

# Global microscope on the microfinance business environment 2010

An index and study by the Economist Intelligence Unit



Supported by



Ministry of Foreign Affairs of the  
Netherlands



## About this report

This report outlines the findings of the Economist Intelligence Unit's in-depth analysis of the microfinance business environment in 54 countries. The index that underlies this report allows countries and regions to be compared across three broad categories: regulatory framework, institutional development and investment climate. The study uses a methodology which was originally developed for Latin America and the Caribbean in 2007 and was employed for the first time on a global basis in 2009. Most of the research for this report was conducted prior to May 2010, although some later developments (up to July) were included where they were particularly significant. Future studies will build on this project by increasing the number of interviews conducted, utilising new data, and refining the methodology. We welcome your feedback. Please contact us at [Microfinance@economist.com](mailto:Microfinance@economist.com).

This work was supported by financing from the Multilateral Investment Fund (MIF), a member of the Inter-American Development Bank Group; CAF (the Andean Development Corporation) and the Netherlands Technical Assistance Trust Fund at the International Finance Corporation (IFC).

The complete index, as well as detailed country analysis, can be viewed at [www.eiu.com/sponsor/GlobalMicroscope](http://www.eiu.com/sponsor/GlobalMicroscope), [www.iadb.org/micamericas](http://www.iadb.org/micamericas), [www.caf.com/mipyme](http://www.caf.com/mipyme) and [www.ifc.org/microfinance](http://www.ifc.org/microfinance).

*For further information, please contact:*

### **Economist Intelligence Unit**

Vanesa Sanchez, Project Manager:  
[vanesasanchez@eiu.com](mailto:vanesasanchez@eiu.com) / +44 20 7576 8301  
Joanne McKenna, Press Officer:  
[joannemckenna@eiu.com](mailto:joannemckenna@eiu.com) / +44 20 7576 8188

### **Multilateral Investment Fund Inter-American Development Bank**

Sergio Navajas, Senior Specialist:  
[sergion@iadb.org](mailto:sergion@iadb.org) / +1 202 623 3268  
Paola A. Pedroza, Special Consultant– Access to Finance  
[paolap@iadb.org](mailto:paolap@iadb.org) / +1 202 623 3602  
Paul Raymond Constance, Press Officer:  
[paulc@iadb.org](mailto:paulc@iadb.org) / +1 202 623 2572

### **CAF**

#### **Dirección de Promoción de Pyme y Microempresas**

Manuel Malaret, Manager:  
[mmalaret@caf.com](mailto:mmalaret@caf.com) / +58 212 209 2060  
Ixone Soroa, Executive:  
[isoroa@caf.com](mailto:isoroa@caf.com) / +58 212 209 2289  
[microfinanzas@caf.com](mailto:microfinanzas@caf.com) / +58 212 209 2291  
Nathalie Gerbasi, Press Officer:  
[ngerbasi@caf.com](mailto:ngerbasi@caf.com) / +58 212 209 2315

### **IFC**

Makanda Kioko, Programme Manager:  
[MKioko@ifc.org](mailto:MKioko@ifc.org) / +1 202 473 4802  
Renate Gamarra, Project Coordinator:  
[RGamarra@ifc.org](mailto:RGamarra@ifc.org) / +1 202 473 5588  
Scott Scheide, Project Analyst  
[SScheide@ifc.org](mailto:SScheide@ifc.org) / + 202 473 3479  
Leila Search, Communications Officer:  
[LSearch@ifc.org](mailto:LSearch@ifc.org) / +1 202 473 7511

The views and opinions expressed in this publication are those of the Economist Intelligence Unit and do not necessarily reflect the official position of MIF, CAF, or IFC.



## About the Economist Intelligence Unit

The Economist Intelligence Unit (EIU) is the business information arm of The Economist Group, publisher of *The Economist*. Through a global network of more than 650 analysts and contributors, we continuously assess and forecast political, economic and business conditions in more than 200 countries. As the world's leading provider of country intelligence, we help executives, governments and institutions by providing timely, reliable and impartial analysis on economic and development strategies. For more information, visit [www.eiu.com](http://www.eiu.com).

## About the Multilateral Investment Fund

The Multilateral Investment Fund (MIF), a member of the Inter-American Development Bank Group, provides grants, investments and loans to promote private sector growth, particularly micro and small businesses with high potential for poverty alleviation in Latin America and the Caribbean. For more information, visit [www.iadb.org/mif](http://www.iadb.org/mif).

## About CAF

Established in 1970, CAF is a Latin American financial institution created with the aim of promoting sustainable development and regional integration. The institution promotes sustainable growth in Latin America and the Caribbean by financing projects in the public and private sectors, and by providing technical cooperation and other specialised services. CAF consists of 18 Latin American, Caribbean, and European governments as well as 14 private banks. It is a major source of multilateral finance and knowledge generation in the region. For more information, visit [www.caf.com](http://www.caf.com).

## About IFC

IFC, a member of the World Bank Group, is the largest global development institution focused on the private sector in developing countries. IFC creates opportunity for people to escape poverty and improve their lives by providing financing to help businesses employ more people and supply essential services, by mobilising capital from others, and by delivering advisory services to ensure sustainable development. In a time of global economic uncertainty, IFC's new investments climbed to a record \$18 billion in fiscal 2010. For more information, visit [www.ifc.org](http://www.ifc.org).



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## Executive summary

Microfinance is entering a new and more dynamic phase. In July 2010 India's SKS became only the second microfinance institution ever to launch an initial public offering (IPO). SKS is well known in India, where it had almost 6 million active borrowers last year, but investors from several major US and European banks also bought shares in the IPO. This speaks volumes about new attitudes towards microfinance, which is increasingly viewed by both providers and investors as a commercially viable industry. Nor is the revolution in microfinance confined to India. Thanks to innovations in mobile microfinance, services like Kenya's M-PESA (with 10 million customers) are using the latest communications technology to bring finance—and hope—to the world's poorest countries.

Indeed, microfinance is rapidly shifting from a niche product to a globally recognised form of finance. Yet as microfinance offerings become more sophisticated and diverse, regulatory and market gaps keep the industry from operating as well as it should. This increases the need for a systematic way of tracking and evaluating conditions for microfinance.

The *Global microscope on the microfinance business environment 2010* provides a basis for benchmarking the business conditions for privately provided microfinance in countries around the world. Commissioned and funded by MIF, CAF and IFC, the Global Microscope 2010 is the second annual effort to evaluate and benchmark 54 developing countries. It is also the fourth yearly index to track conditions in the 21 countries of the Latin American and Caribbean region.

The 2010 index covers the period from August 2009 through May 2010, and evaluates microfinance across three distinct categories: 1) the regulatory framework, including official legal recognition, interest rate restrictions, market distortions, capital requirements and regulatory capacity; 2) the general investment climate for microfinance providers, especially accounting standards, governance tendencies and transparency requirements; and 3) the level of microfinance institutional development, as measured by market concentration, the range of services provided beyond credit and the quality of borrower information. Although it is impossible to capture every dimension of the microfinance environment, the index highlights countries that have improved financing options for the poor and those that still have work to do.

Each year the Economist Intelligence Unit seeks to improve the methodology used to construct the index. A larger and more diverse group of stakeholders was interviewed this year. An online survey was conducted to solicit the views of an expanded community of microfinance specialists and in-country



stakeholders. The Microscope research team also nearly doubled in size, and new institutions were invited into the review process. New data and sources were also incorporated into the report.

Additional information on methodology and scoring is provided in the *Microscope indicators* section and in the appendix.



## Key findings

For the second year running, Peru, the Philippines, and Bolivia top the Economist Intelligence Unit's *Global Microscope* index. Peru retained its position as the global leader, scoring 74.3 out of 100, similar to last year's score. The Philippines and Bolivia swapped positions and finished second and third, respectively, this year. Two newcomers, Pakistan and Kenya, joined the top ten, displacing Nicaragua and Uganda.

The three best-performing countries score especially well in two of the main index categories: regulatory framework and institutional development. Peru is the only country that ranks in the top five for all three categories. The Philippines enjoys the best overall regulatory environment for microfinance, alongside Cambodia, which does not make the top ten overall, and Pakistan which does. As with the highest-ranked countries, the remaining top-ten nations come from different regions and exhibit varied macroeconomic and political characteristics. India, a large, fast-growing democracy, ranks eighth, just below its neighbour, fifth-ranked Pakistan, which is less stable politically and economically. Ecuador and El Salvador, both with left-leaning governments, tie for sixth, ahead of ninth-placed Colombia, which has worked hard to improve its business environment in the last decade. The two African countries in the top ten, Ghana and Kenya, are among their region's most stable economies. The countries that dropped from the top ranks have either experienced notable deteriorations in investment and operating conditions for microfinance since 2009 (Nicaragua, as a result of the "No Pago" movement) or have simply not kept pace (Uganda).

New to the bottom rank (54th place), Venezuela finishes last in the 2010 index. It replaces Thailand, in large part because of deteriorating investment and operating conditions for NGOs, but also because of slight improvements in Thailand, whose microfinance sector remains highly state-led. Microfinance in Venezuela suffers from a weak regulatory structure and low levels of market development. Although ranked just above Venezuela, three countries in the bottom ten—Trinidad and Tobago, Jamaica and Turkey—also lack the appropriate level of regulatory support and have underdeveloped markets. They are, however, unique in that relatively strong investment climates help to compensate for their weaknesses elsewhere.

Two countries, Azerbaijan and Nepal, left the bottom ranks this year. Azerbaijan now places 38th and ties with China, thanks to improvements in its regulatory framework. Nepal benefited from a more hands-off approach by the state and from new regulations that facilitate micro-deposit taking. Nepal is also in the process of drafting its first microfinance law.



