138	6.8
Guatemala	833	12,820	6.5
Bolivia	494	8,153	6.1
Nicaragua	220	4,932	4.5
Gambia	50	1,367	3.6
Tunisia	313	9,564	3.3
Niger	322	10,174	3.2
El Salvador	191	6,123	3.1
Honduras	183	6,201	3.0
Thailand	1,728	62,352	2.8
Ecuador	345	12,505	2.8
Sri Lanka	524	19,239	2.7
Malawi	260	10,874	2.4
Senegal	233	9,784	2.4
Mongolia	61	2,601	2.3
Peru	588	25,980	2.3
Nepal	492	24,702	2.0
Cambodia	243	12,433	2.0
Benin	122	6,428	1.9
Togo	90	5,033	1.8
Colombia	699	39,686	1.8
Uganda	407	23,496	1.7
Bosnia and Herzegovina	59	3,836	1.5
Paraguay	69	5,586	1.2
Dominican Republic	97	8,354	1.2
Georgia	54	4,777	1.1
Samoa	2	179	1.0
Ethiopia	638	62,651	1.0

Source: Authors' calculations, based on CGAP.

# MFI's by number of borrowers

Available Heat Maps

Source: All MFIs Year: 2003

Get Heat Map

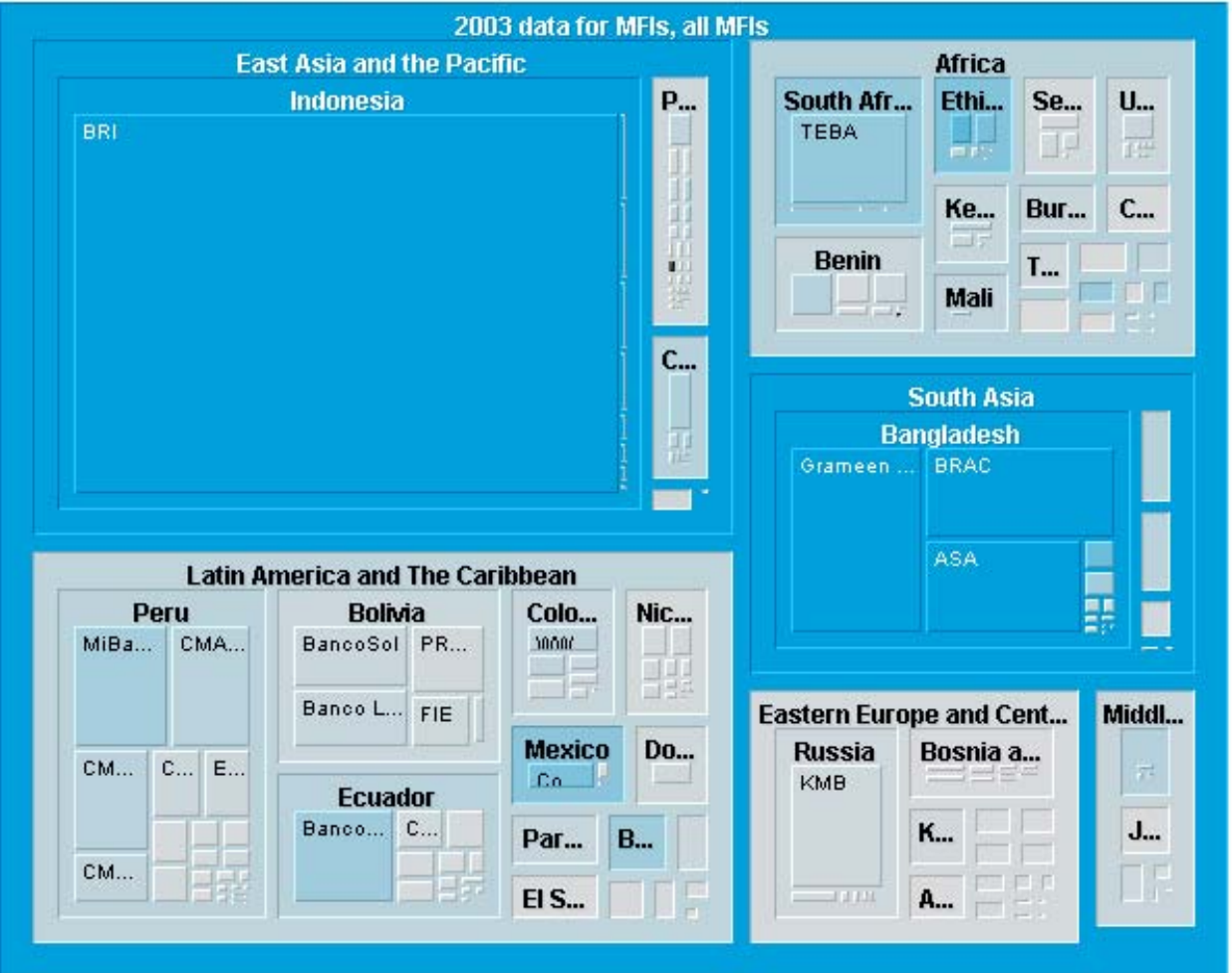
Browse Zoom Pan  
Back Forward Update

**Categorization**  
Region  
Size  
Gross Loan Portfolio  
Color  
Number of active borrowers  
Highlights  
None  
Find

? Instructions

**Color code**  
-500,000 500,000  
Span  
Depth Mn 2 3 Max  
Renderer Cluster

powered by:  
**panopticon**



Crystallizer  Color  Size

0 5 10 15 20 25 30 35 40 45 50 55 60 65 70 75 80 85 90 95 100

0% - 100%: 519 Nodes  Symmetric

# Why is microfinance where it is? Why isn't it where it isn't?

- Bangladesh has more than India
- Peru has more than Brazil
- Benin has more than Nigeria

Implication: On a global scale, the most important success factors are external to MFIs

What are they?