## Changes since last year

Of the 54 countries included in the 2010 index, 29 improved their scores, 21 fell back, and four were unchanged. Madagascar posted the biggest improvement, largely because of its increasingly favourable regulatory framework, a wider range of microfinance services and efforts to improve credit reporting. Pakistan and Nepal had the second- and third-largest gains, helped by regulatory and market reforms. A comprehensive list of changes for 2010 can be viewed by score and by category in the Excel model, available free of charge at [www.eiu.com/sponsor/GlobalMicroscope](http://www.eiu.com/sponsor/GlobalMicroscope), [www.iadb.org/micamericas](http://www.iadb.org/micamericas), [www.caf.com/mipyme](http://www.caf.com/mipyme) and [www.ifc.org/microfinance](http://www.ifc.org/microfinance).

## Changes in methodology

As the Microscope index has evolved from a pilot project to a more established global study, improvements in the data have been made and the number of interviews and contributing reviewers has been increased. This has occasionally led to adjustments in country evaluations even if a net change was not noted in a particular country since last year.

A specific case worth mentioning is the inclusion of updated competition data from MIX Market and additional sources and microfinance networks in Latin America and the Caribbean and Africa. Improvements in the figures and in number of institutions reported since last year led to both positive and negative changes for countries in this study.

Finally, Ethiopia was not included this year due to a lack of corroborating information. The study will seek to re-incorporate Ethiopia in 2011.

## A note on regional representation

This index builds on earlier studies of Latin America and the Caribbean; as a result, countries from that region are somewhat over-represented in the study (21 of 54). Countries in other regions were selected on the basis of the importance of their existing microfinance sectors or the potential for future market development. The study therefore provides differing levels of geographic coverage: 11 countries were selected from Sub-Saharan Africa, five from South Asia, seven from East Asia, three from the Middle East and North Africa, and seven from Eastern Europe and Central Asia. These differences in coverage impact regional conclusions and should be considered carefully when evaluating index results beyond individual country scores.





## Regional findings

### East and South Asia

The Philippines and Pakistan fill the top regional ranks, scoring 64 points or more. They are followed by India and Cambodia, whose scores are almost ten points apart. Despite the apparent room for improvement (on a scoring scale of 0 to 100), these countries have frameworks in place that permit banks, non-bank financial institutions (which may or may not enjoy a specific microfinance classification), NGOs and cooperatives to offer microfinance services. These countries have also limited the extent and impact of state involvement in the sector (if any). A minimum and necessary level of regulatory capacity to oversee the active markets created by this approach has also been developed. One of the region's strongest gainers since last year, Nepal, has made moves in this direction.

The remaining eight countries score 40 points or less and struggle with regulatory conditions in particular. Bangladesh, which enjoys an elevated public profile for microfinance (owing to the presence of Grameen Bank), ranks a mere 33rd and scores lower than it did in 2009. Bangladesh has a moderately restrictive regulatory framework that serves to constrain a majority of microfinance institutions, and has a fairly consolidated market. China and Mongolia also have restrictive frameworks, although market activity is far less robust in these locations than in Bangladesh; as a result they rank several spots lower.

Countries such as Thailand, Vietnam, Sri Lanka and Indonesia wrestle with both regulatory restrictions and significant state intervention that impacts competition and market development. Indeed, Sri Lanka experienced the biggest score decrease of all the Asian countries in the study. In other cases, such as Indonesia, creative solutions are used to bypass these constraints and private providers have become active in microfinance. For the most part, though, government intervention through regulation and lending programmes creates a strong crowding-out effect.

### Eastern Europe and Central Asia

None of the Eastern European or Central Asian countries finished in the top ten. The region's best performer, the Kyrgyz Republic, places 12th globally despite experiencing a slight decline in its overall score since last year. Turkey and Bosnia place in the top three worldwide for the quality of their investment climate, and another two countries in the region place in the top ten for their legal and regulatory frameworks (Kyrgyz Republic and Tajikistan). Despite noticeable regulatory capacity gaps



in Turkey and Bosnia, the majority of the countries in the region enjoy at least some (if not significant) specialised capacity for microfinance oversight. To their credit, governments in Eastern Europe and Central Asia generally do not engage in direct first or second-tier microlending<sup>1</sup>; rather, their weakness generally stems from a need to streamline regulations and change legal frameworks to allow or facilitate NGO participation in the sector. Turkey is the region's most extreme case: the legal framework and regulatory environment actually serve as obstacles to the establishment of new microfinance institutions.

## Latin America and the Caribbean

As home to the overall best and worst performer in this year's index, Latin America and the Caribbean has the largest range of scores among the six regions—a trend that is also evident among the three category scores.

Interestingly, only three out of 21 countries place in the top ten for their regulatory and legal frameworks (Peru, Bolivia and Paraguay). Yet five countries from the region place in the top ten overall (Peru, Bolivia, El Salvador, Ecuador and Colombia). This can be explained by the fact that non-regulatory measures, including market activity, services offered and credit bureau infrastructures, are relatively well-established on a regional level. The relative dominance of Latin American countries in the institutional development category—they hold eight of the top ten slots—reinforces this point.

Conversely, Latin America and the Caribbean house some of the most inactive markets. Countries such as Venezuela, Trinidad and Tobago and Jamaica score at the bottom of the index overall and for at least two of the three categories. Nine countries exhibit high levels of market concentration and low competition, and the majority (14 out of 21) only offer a modest range of services. Of all countries in the region, Nicaragua lost the most points. This is mainly due to the negative effects of the "No Pago" movement on the regulatory environment and financing conditions for microfinance institutions (MFIs).

## Middle East and North Africa

The three Middle Eastern and North African countries examined in this study offer stark contrasts. The best performer is Yemen, ranking 27th globally despite high levels of political instability and economic stress. Yemen has developed and maintained a good regulatory framework for microfinance and has worked to strengthen regulatory capacity. The second-best performer regionally is Morocco. Although it has a highly active microcredit market, the range of services microfinance institutions are allowed to offer is restricted and the market is dominated by a few large players. The country's investment climate for microfinance remains among the best in the world, however. The lack of microfinance-specific regulatory attention is strongly felt in Lebanon, where the market remains underdeveloped, under regulated and is fragmented along ethnic and political lines.

## Sub-Saharan Africa

Ghana and Kenya, two of Sub-Saharan Africa's strongest and most stable countries, are leaders on a regional and global level, placing in the top ten overall. Uganda is close behind, ranking 11th. All three countries have strong regulatory frameworks that allow all types of microfinance institutions to

1. The Kyrgyz Republic is an exception to this generalization, as a state-funded microlender began operations earlier this year.



serve low-income populations. Clients in these three countries benefit from active markets in which institutions offer a wide range of services beyond microcredit; indeed, Kenya has a global reputation for innovation and dynamism in microfinance. The presence of savings and credit co-operatives in these countries contributes in large part to service availability and variety, though these institutions, when left unregulated, can also negatively influence governance and transparency standards.

All 11 Sub-Saharan African countries examined in this study have microfinance-specific frameworks and policies in place, regardless of their regional or global rank. Some countries have begun improving their frameworks; Nigeria is reviewing existing policies to address rapid institutional growth, Kenya is re-evaluating its framework governing institutional transformation, and Ghana has strengthened regulatory requirements for microfinance institutions. Some countries struggle with larger macroeconomic and government effectiveness issues that undermine the microfinance environment at a broader level (including the Democratic Republic of Congo, which had the biggest score decrease, and Madagascar which saw the most improvement). Others, such as Senegal and Cameroon, wrestle with the slow pace of regulatory implementation for reforms passed in prior years. However the regulatory framework in the region showed little evidence of deterioration over the past year. Ten of the 11 countries covered saw their regulatory framework scores either increase or hold steady. The greatest room for improvement is in credit bureau development, competition levels and investment climate. Nine of the 11 countries fall in the bottom half globally for investment climate, and they struggle to ensure minimum transparency, governance and accounting standards for microfinance.



## Overall microfinance business environment rankings

Weighted sum of category scores (0-100 where 100=most favourable)

Rank	Country	Score	Score change since 2009	Rank	Country	Score	Score change since 2009
1	Peru	74.3	+0.5	28	Nigeria	44.2	+4.8
2	Philippines	71.8	+3.3	=29	Costa Rica	42.4	-
3	Bolivia	69.6	-2.2	=29	Rwanda	42.4	+3.9
4	Ghana	64.9	+4.0	31	Madagascar	41.3	+9.0
5	Pakistan	64.8	+8.3	32	Bosnia	40.4	-2.7
=6	Ecuador	61.3	+1.7	33	Bangladesh	39.5	-3.2
=6	El Salvador	61.3	+3.8	34	Mozambique	38.6	-1.7
8	India	59.1	-3.0	35	Nepal	38.1	+8.1
9	Colombia	56.8	-1.8	36	Cameroon	37.3	+5.7
10	Kenya	55.0	-0.8	37	Argentina	36.7	+5.8
11	Uganda	53.9	-3.6	=38	Azerbaijan	35.9	+7.0
12	Kyrgyz Republic	53.0	-3.2	=38	China	35.9	+1.8
13	Nicaragua	52.3	-6.3	40	Haiti	35.7	+2.3
14	Chile	52.0	+4.0	41	Indonesia	35.3	+0.2
15	Paraguay	52.0	+2.5	42	Sri Lanka	34.2	-6.2
16	Cambodia	51.0	-3.2	43	Senegal	32.5	-0.1
17	Panama	50.8	-	44	Mongolia	30.4	+0.4
18	Honduras	49.8	+0.5	45	Morocco	30.3	-
19	Guatemala	49.5	-2.3	46	Uruguay	29.8	+1.5
20	Dominican Republic	48.7	+1.7	47	Democratic Republic of Congo	27.8	-9.1
21	Georgia	48.7	+3.7	48	Turkey	27.4	-2.8
22	Armenia	47.6	+3.7	49	Lebanon	26.3	-3.0
23	Mexico	47.3	-	50	Thailand	24.6	+3.3
24	Tanzania	46.2	-2.2	51	Jamaica	23.3	-0.3
25	Tajikistan	45.7	+5.3	52	Vietnam	22.7	+1.2
26	Brazil	45.0	+1.0	53	Trinidad and Tobago	21.9	-1.0
27	Yemen	44.4	+2.3	54	Venezuela	21.6	-2.5



## Rankings by category

### Regulatory framework

*Weighted 40% in the overall index*

Rank	Country	Score	Score change since 2009	Rank	Country	Score	Score change since 2009
=1	Cambodia	87.5	-	=26	Chile	50.0	-
=1	Pakistan	87.5	+12.5	=26	Dominican Republic	50.0	-
=1	Philippines	87.5	-	=26	Democratic Republic of Congo	50.0	-12.5
4	Peru	81.3	-	=26	Honduras	50.0	-
=5	Bolivia	75.0	-6.3	=32	Azerbaijan	43.8	+6.3
=5	Ghana	75.0	-	=32	Bangladesh	43.8	-
=5	Kenya	75.0	-6.3	=32	Bosnia	43.8	-6.3
=5	Kyrgyz Republic	75.0	-6.3	=32	China	43.8	-
=5	Uganda	75.0	-	=32	Costa Rica	43.8	-
=10	Paraguay	68.8	+6.3	=32	Guatemala	43.8	-6.3
=10	Tajikistan	68.8	-	=32	Haiti	43.8	-
=10	Tanzania	68.8	-	=32	Indonesia	43.8	-
=10	Yemen	68.8	+6.3	=32	Nicaragua	43.8	-12.5
=14	Ecuador	62.5	-6.3	=32	Senegal	43.8	-
=14	El Salvador	62.5	-	=42	Lebanon	37.5	-
=14	India	62.5	-	=42	Mongolia	37.5	-6.3
=14	Nigeria	62.5	+6.3	=42	Morocco	37.5	-
=14	Rwanda	62.5	+6.3	=42	Nepal	37.5	+6.3
=19	Cameroon	56.3	+6.3	=46	Argentina	31.3	+6.3
=19	Colombia	56.3	-6.3	=46	Uruguay	31.3	-
=19	Georgia	56.3	-	=46	Vietnam	31.3	-
=19	Madagascar	56.3	+6.3	=49	Jamaica	25.0	-
=19	Mexico	56.3	-	=49	Sri Lanka	25.0	-6.3
=19	Mozambique	56.3	-	=49	Turkey	25.0	-
=19	Panama	56.3	-	=52	Thailand	18.8	+6.3
=26	Armenia	50.0	-	=52	Venezuela	18.8	-6.3
=26	Brazil	50.0	-	54	Trinidad and Tobago	12.5	-



## Investment climate

*Weighted 20% in the overall index*

Rank	Country	Score	Score change since 2009	Rank	Country	Score	Score change since 2009
1	Chile	76.7	+3.3	=27	Dominican Republic	43.3	+8.3
2	Turkey	70.6	+2.5	=27	Guatemala	43.3	+0.8
3	Bosnia	64.7	-0.8	=27	Tanzania	43.3	+5.6
4	Morocco	59.7	-	=31	Azerbaijan	42.2	+5.8
5	Peru	59.2	+2.8	=31	China	42.2	+9.2
=6	Brazil	58.3	+4.7	33	Senegal	41.7	-0.3
=6	Kenya	58.3	+8.3	=34	Nicaragua	40.8	-6.7
=6	Panama	58.3	-	=34	Tajikistan	40.8	+10
9	Costa Rica	58.1	-	36	Lebanon	40.0	+1.7
10	Ghana	57.8	+3.3	37	Indonesia	39.2	+0.8
11	Mexico	57.5	-	38	Paraguay	38.9	-
12	Colombia	55.0	+3.6	39	Sri Lanka	37.8	-1.7
13	Armenia	54.7	+1.7	40	Argentina	37.5	-
14	India	53.6	+1.7	=41	Rwanda	37.2	+6.9
15	Uruguay	53.3	+7.5	=41	Venezuela	37.2	-
16	Uganda	52.9	-1.3	43	Thailand	35.3	+4.2
17	Trinidad and Tobago	51.1	-5.0	44	Yemen	34.7	-0.8
18	Philippines	50.6	-	45	Vietnam	34.4	+5.8
19	Jamaica	50.0	-1.7	46	Honduras	32.2	+2.5
20	Pakistan	49.2	-	47	Nepal	31.9	+11.1
21	El Salvador	48.3	+2.5	=48	Ecuador	31.7	+4.2
=22	Bolivia	47.8	+1.7	=48	Kyrgyz Republic	31.7	-3.3
=22	Georgia	47.8	+1.7	50	Nigeria	29.2	-5.0
24	Mozambique	47.1	+8.2	51	Madagascar	27.2	-0.8
25	Cambodia	46.4	+0.8	52	Haiti	24.4	-5.0
26	Mongolia	43.6	-2.0	53	Cameroon	23.9	-0.8
=27	Bangladesh	43.3	+0.8	54	Democratic Republic of Congo	22.2	-3.6



## Institutional development

*Weighted 40% in the overall index*

Rank	Country	Score	Score change since 2009	Rank	Country	Score	Score change since 2009
=1	Bolivia	75.0	-	=23	Madagascar	33.3	+16.7
=1	Ecuador	75.0	+8.3	=23	Mexico	33.3	-
=1	Peru	75.0	-	=23	Nigeria	33.3	+8.3
=4	El Salvador	66.7	+8.3	=23	Uganda	33.3	-8.3
=4	Nicaragua	66.7	-	=32	Azerbaijan	25.0	+8.3
=4	Philippines	66.7	+8.3	=32	Bosnia	25.0	-
=7	Colombia	58.3	-	=32	Cameroon	25.0	+8.3
=7	Ghana	58.3	+8.3	=32	China	25.0	-
=7	Guatemala	58.3	-	=32	Indonesia	25.0	-
=7	Honduras	58.3	-	=32	Rwanda	25.0	-
=7	India	58.3	-8.3	=32	Tajikistan	25.0	+8.3
=12	Dominican Republic	50.0	-	=32	Tanzania	25.0	-8.3
=12	Pakistan	50.0	+8.3	=32	Thailand	25.0	-
=14	Argentina	41.7	+8.3	=32	Yemen	25.0	-
=14	Armenia	41.7	+8.3	=42	Cambodia	16.7	-8.3
=14	Chile	41.7	+8.3	=42	Mongolia	16.7	+8.3
=14	Georgia	41.7	+8.3	=42	Mozambique	16.7	-8.3
=14	Kyrgyz Republic	41.7	-	=42	Senegal	16.7	-
=14	Nepal	41.7	+8.3	=42	Trinidad and Tobago	16.7	-
=14	Panama	41.7	-	=42	Uruguay	16.7	-
=14	Paraguay	41.7	-	=42	Venezuela	16.7	-
=14	Sri Lanka	41.7	-8.3	=49	Democratic Republic of Congo	8.3	-8.3
=23	Bangladesh	33.3	-8.3	=49	Jamaica	8.3	-
=23	Brazil	33.3	-	=49	Lebanon	8.3	-8.3
=23	Costa Rica	33.3	-	=49	Morocco	8.3	-
=23	Haiti	33.3	+8.3	=49	Turkey	8.3	-8.3
=23	Kenya	33.3	-	=49	Vietnam	8.3	-



## Microscope indicators

The 13 indicators for this index, and the categories into which they are subdivided, are as follows:

### **Regulatory framework**

- 1) Regulation of microcredit operations
- 2) Formation and operations of regulated/supervised specialised MFIs
- 3) Formation and operation of non-regulated MFIs
- 4) Regulatory and examination capacity

### **Investment climate**

- 1) Political stability
- 2) Capital market stability
- 3) Judicial system
- 4) Accounting standards for microfinance
- 5) Governance standards for microfinance
- 6) MFI transparency

### **Institutional development**

- 1) Range of services offered by MFIs
- 2) Credit bureaus for microfinance
- 3) Level of competition in the microfinance sector

Scoring methodology: Each of the 13 scoring criteria are scored from 0 to 4, where 4= best and 0 = worst. Ten of the 13 indicators receive integer scores. The remaining three (Political stability, Capital market stability, and Judicial system) are an average of several sub-indicators, thereby producing decimal scores in some cases.

Once indicator scores have been assigned, these are aggregated to produce an overall scoring range of 0 – 100, where 100= best. Overall scores and rankings were calculated by attributing a 40% weight to Regulatory framework and Institutional development category scores and a 20% weight to the Investment climate category score. For a detailed description of the scoring methodology, please refer to the appendix.





## **Microfinance country profiles**

The following section provides a brief profile of the microfinance business environment and indicates key changes since last year for each of the 54 countries in this study. Countries are listed in alphabetical order and are organised by region. Each country profile is presented in two parts: the first section contains a brief background on a country's microfinance sector, and the second section outlines key developments since last year. Please note that the information selected for the country profiles is meant to be a high-level overview. It is not intended to provide a complete outline of the legal environment or represent a comprehensive account of all recent activity. For more in-depth analysis and regulatory detail, please visit the "country profile" tab of the Excel model available free of charge at [www.eiu.com/sponsor/GlobalMicroscope](http://www.eiu.com/sponsor/GlobalMicroscope), [www.iadb.org/micamericas](http://www.iadb.org/micamericas), [www.caf.com/mipyme](http://www.caf.com/mipyme) and [www.ifc.org/microfinance](http://www.ifc.org/microfinance).



## East and South Asia

### ■ Bangladesh

#### Key characteristics of the microfinance business environment:

- Non-governmental organisations (NGOs) are regulated by the Microcredit Regulatory Authority (MRA), whereas banks are regulated by Bangladesh Bank (the central bank). Grameen Bank, the country's largest microfinance institution (MFI), is regulated by a separate law that established the Grameen Bank Project as a specialised bank in 1983.
- Microfinance is well-established and the market continues to grow, despite exceptionally high market penetration. Although many MFIs operate in Bangladesh, the top ten account for 87% of total savings and 81% of total loans.
- The lack of effective credit bureaus for microfinance transactions, a ban on deposit-taking by MFIs from non-members, and the current prohibition on the use of mobile technology by MFIs restricts the expansion of microfinance operations.