# Cultural barriers: example

Two kinds of credit in Brazilian culture

- Conventional loan—disbursed and repaid
  - More stigmatized as debt
- Deferred payment—take the TV home today and pay over following months
  - Keeping your promise is good behavior
- Reduces demand for conventional microcredit

# Government barriers: example

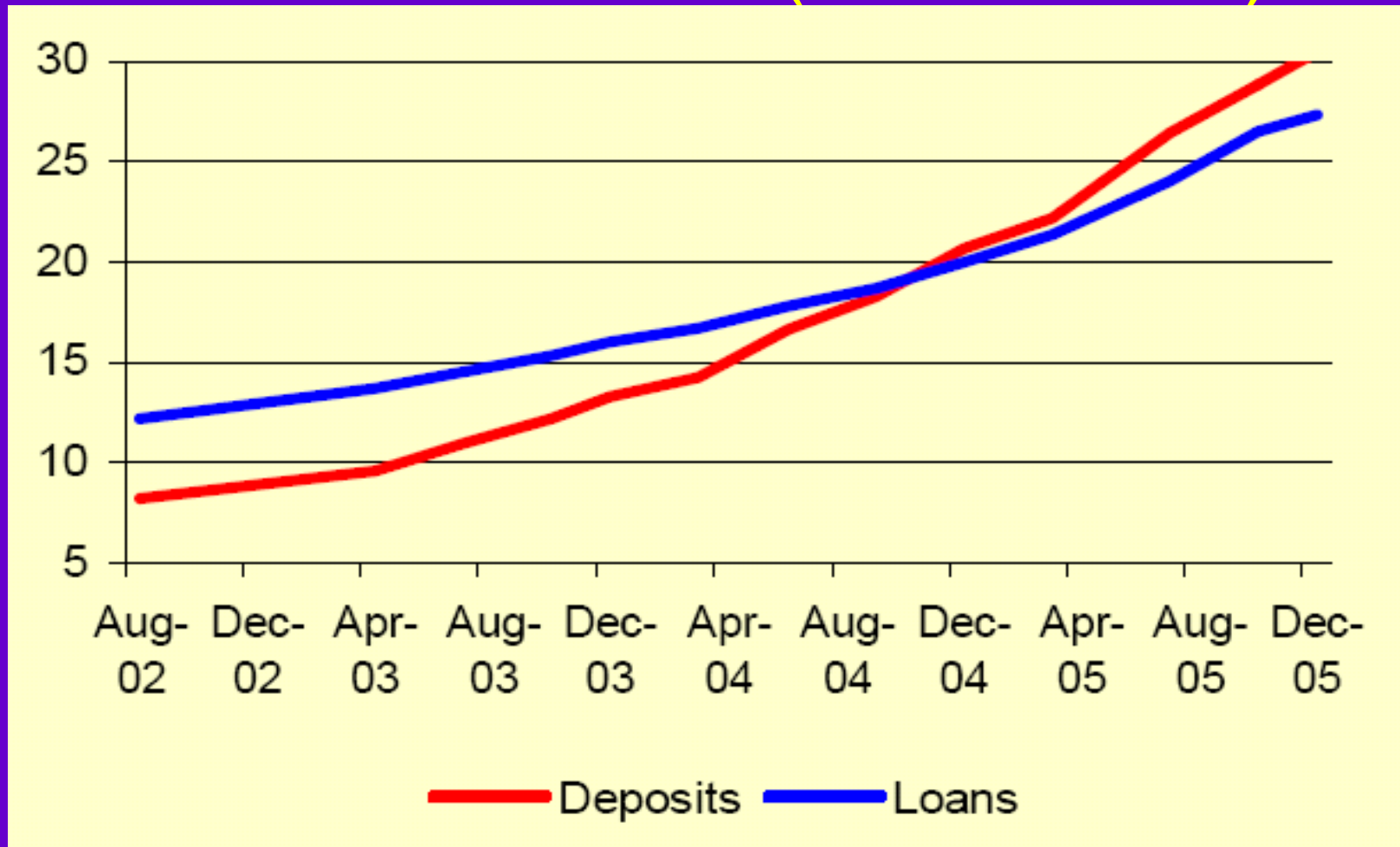
Almost no microfinance in Turkey

- Subsidized government credit (Halk and Ziraat Banks): undercuts microfinance, creates culture of low interest rates and non-repayment
- Unstable macroeconomy: hyperinflation, banking crises
- Legal limbo: MFIs in Turkey taxed as banks but cannot operate like them. Enabling law drafted but not passed.
- Red tape: Local and regulatory authorities do not look the other way.

# Government assistance: examples

- *Benign neglect*
  - Cambodia, Mongolia: government allowed microfinance to take root by leaving it alone
- *Active support*
  - Bangladesh: special law passed to make Grameen a bank
  - Bolivia: regulators and legislators worked with local MFIs to develop regulatory framework
- *Government ownership*
  - Indonesia: BRI state-run

# Deposit and loan portfolios, Grameen Bank (billion taka)



Source: Stuart Rutherford, *Grameen II: The First Five Years, 2001–2005* (Dhaka: MicroSave, 2006)

# What is true success?

- *Direct impact on clients?*
  - Evidence fairly weak, especially in Latin America
  - Commercial explanations for product designs weaken confidence that it is designed to help
  - \$0.5-1.0 billion into microfinance each year. Put small % into rigorous evaluation.
- *Institutional development?*
  - Then commercial success=development success??