#### Key changes and impacts since last year:

- Internal and external threats to the stability of the government and the political system have been greatly reduced since civilian rule resumed in January 2009. The risk of ad hoc policy reversals or populist interventions in the microfinance sector is low.
- The Microcredit Regulatory Authority (MRA) has become more proactive in enforcing the national policy framework passed in 2006 for NGO-MFIs. The MRA has made progress in developing licensing standards for MFIs, has increased consultations with MF stakeholders and is gradually building its still-minimal capacity (staffing is limited and the MRA has no office outside the capital).
- As of June 2010 the MRA was preparing draft rules to enforce interest rate regulations and to restrict NGO-MFIs' ability to receive and mobilise compulsory deposits.
- High inflation has eroded the disposable incomes of the poor and has led to a marginal decline in repayments. This has increased pressure on the central bank and the MRA to reduce or restrain interest rates in the sector.
- Both the MRA and MFIs are keen to see the creation of credit bureaus. The number of borrowers with multiple loans has increased, as evidenced by a report from the Bangladesh Institute of Development Studies which found that about 15% of microfinance households had loans from multiple MFIs, suggesting high indebtedness.



## Cambodia

### Key characteristics of the microfinance business environment:

- Licensing, regulation, and supervision of microfinance are conducted by the National Bank of Cambodia (NBC, the central bank) under the Law on Banking and Financial Institutions (LBFI) of 1999. The regulatory framework permits limited liability companies (LLCs, including banks) to offer microcredit services. So far, only one bank is active in microfinance.
- A framework for upgrading from non-governmental organisation (NGO) status exists, and the NBC actively encourages the transformation of microfinance institutions (MFIs) into regulated institutions. In accordance with the LBFI, MFIs meeting certain portfolio or borrower-size criteria are required to become licensed as an LLC or a co-operative.
- The role of international NGOs in creating many of the leading MFIs, and the desire to attract foreign investors, has led to relatively strong governance standards. Representatives of international institutions sit on most MFI boards, and internal audit and control functions are well developed.
- The NBC has a strong commitment to transparency in the sector. It collects and publicises the interest rates of all financial institutions on a quarterly basis. The charging of flat interest rates is outlawed, so all microfinance providers charge interest on the declining balance of the loan. Almost all the major MFIs have received an external rating, as this is required by international investors.
- The onset of the global financial and economic crisis revealed a severe over-indebtedness problem in the Cambodian microfinance sector. A plan to create a credit bureau exists, but it is not expected to be operational before 2011.

### Key changes and impacts since last year:

- The NBC has eased the process for non-bank financial institution-MFIs (NBFIs-MFIs) to win permission to take deposits. Four NBFIs-MFIs already have licences, and others have submitted applications.
- There are no official mobile money regulations in Cambodia. However, the first mobile payments programme in the country was launched in January 2009 by WING, a subsidiary of the Australia and New Zealand Banking Group (ANZ). Expansion of this service is held back by the requirement to use local currency, as Cambodia is highly dollarised. Institutions (including MFIs) generally lend in dollars to avoid exchange-rate risk.
- A new NGO law is being drafted that could restrict for-profit activities, such as microfinance. However, the details of the draft legislation have yet to be finalised and it remains to be seen how it will impact on the MFI-NGO segment. At the same time, a draft law (the Financial Trust Law) has been prepared and is currently in formal revision stages. If passed, the law would help MFIs clarify their ownership structures.



## China

### Key characteristics of the microfinance business environment:

- Microfinance is in its infancy in China and there is little competition among the main players, owing to their small size and wide geographical distribution. Usually, not more than one microcredit company (MCC) is active in any given county. Regulatory restrictions help to explain why most microfinance institutions (MFIs) remain relatively contained geographically. This is especially the case for sector institutions such as village and township banks (VTBs).
- The regulatory capacity of the People's Bank of China (PBC, the central bank) and China Banking Regulatory Commission (CBRC) are relatively strong, so the institutions that fall under their authority are well regulated. MCCs are supervised by provincial government financial offices, whose capacity is much weaker. Given the rapid expansion of MCCs in the last two years, this is a major concern, although it is unlikely to imperil financial sector stability, as they do not take deposits.
- The China Foundation for Poverty Alleviation (CFPA) enjoys a privileged position owing to its ties with the state, and can lobby effectively within the regulatory system. CFPA is in theory a non-governmental organisation (NGO), but it emerged from a poverty-alleviation programme. The state's past view of microfinance as a poverty-alleviation tool has hindered the development of profitable microfinance, notably by distorting customer expectations.
- It is relatively difficult and unusual for lightly regulated institutions, such as the MCCs, to upgrade into deposit-taking institutions like VTBs. It is more common to see regular banks moving into downscale lending via VTBs.

### Key changes and impacts since last year:

- The CBRC does not appear to support a rapid expansion of VTBs; as of end-2009 there were around 150. Rural credit co-operatives (RCCs) were formerly ineffective as a vehicle for financing small loans in rural areas, partly owing to a very conservative approach to loan issuance and the difficulty of persuading loan officers to approve loans. Their provision of microcredit has, however, recently improved.
- Although the China Credit Reference Centre (CRC, the central credit bureau) is reasonably comprehensive, most MFIs do not yet participate in the system. The government has undertaken consultations on a new law that would regulate credit bureaus (excluding the CRC).
- The Agricultural Bank of China (ABC) extended an Rmb200m (US\$29.5m) loan to the CFPA in 2009. This loan should help the CFPA increase the scale of its microfinance operations significantly.
- The services offered by MFIs depend on their legal status. MFIs that are regulated by the CBRC can offer a wide variety of services, including deposit-taking and other banking services. However, those not under the CBRC, such as MCCs and unregulated MFIs, are essentially limited to lending and offering financial consultation services. There are some tentative projects underway in the field of microinsurance, especially in poorer regions, but the insurance regulator, the China Insurance Regulatory Commission, has not been enthusiastic in its promotion of this concept.



## India

### Key characteristics of the microfinance business environment:

- The microfinance sector has continued to grow rapidly and with it the need for better regulation. The proposed Microfinance Bill has been pending in Parliament since 2007, although it is expected to pass in 2010. However, the bill does not cover non-bank financial companies (NBFCs) and microfinance institutions (MFIs) registered as not-for-profit companies, thereby ignoring over 80% of the microfinance sector.
- The Reserve Bank of India (RBI, the central bank) regulates two types of institutions that engage in microfinance activities: banks and NBFCs. There are also Self-Help Groups (SHGs) that operate as informal credit and savings groupings of 5-30 poor individuals. Under the proposed bill, the National Bank for Agriculture and Rural Development (NABARD) would be responsible for regulating, registering and overseeing the microfinance activity of SHGs and NGO-MFIs. A real possibility is a regime with two regulators—RBI for NBFCs and banks and NABARD for SHGs and NGO-MFIs.
- Although they are the largest MFIs, NBFCs are not allowed to accept fixed-term deposits without special approval, which requires an investment grade rating from a credit rating agency. Both regulatory approval and credit ratings have become increasingly difficult, if not impossible, to obtain. NGO-MFIs are currently prohibited from accepting deposits; however, the Micro Financial Sector Bill pending in parliament since 2007 could open up deposit-taking restrictions on NGO-MFIs.

### Key changes and impacts since last year:

- Under two separate circulars issued in 2009, domestic banks are required to lend 10% of their adjusted net bank credit to weaker players, such as SHGs, or to MFIs that lend to SHGs.
- A Microfinance Credit Information Bureau is being created; it will pool borrowers' details from 34 participating NBFC-MFIs that are part of the Microfinance Institutions Network (MFIN, a regulatory organisation). Moreover, existing credit bureaus are actively involved in a collective effort to standardise data collection from MFIs, as well as to settle on a common data format.
- The central bank has allowed 29 banks to operate mobile-based payment services. Some pilots have involved MFIs, but there has been no widespread roll-out of the service.
- As of 1st July 2010, RBI lifted interest rate restrictions on small loans provided by commercial banks in an effort to increase the level of competition in the microfinance sector. Previously, interest rates for all loans under Rs200,000 (around US\$4,300) from commercial banks had to be set at a level equal to or below the bank's benchmark Prime Lending Rate.



## Indonesia

### Key characteristics of the microfinance business environment:

- Commercial banks are the most important providers of microcredit in Indonesia, accounting for around 90% of loans.
- The government-backed Bank Rakyat Indonesia (BRI) is the largest single microfinance provider through its Unit Desa offices. It mainly operates on a commercial model, but is also responsible for rolling out government finance schemes, which give them a competitive advantage over private microfinance institutions (MFIs).
- Non-governmental organisations (NGOs) in Indonesia are usually organised as foundations. However, legally they must convert into a commercial bank, co-operative, or a Bank Perkreditan Rakyat (BPR, people's credit bank) or a venture capital firm in order to provide microfinance. The conversion process into a bank is considered onerous, and few NGO-MFIs take this route. A number of prominent NGO-MFIs have converted into venture capital firms.
- Commercial banks with microfinance operations are regulated by the Bank of Indonesia (the central bank). BPRs are also regulated by the central bank, and there is some discussion of adopting a ratings-based approach to BPRs, rather than subjecting them to formal on- and off-site supervision. Non-bank MFIs (NBFIs) lack clarity over their legal status and eligibility to mobilise deposits. Village credit organisations are regulated by BRI branches, and co-operative MFIs are regulated by the Ministry of Co-operatives, but in practice there is little effective oversight of either type.
- Governance standards in Indonesia are weak, and managerial quality at many BPRs, co-operatives, and semiformal microfinance providers is low. Regulators provide only limited technical assistance, mostly focused on BPRs.

### Key changes and impacts since last year:

- The government launched a scheme in 2010 to encourage savings by offering savings accounts that have no administration fees and require initial deposits of just Rp10,000 (US\$1.1) at rural banks and Rp20,000 at commercial banks. Only BRI will be operating this scheme.
- Plans to shift supervisory authority over commercial banks to a newly established financial services agency remain on indefinite hold. The institution's launch has been repeatedly delayed since 2004, and the central bank is likely to remain the key banking regulator for the foreseeable future.
- Demand for microfinance services far outstrips supply throughout the country. Several large commercial banks besides BRI already offer microfinance services. These are becoming more expansion-minded and others are clearly poised to begin serving the sector.



## Mongolia

### Key characteristics of the microfinance business environment:

- Commercial banks are the primary providers of formal microfinance in Mongolia. These institutions are governed by banking laws and are regulated by the Bank of Mongolia (the central bank). There are only a handful of significant, regulated non-bank financial institutions (NBFIs), although some small-scale microfinance institutions (MFIs) operate outside of the law or on the basis of ad hoc agreements with the government.
- Mongolia has a relatively developed microfinance sector, with a high degree of outreach. However, two commercial banks (Khan Bank and XacBank) dominate the market.
- Banks are permitted to take deposits, but NBFIs are not.
- Partly owing to the influence of foreign investors, accounting and governance standards in the leading MFIs tend to be higher than the average for Mongolia's financial sector. However, many NBFIs and savings and credit co-operatives (SACCOs) lack management experience and do not follow international management practices.
- Mobile banking services (m-banking) exist and are used by both Khan Bank and XacBank, and licensed NBFIs can also offer these services. However, there is no legal framework for overseeing agencies involved in m-banking.

### Key changes and impacts since last year:

- A private credit bureau was legally incorporated in Mongolia in 2009 and preparations for full operation are underway. It has 18 shareholders, including Khan Bank and XacBank.
- The Financial Regulatory Commission is now inspecting non-deposit-taking lenders, insurance companies and SACCOs on a regular basis. However, lack of transparency remains a problem.
- The non-bank SACCOs experienced a serious downturn in 2008 when global commodity prices fell sharply in response to the international financial crisis. Two mid-sized banks have since gone into receivership—although the country's top banks (which account for the majority of financial system assets) look more stable.

## Nepal

### Key characteristics of the microfinance business environment:

- The main formal providers are upscaled non-governmental organisations (NGOs) and regional rural development banks (RRDBs); as of April 2010 there were 18 of these institutions in operation.
- RRDBs were formerly state-run, but four out of five are now privately owned. The largest government player is the Agricultural Development Bank, which provides wholesale funds to related standalone co-operatives (Small Farmer Co-operatives).
- Private-sector institutions that were created by greenfield or upscaled NGOs are officially classified as microcredit development banks (MCDBs).
- Public and private institutions are regulated identically. Although there are no interest rate



restrictions in Nepal, the role of government institutions has kept lending rates unsustainably low, at 18-25%.

- As of April 2010, 45 financial intermediary NGOs (FINGOs) were in operation and are currently registered with the Nepal Rastra Bank (NRB, the central bank). FINGOs and MCDBs can take deposits from their members. FINGOs also have a limited banking licence, which allows them to borrow from commercial banks for client-lending purposes. These borrowings usually fall under the mandatory deprived-sector lending portfolio of commercial banks.
- Savings and credit co-operatives (SACCOs) are key microfinance providers; several thousand are estimated to exist, of which only 16 have a limited banking licence from the NRB. As of June 2009, 639 SACCOs were members of the Nepal Federation of Savings and Credit Co-operatives, covering 325,000 clients.
- Mobile banking is non-existent in Nepal at present. A handful of pilot projects have been implemented and more banks have plans to start them. This is not, however, a priority for mobile service providers, and there is no regulatory framework for this kind of service in the financial sector or within microfinance specifically.

#### **Key changes and impacts since last year:**

- Based on a central bank directive issued in August 2009, several banks and financial services providers have applied to open microfinance institutions (MFIs) as subsidiary companies.
- In March 2010 the NRB opened the door for MCDBs to collect voluntary deposits from the public (in addition to their members). This was meant to address resource constraints and competitive pressures facing independent MFIs now that banks and other financial institutions can invest in their own subsidiary MFIs following the 2009 directive.
- The country is developing its first microfinance law. Currently, a draft of the Microfinance Act includes plans to establish a separate regulatory organisation to supervise microfinance development banks and financial intermediary NGOs. Ongoing political instability, however, threatens the promulgation of the Act.

## **Pakistan**

#### **Key characteristics of the microfinance business environment:**

- All microfinance providers are required to register either with the Security and Exchange Commission of Pakistan (SECP), the State Bank of Pakistan (SBP, the central bank), or their respective provincial authority. The SBP's supervisory capacity is considered strong.
- In 2005 the SBP issued guidelines permitting non-governmental organisation-microfinance institutions (NGO-MFIs), rural support programmes (RSPs) and co-operatives to transform into formal microfinance banks (MFBs). Specialised MFBs are the most important service providers in Pakistan. Five are active at a national level and two are active at the district level. Microfinance banks face the same prudential regulations as commercial banks and can offer the same range of services to their clients.





- Provincial government-backed financial institutions, such as the Bank of Khyber, and institutions that were launched with an endowment from the government, such as the National Rural Support Programme (NRSP), do not distort the market.
- At the end of 2009 there were 2.35m micro-savers in the country, more than the number of borrowers (1.8m). However, many of those savers are part of borrower groups who are required to save to receive a loan. In fact, 56% of the savers as a whole are members of the NRSP. The number of voluntary micro-savers at MFBs numbered only 450,000 at the end of 2009.
- The range of products offered by MFBs remains focused on credit, based on group-lending methodologies. Micro-insurance has begun to move beyond the traditional credit-life product offering to health and hospitalisation insurance, as in the case of the NSRP. At the end of 2009 there were 3.3m micro-insurance policy holders in Pakistan, nearly double the number of borrowers.

#### **Key changes and impacts since last year:**

- In 2009 the central bank issued a number of new rules supporting microfinance banks (MFBs), such as lifting regulations that prevented them from accepting foreign currency loans from international investors. The limits on borrowers' annual income were revised upward from PRs150,000 (US\$1,780) to PRs300,000 for general loans, and PRs600,000 for housing loans. Also, the loan classification criteria for MFBs were aligned with international best practice and industry norms.
- The Pakistan Microfinance Network (PMN), a sector association with 26 MFI members, plans to set up a credit bureau. The bureau will be pilot-tested in the most populous district, Lahore, before being rolled out nationwide in 2011.
- Islamic banking is expected to come to Pakistan's microfinance sector in 2010 with the opening of an Islamic branch by the NGO-MFI, Asaha. Once the branch opens, Asaha plans on converting 27 existing branches into a Sharia-compliant network.

## **Philippines**

#### **Key characteristics of the microfinance business environment:**

- Since the adoption of a National Strategy for Microfinance in 1997, the government has promoted a regulatory and policy framework that is conducive to microfinance activity. The government has encouraged the establishment of microfinance banks (MFBs) and the commercialisation of the microfinance sector, and has specifically promoted the upgrading of non-governmental organisations (NGOs).
- Downscaling is also legal and fairly straightforward. However, commercial banks have withdrawn the few attempts made to provide retail microfinance services, preferring to act as wholesale funders to the sector instead.
- There are no regulatory restrictions on the ability of microfinance institutions (MFIs), whether banks or NGO-MFIs, to accept debt investment from international investors in foreign currency. However, rural banks are prevented from taking foreign equity investments.
- The Bangko Sentral ng Pilipinas (BSP, the central bank) requires all regulated MFIs to disclose



effective interest rates and to be audited by an external auditor. However, NGO-MFIs, which are among the largest providers in the country, are unregulated and thus not obligated to disclose information under these provisions.

- Although still very much credit-oriented, MFIs in the Philippines are able to offer a variety of services, and many do. Regulated MFIs can accept deposits, and those linked to the international payments system can accept remittances.
- Clients in the Philippines have a wide choice of service providers, including local and national institutions. There are a relatively small number of national microfinance providers and many smaller local ones. The top ten service providers account for just over half of all loans outstanding in the sector and 66% of all clients.

#### **Key changes and impacts since last year:**

- In 2010 BSP began allowing rural, co-operative, and thrift banks to sell authorised micro-insurance products. These institutions can be licensed as micro-insurance agents, and can only sell policies up to Php190,000 (around US\$4,000) under certain provisions.
- In April 2010 the BSP issued a circular that set the rules for accrediting microfinance rating agencies, a move seen as encouraging local MFIs to be rated. Until recently, it was rare for microfinance banks (MFBs), rural banks, or thrift banks with microfinance operations to become externally rated.
- In 2010 BSP issued rules on the extension of housing microfinance and eased requirements for micro-lending in agriculture.
- The Credit Information System Act signed into law in September 2008 requires all regulated entities to submit positive and negative information to a new credit bureau under the Securities and Exchange Commission (SEC). However, the establishment of the Central Credit Information Corporation (CCIC) has not yet resulted in the operation of a functioning, active credit bureau, despite the fact that implementing rules and regulations (IRR) were approved in May 2009. According to local press, operations are now expected to begin in the third quarter of 2010.
- In 2009 the Bank of the Philippine Islands and one of the two main mobile telephone service providers, Globe, formed a joint venture to launch mobile-oriented retail microfinance.

## **Sri Lanka**

#### **Key characteristics of the microfinance business environment:**

- There is no specific regulation governing the microfinance sector, which has led to a variety of different regulatory regimes and the lack of a level playing field between microfinance institutions (MFIs). As a result, many non-governmental organisations (NGOs) operate in what amount to regulatory “black holes”.
- The regulated microfinance sector consists of rural development banks (RDBs) and similar specialist banks; the Samurdhi Bank Societies (SBSs), co-operative rural banks (CRBs); the thrift and credit co-operative societies (TCCSs) of the SANASA network; NGO-MFIs; and other financial entities, including commercial banks and finance companies.



- Interest rates are not circumscribed by regulation, but the market is heavily distorted by a high level of state-led intervention. The government often regards microfinance services as a welfare issue, and sometimes applies political pressure to give free loans or cap interest rates. Some MFIs themselves place greater focus on social welfare activities, leading to conflicts of interest that impede the commercialisation of microcredit.
- Many MFIs offer broad product portfolios that generally consist of loans differing in name and tenure. Licensed and specialised banks mobilise deposits, while NGO-MFIs impose compulsory savings requirements on their loans. Government suspicions about the risks of MFIs expanding into new services impede the diversification of the sector.
- Financial institutions that lend to MFIs and to microfinance clients consider their clients a homogeneous demographic. This is not the case, however, and inadvertently directs services toward institutions and clients with incomes well above the poverty line.

**Key changes and impacts since last year:**

- The North and East of the island, which include some of the island's poorest regions, provide an opportunity for the expansion of microfinance services.
- The National Development Trust Fund (NDTF) in 2009 imposed a cap of 15% on interest rates for on-lending of its funds. At such a low rate, there is little commercial incentive for banks to expand into microcredit.
- The electoral season in early 2010 (when presidential and parliamentary elections were held) may have exerted pressure on MFIs to write off and extend loans at unprofitable rates. This has not been confirmed, however.
- NGO-MFIs are having a harder time obtaining capital, as donor funds associated with the 2004 Indian Ocean tsunami recovery effort are running out.
- In March 2010 plans were announced to introduce a Microfinance Act later in the year. No details have been confirmed, although early reports suggest that it will be substantially different than the previous draft of a similar name.
- In 2009 the government launched the Vadakkin Vasantham special loan scheme for the Northern province, which provides SLRs3bn (around US\$26m) to finance loans to micro-, small and medium-sized enterprises at a concessionary rate of 9%. The subsidised interest rate continues a government trend of using subsidised lending for welfare purposes, which crowds out commercial microfinance activity.



## ■ Thailand

### Key characteristics of the microfinance business environment:

- Microfinance in Thailand is generally a government-sponsored activity. Although there is a commitment to the provision of microloans through local “village funds”, this has stifled the development of private sector provision. The Bank of Thailand (BOT, the central bank) is keen on making changes, and has unveiled a plan affording opportunities to new and qualified microfinance service providers to enter the market.
- That said, the BOT has yet to prove that it has developed the specialised capacity to regulate or supervise microfinance institutions (MFIs).
- Under the Civil Procedure Code, an interest rate ceiling of 15% is in place for lending by unofficial financial institutions. In practice, lending rates by unofficial lenders are higher than this. The central bank has set a ceiling of 28% for combined interest and charges on all personal consumer and credit card loans; according to local commentators, this prevents some small-scale credit companies from offering microcredit. Other loans, such as corporate loans, are not subject to caps on interest rates
- Large state-owned specialised financial institutions dominate the microfinance market. Since competition is constrained by government players, there has been no adoption of international accounting standards.

### Key changes and impacts since last year:

- Under the Financial Sector Master Plan (FSMP) Phase II for 2010-14, which was unveiled in late 2009, the authorities intend to relax some regulations to allow new domestic or foreign microfinance providers to set up operations. The new plan will also permit commercial banks to establish affiliate companies to provide microfinance and tie up with other operations (such as co-operatives) to provide services. The BOT and Ministry of Finance intend to consider new licences on a case-by-case basis, subject to applicants’ qualifications and the guidelines set.
- Although the FSMP Phase II plan has been unveiled, the practical implications of the new regulations have not yet been detailed, and the stated plans have generally met with a negative response from existing microfinance providers.
- A state-owned specialised financial institution, the Bank for Agriculture and Agricultural Co-operatives (BAAC), is planning to launch a new Village Banking programme in 2010, with a loan fund of Bt3bn (US\$93m) and which will offer subsidised interest rates. The introduction of BAAC is expected to further limit competition from small-scale private institutions.



## Vietnam

### Key characteristics of the microfinance business environment:

- The microfinance sector in Vietnam is dominated by the Vietnam Bank for Social Policy (VBSP), which disburses heavily subsidized loans. There are other government programmes and institutions, which, along with VBSP, comprise around 90% of microcredit in the country.
- The few private semi-formal microfinance institutions (MFIs) that exist are geographically limited and mainly offer services to members of the “mass organisations” with which they are affiliated. The only sizeable semi-formal MFIs are Capital and Fund for Employment of the Poor (CEP, in Ho Chi Minh City), and Tao Yeu May (TYM, in Hanoi). Given their different locations, they do not compete with each other, although they both compete with the VBSP.
- The supervisory capacity of the State Bank of Vietnam (SBV, the central bank) for microfinance is considered weak. The SBV is thought to focus more on compliance than supervision of financial institutions, but the lack of progress in issuing licences to semi-formal MFIs is symptomatic of the central bank’s inability to adequately assess regulatory compliance.
- The range of services offered by MFIs is limited. Although loans are widely available, other services, such as risk-management products, are neglected. State-owned banks focus more on providing cheap credit than mobilising savings, while the semi-formal MFIs are not allowed to take voluntary deposits.
- Accounting and governance standards are generally poor. In the microfinance sector, state-owned providers follow Vietnamese Accounting Standards, which fall short of international best practice. The semi-formal MFIs have not adopted any international standards either, as they are prohibited from accepting foreign investment.

### Key changes and impacts since last year:

- Although new regulations have been introduced that provide a legal foundation to formalise MFIs and incorporate them into the financial system, the SBV is still in the process of finalising legislation that will guide regulatory implementation. The SBV has indicated that it will not be able to issue any licences until 2011 at the earliest. Until then, semi-formal MFIs will continue to face a host of operational difficulties, such as the inability to mobilise deposits and access foreign funds.
- In late 2009 the Asian Development Bank (ADB) and the Japan Fund for Poverty Reduction announced the provision of a US\$1.5m grant aimed at assisting the government in formalising the provision of microfinance by private institutions under the new regulatory environment. Staff at MFIs receiving support will receive training on compliance and international best practice.
- The SBV lifted restrictions on interest-rate setting for semi-formal MFIs effective March 2010. The cap on rates for loans was previously 150% of the base rate of the SBV.
- A new decree on credit information was enacted in February 2010, creating the legal framework for the establishment and operation of private credit bureaus (PCBs). Potential PCBs may become operational in 2011. A public registry exists, but is not available to MFIs.



## Eastern Europe and Central Asia

### Armenia

#### Key characteristics of the microfinance business environment:

- There is no law specific to microfinance institutions (MFIs), although a 2002 law on credit organisations defines several different types of non-banking financial institution (NBFI) under which microfinance providers can legally operate. Universal Credit Organisations (UCOs), a type of NBFI, have the largest share of the microfinance sector.
- Laws passed in 2005 and 2007 require a non-profit organisation wishing to partake in lending to register as a credit organisation by taking on the legal form of a limited liability company (LLC), a joint stock company (JSC) or a co-operative, and retaining 100% ownership.
- Only banks can offer a range of services beyond microcredit. Other MFIs are limited to microlending to individuals and groups for business development and consumption.
- Governance standards have markedly improved since the passage of the 2005 and 2007 laws on credit and financial institutions. Both laws increased the involvement of the Central Bank of Armenia in supervising MFIs. Previously, many were operating as foundations, and as such remained outside the scope of financial supervision. Also, the need for external funding has placed more pressure on MFIs to increase transparency and improve reporting standards.

#### Key changes and impacts since last year:

- Over the course of 2009 regulatory emphasis has been placed on consumer protection, consumer rights, and improving guidelines on existing prudential regulations. Armenia is one of the first countries in the region to start working on a comprehensive consumer protection framework, and has begun adopting measures to boost transparency.
- Recent proposed adjustments to consumer credit regulations aim to introduce the concept of calculating interest rates so that they are effective rather than nominal.
- Since the passage of a 2008 law, both listed and unlisted companies must report in a manner compliant with International Financial Reporting Standards (IFRS). A majority of MFIs follow IFRS after a January 2010 deadline that required all NBFIs (including UCOs, which make up much of the market) to adopt these standards.



## ■ Azerbaijan

### Key characteristics of the microfinance business environment:

- The microfinance sector in Azerbaijan has grown rapidly in recent years, but has been hampered until recently by a lack of legislation.
- Foreign non-governmental organisations (NGOs), some of which offer microfinance services, have been subject to increased regulatory harassment in recent years.
- Banks dominate the microfinance sector. The largest, Access Bank, held almost 40% of the total microcredit loan stock in early 2010.

### Key changes and impacts since last year:

- The passage of a new law on non-bank credit institutions (NBCIs) in late 2009 will go a long way toward clarifying the legal and regulatory regime for microfinance.
- Expansion in the microfinance sector slowed in 2009 as the market became saturated and microfinance institutions (MFIs) concentrated on portfolio quality and risk management, in light of the global financial crisis.
- In early 2010 the public credit registry began collecting information from MFIs and providing them with access to its database. This is likely to increase loan quality over time, although the credit bureau currently covers only 7% of the adult population.

## ■ Bosnia

### Key characteristics of the microfinance business environment:

- The country has a mature microfinance sector, with high levels of penetration and many players.
- The regulatory environment is divided as a result of the different microfinance regulations in the Republika Srpska and Bosnia. Bosnian microfinance institutions (MFIs) are generally classified as non-governmental organisations (NGOs). At the same time banks such as ProCredit Bank are very active in microfinance.
- Supervision is quite strong on paper, but capacity and enforcement do not yet match regulatory intent.
- Some commentators say a substantial share of microfinance loans in the past were used to finance consumption, rather than business development, and over-indebtedness has become a key issue that microfinance institutions must address.
- Remittances play an important role in servicing existing debts.

### Key changes and impacts since last year:

- An increase in portfolio at risk (PAR) is the main issue facing the sector.
- Obtaining funds is becoming more difficult, although liquidity remains at reasonable levels.
- Growth in new loans has been slowed by the credit crisis, and regulatory oversight has intensified.
- MFIs are experiencing a negative return on assets, having previously been among the most profitable



in the region

- A pilot project is underway in Tuzla, financed by the British Department for International Development (DFID), that seeks to educate people about financial management and the risks of indebtedness. Known as the Client Debt Advice Centre, this new institution could help to mediate between creditors and debtors.

## Georgia

### **Key characteristics of the microfinance business environment:**

- Georgia's commercial banking law does not specifically limit microcredit, but provisions on uncollateralised lending are generally very stringent. Microfinance organisations (MFOs) are prohibited from accepting deposits.
- A law specific to microfinance was passed in 2006, although it makes no provision for deposit-taking. In accordance with the law, organisations can register with the National Bank of Georgia (the central bank) to become MFOs. There is no interest rate ceiling, and the maximum amount extended by an MFO to one borrower as a microloan cannot exceed Lari50,000 (US\$27,000), which is well above the average loan size.
- According to a joint MIX Market-CGAP study, MFOs lend to around half of the total borrowers in the Georgian microfinance market. Specialised microfinance banks follow MFOs in terms of number of borrowers, but have almost triple the loan portfolio.
- Supervision by the central bank is adequate and regulators understand the sector well. The central bank requires reporting through monthly financial statements.

### **Key changes and impacts since last year:**

- Growth in microcredit loans expanded at a double-digit pace in 2009. Microfinance institutions (MFIs) increased their regional reach and began to move into remote areas.
- Georgian regulators continued to mitigate financial risks in the economy, and MFIs have been pressured to increase their loan-loss provisions.
- Nonetheless, MFIs accounted for less than 5% of total banking assets in 2009 and are not considered a systemic risk. Traditional banks continue to dominate the financial sector and are the main focus of financial regulation.
- MFIs are gradually adding new services. Credo, a leading MFO, launched a pilot life insurance product and a range of money payment systems throughout 2009. In February 2010 Bank Constanta added a fund remittance system to its roster of services.





## ■ Kyrgyz Republic

### Key characteristics of the microfinance business environment:

- The country is home to a large number of microfinance institutions (MFIs)—more than 350 in 2009—which suggests a highly competitive environment. However, many of these are small and localised in their operations.
- The Kyrgyz Republic is considered to be a regional leader in microfinance regulation. It passed a law on MFIs in 2002 that permitted a tiered range of MFIs with varying regulatory and supervisory requirements.
- In view of the low entry barriers, many small MFIs are poorly managed.
- The limited number of MFIs that can take deposits restricts their ability to upgrade.

### Key changes and impacts since last year:

- As in all countries in the region, credit growth slowed sharply in 2009 in response to the global financial crisis and funding constraints.
- The total loan portfolio has continued to grow, but there are reports of a reduction in the customer base as MFIs concentrate on credit quality to reduce loan losses.
- Increasing political authoritarianism led to concerns about the independence of the National Bank of the Kyrgyz Republic (the central bank), which regulates MFIs. However, after the recent ouster of the previous president, the trend towards political authoritarianism may change. Amendments to the country's microfinance law that had not been signed by the previous president are currently being discussed with the new interim government.
- The entry into the market of a new state-funded MFI—the AUB-AGRO Microcredit Company, which plans to lend US\$22.5m to the agricultural sector in 2010—may undermine some existing MFIs.

## ■ Tajikistan

### Key characteristics of the microfinance business environment:

- There are around 120 microfinance institutions (MFIs) in Tajikistan, about one-quarter of which can take deposits. However, most of them are small and lack the capacity to expand their credit portfolios significantly, which means that demand for microcredit still outweighs supply.
- Despite the high number of MFIs, the microfinance market is dominated by banks, with the four largest banks holding around 90% of the loan portfolio market share.
- MFIs have found it difficult to secure licences to accept deposits. However, the National Bank of Tajikistan (the central bank) is apparently becoming more willing to issue these licences.

### Key changes and impacts since last year:

- The total loan portfolio has continued to grow, but there has been a drop in loan quality as remittance inflows from relatives working in Russia fell during the global recession in 2009. Commentators report a drop in the number of customers served, suggesting that MFIs are concentrating on improving credit quality.



- A functioning private sector credit bureau is expected to be in place by the end of 2010, following passage of legislation a year earlier.
- Legislative amendments in 2009 increased disclosure requirements in cases of conflicts of interest, and increased director liability and shareholders rights, which will improve standards of transparency within the sector.

## ■ Turkey

### **Key characteristics of the microfinance business environment:**

- Microfinance remains under-represented within the financial sector, with a large number of unserved clients, especially in rural areas of Eastern Anatolia.
- As a middle-income country, Turkey has an advanced banking sector, which reduces the need for microfinance.
- The percentage of loan recovery is very high. The Turkish Grameen Microcredit Programme (TGMP), one of the two largest microfinance players (the other being Maya Bank), claims loan recovery levels of 100%. Portfolio-at-risk (PAR) levels are very low.
- Basic loans are the most common form of microfinance; these usually start at US\$75.
- Lending to individual clients dominates; lending to groups is much less common.

### **Key changes and impacts since last year:**

- Authorities are now looking at the microfinance sector more seriously.
- Several large private banks are launching or are about to launch microcredit products (including HSBC and Sekerbank).
- TGMP has expanded its geographic reach, covering most of Eastern and Central Turkey, including cities in the West, such as Bursa. TGMP has 32 branches around the country, with more than 10,000 customers.
- Awareness of microfinance is improving, but remains at a low level.



## Latin America and the Caribbean

### ■ Argentina

#### **Key characteristics of the microfinance business environment:**

- The microfinance sector in Argentina is small. It is composed mainly of second-tier public institutions, non-prudentially regulated entities (such as Sociedades Anónimas (SAs) that are associated with banks) and non-governmental organisations (NGOs).
- Interest rates are not regulated directly, but microfinance institutions (MFIs) must apply administratively determined rates when lending government funds. They also face competition from subsidised, first-tier public lending.
- Sector supervision is weak and the legal and regulatory environment is underdeveloped. As a result, standards of accountancy and governance remain poor.

#### **Key changes and impacts since last year:**

- The December 2008 Central Bank circular on microfinance, which allows banks to grant microfinance directly (rather than through SAs), is beginning to have a positive impact on the sector, and banks are steadily increasing their presence.
- Two co-operatives were created in 2009, the first to open under a 2007 law pertaining to such financial organisations. Their full market presence and role is still being established.
- Modest efforts by the Superintendency to begin regulating microfinance have been impeded by continued fragmentation of policy across several government institutions, as well as by the growing politicisation of the Banco Central de la República Argentina (the central bank, under which the Superintendency lies).



## Bolivia

### Key characteristics of the microfinance business environment:

- Bolivia maintains a strong and favourable microfinance regulatory environment, notwithstanding the loss of important personnel following the creation of the Autoridad de Supervisión del Sistema Financiero (ASFI, Financial System Supervisory Authority), some loss in its autonomy vis-à-vis its predecessor agency, and uncertainty about the effects of bringing non-governmental organisations (NGOs) and closed co-operatives under regulation.
- The depth and range of microfinance services continues to grow impressively, as market competition remains strong.
- NGOs offer a wide variety of services and practice good governance and transparency, but their accounting standards remain below international norms.

### Key changes and impacts since last year:

- The availability of cheap commercial bank on-lending and relative insulation from the international financial crisis have meant improved profitability, falling interest rates, and continuing low rates of arrears and defaults.
- The process of upgrading into formal, regulated institutional status for NGOs and closed co-operatives, which are now regulated by the ASFI, is underway, with still-uncertain outcomes, timelines, and impacts.
- Consumer-protection regulation of fees and commissions continues to be strict, but no formal interest rate caps have materialised. Moreover, concessional on-lending has not led to concessional first-tier competition from public entities as had been feared.

## Brazil

### Key characteristics of the microfinance business environment:

- Although Brazil is making moves in the right direction, it still lacks a specific definition of microcredit that would distinguish it from other lending portfolios, and does not have clear upgrading pathways for non-regulated institutions.
- Most regulated institutions engaged in microfinance are banks and co-operatives, however few of these actually offer microcredit for productive use as this market segment is generally served by non-regulated institutions.
- Co-operatives are growing faster than the financial system as a whole, but a lack of distinction in their portfolios between microfinance, consumer finance, small business lending, and other forms of credit makes it difficult to know if microcredit is growing.
- Competition from the state and interest-rate caps for loans that use public funding continue to be obstacles.
- The regulatory capacity of the Banco Central do Brasil (BCB, the central bank) continues to expand modestly in terms of staff training and co-ordination, but the required level of microfinance specialisation is still limited.



### **Key changes and impacts since last year:**

- The BCB's supervision of, and the transparency of, co-operative governance were strengthened by an April 2009 law that expanded the terms of banks' fiscal commissions and gave a fiscal oversight role to co-operative federations for the first time, including calling member assemblies when problems arise.
- The federal government has adopted "financial inclusion" as a strategic priority for the BCB and government as a whole, and the level of training in microfinance and the degree of interdepartmental co-ordination among Central Bank officials with such expertise has grown. These efforts come at a time when the current government is emphasising microfinance in its re-election campaign.
- Second-tier funding from various official sources that passes through the Banco Nacional de Desenvolvimento Econômico e Social (BNDES, the national development bank) and the Labour Ministry continues to grow. The Serviço Brasileiro de Apoio às Micro e Pequenas Empresas (SEBRAE, the agency that promotes small business), has recently opened a microfinance department to provide second-tier lending.

## **Chile**

### **Key characteristics of the microfinance business environment:**

- The banking Superintendency does not treat microfinance as a separate activity with different rules, and does not have significant specialised knowledge of the sector.
- While non-governmental organisations enjoy certain fiscal advantages compared with regulated microfinance institutions and do not face interest rate restrictions, they lack the capital and expertise to upgrade to regulated status, and do not have strong incentives to do so. As a result, they mostly remain small in size.
- Governance and accounting standards are above average; transparency has room for improvement.

### **Key changes and impacts since last year:**

- Commercial and state-owned banks are steadily increasing their presence in the microfinance sector through the opening of microfinance units.
- A legislative proposal is pending that would allow for publication of disaggregated credit history, by both the public and private bureaus.
- It is not clear that the change of governments and parties will make any significant difference in microfinance regulation.



## Colombia

### Key characteristics of the microfinance business environment:

- The microfinance regulatory framework is still only modestly developed. Interest rates remain strictly regulated and microfinance is still treated like traditional banking in many ways. Technologies and methods typically used in consumer-based commercial lending have been applied to microfinance.
- The quality of credit bureaus and governance standards are areas of relative strength, although issues of over-indebtedness and client default have been common during the past two years.
- Microfinance institutions need to improve their accounting standards and levels of transparency.

### Key changes and impacts since last year:

- The government has not readjusted the micro-lending interest rate since 2007, despite provisions requiring annual review. An adjustment would seem to be overdue, and some microfinance players find the interest rate (and the usury cap) restrictive.
- Apparent gains in regulatory capacity for microfinance have proved ephemeral in the face of continuing turnover in leadership and technical staff in the Superintendency. This is reflected by a failure to ensure that institutions are genuinely conducting microcredit, and that they apply best practice (such as home visits to assess creditworthiness and repayment).
- Banks and other financial services players continue to establish microfinance units, and some non-governmental organisations seek to upgrade to finance companies.

## Costa Rica

### Key characteristics of the microfinance business environment:

- Although there are no meaningful interest rate restrictions, first-tier state programmes offer subsidised competition for microfinance institutions (MFIs).
- Non-governmental organisations (NGOs) tend to be small and undercapitalised (except the two largest), and they lack access to international assistance.
- NGOs lack suitable public second-tier funding (although talks are currently underway that would allow greater access to funds as the 2008 Development Banking Law is implemented). Furthermore, NGOs are subject to the same taxes as regulated institutions.
- Accounting, governance, and transparency standards are reasonably well developed and observed.

### Key changes and impacts since last year:

- Low microfinance default rates have led some banks recently to downscale and expand their market presence.
- Credit bureau coverage, for both private bureaus and the public registry, continues to grow, although the quality of information remains uneven.
- Although the 2008 Development Banking Law gives the Superintendency the authority to supervise and regulate microfinance, it has so far shown little interest in exercising these powers.



## ■ Dominican Republic

### Key characteristics of the microfinance business environment:

- The lack of a specific, comprehensive regulatory framework for microfinance continues to be an obstacle.
- The quality of general financial supervision and oversight continues to be better than for microfinance specifically.
- Institutional development, as measured by governance, accounting, and transparency, is uneven, particularly between regulated and non-regulated institutions.
- The quality and coverage of credit information for microfinance transactions is one of the country's strengths.

### Key changes and impacts since last year:

- A new company law has improved corporate governance, with apparent, but still unconfirmed, benefits for regulated microfinance.
- A December 2008 law—still awaiting implementation as of June 2010—would require 90% of microfinance lending by the Consejo Nacional de Promoción y Apoyo a la Micro, Pequeña y Mediana Empresa (PROMIPYME, a public institution that engages in non-collateralised, unregulated lending to “microenterprises” and “subsistence microenterprises”) to be first-tier in nature. This could strain the institution's capacity, and if sole representation on its governing council is given to the Council of Small and Medium-Sized Enterprises, could exclude and negatively impact the activities of unregulated institutions.
- Competition continues to be distorted through government subsidies for first-tier lending, the use of political criteria in first- and second-tier loans, and caps on interest rates for on-lending.
- Commercial banks have begun moving more aggressively into microcredit, increasingly competing with established regulated and non-regulated microfinance institutions.

## ■ Ecuador

### Key characteristics of the microfinance business environment:

- The constitution of 2008 mandates the formation of separate superintendencies for the public, private, and “social” financial systems, but until such time as implementing regulations are enacted, the previous system, with its single superintendency, remains in force, creating regulatory uncertainty.
- Interest rate restrictions have been tightened in recent years, with commissions outlawed and caps set that pose a significant obstacle to microfinance institutions in terms of covering operating costs. Several public programmes with high subsidies and non-market social criteria distort competition by re-shaping borrower expectations.
- A significant number of specialised microfinance institutions continue to exist among all the major formal categories (that is, banks, finance companies, credit unions).



### **Key changes and impacts since last year:**

- Non-governmental organisations face problems in terms of scale and capitalisation. There are also increasing difficulties in competing with banks and regulated institutions, as well as with public first-tier lenders, especially under current interest rate restrictions. The tax burden has also increased since 2009.
- A decline in the size of microfinance portfolios and in the rates of financial inclusion are evident; co-operatives are the fastest-growing segment of a shrinking overall market.
- Under a new co-operatives law passed in late 2009, any co-operative that takes deposits, whatever its size, is considered to practise financial intermediation, and therefore is subject to prudential regulation. (Around 50 are currently in this category). The law does not, however, treat them exactly the same as banks, increasing their ability to operate in more leveraged fashion. Co-operatives not taking deposits remain supervised, but not prudentially regulated, by the Ministry of Social Welfare.

## **El Salvador**

### **Key characteristics of the microfinance business environment:**

- While supervisory and examination capacity are moderate, the absence of negative government interference has facilitated a fairly dynamic microfinance sector.
- Credit bureau coverage of micro-lending transactions is a relative strength.
- Accounting, governance, and transparency standards of microfinance institutions remain modest.

### **Key changes and impacts since last year:**

- Private credit bureau coverage continues to expand and has become near-universal, yet the quality and sharing of data remain problematic.
- Broadly, there were no major changes in regulations (despite a new superintendent) and few changes in the microfinance business environment.
- There are now three private credit bureaus, one of which is specialised in microfinance, a second that has expanded into that area and a third, newly created one. They provide both positive and negative information, although information-sharing across the divide of regulated and non-regulated institutions is not good. There is also a public registry operated by the Superintendency, although it tends not to cover transactions by and with small and micro-businesses, and non-regulated institutions do not have access to it.





## Guatemala

### Key characteristics of the microfinance business environment:

- The regulatory framework remains limited and static, given the failure to pass a new microfinance law that has been under discussion for most of the past decade. Regulatory capacity and interest in microfinance on the part of the Superintendency is limited.
- Commercial banks continue to expand aggressively into microfinance. Some non-governmental organisation-microfinance institutions (NGO-MFIs) have grown, while others have seen their portfolios shrink.
- Although transparency standards remain fair, accounting and governance are weak.

### Key changes and impacts since last year:

- Banrural, a minority state-owned bank, has an important market presence. There is a widely held view among competitors that the bank benefits from subsidies, although strong evidence to support this is lacking, in part owing to low transparency surrounding its operations and the economy of scale benefits that it enjoys. This makes it difficult to assess the stand-alone profitability of its microfinance operations.
- NGOs' tax liabilities and access to second-tier funding have been especially problematic. Some stakeholders believe NGOs face significant restrictions when offering microfinance.
- Credit bureau coverage and the quality of information continue to improve, although the country's performance is still only modest in this area, given the weak integration of data across bureaus and the lack of effective regulation of credit bureaus.

## Haiti

### Key characteristics of the microfinance business environment:

- Microfinance regulation is weak, and specialised supervisory capacity sorely lacking. However, the government does not interfere with interest rate setting or sponsor first-tier programmes that compete with microfinance institutions (MFIs).
- Accounting practices remain distant from international standards and governance standards are poor. Transparency is rated average.

### Key changes and impacts since last year:

- MFI networks estimate that their member institutions' portfolios have been put at risk by the recent earthquake. The human and financial toll on MFI clients, and on MFIs themselves, has been huge.
- One focus of reconstruction efforts is establishing a guarantee fund that—in the words of the government's March 2010 Action Plan—would enable banks to lend for “productive investments and not to guarantee or write off doubtful credit as a result of the earthquake or other economic dangers”.
- The role of microfinance in recovery is addressed in four points proposed by the government: a guarantee fund; grants; recapitalisation of MFIs; and insurance for long-term risks to MFIs from



natural disasters and other shocks. How these priorities are addressed, and what level of funding commitments they receive from donors, will be decisive in determining the recovery role of MFIs and the sustainability of these institutions.

## Honduras

### Key characteristics of the microfinance business environment:

- The regulatory framework for microfinance is partially developed, and includes a definition of the activity and one type of specialised institution. Pathways to upgrade into specialised or regulated institutional forms are still underdeveloped.
- There is a fairly broad range of institutional types in the microfinance sector, both among regulated institutions and across the regulated/non-regulated divide.
- There is ample room for improvement in the governance, accounting, and transparency standards of microfinance institutions.

### Key changes and impacts since last year:

- In the context of a change of government and a contested interim government, there were few major changes in microfinance regulation.
- A manual for microfinance supervision was prepared under the previous government, and could be a step forward. But turnover among technical staff following the recent political conflict makes implementation uncertain.
- Organismos Privados de Desarrollo Financiero (OPDFs, private financial development organisations) are non-bank financial institutions that were created as regulated microfinance vehicles, particularly intended for upscaling non-governmental organisations. Not as many have been created as was initially hoped, however. As of November 2009 there were five OPDFs, three of which began operations in 2008.

## Jamaica

### Key characteristics of the microfinance business environment:

- There is no clear microfinance regulatory framework. The Bank of Jamaica (the central bank) has little supervisory capacity, and very few institutions operate in the sector.
- A small number of non-regulated non-governmental organisations comprise the bulk of the sector, along with credit unions, which have only recently come under regulatory scrutiny.
- Standards of transparency and governance among institutions active in microfinance are poor.

### Key changes and impacts since last year:

- Jamaica's first regulated credit unions will reportedly begin operation by the third quarter of 2010, although enabling legislation is still not in place.



- Improved financial sector supervision has strengthened oversight of regulated institutions that offer financial services on a more general level. A supervisory framework for credit unions is still being established and is expected to be more fully in place by late 2010.
- A private credit bureau has been in the process of forming since 2006. Operations are expected to begin by mid-2010.

## **Mexico**

### **Key characteristics of the microfinance business environment:**

- Supervisory and examination capacity remain limited for microfinance institutions (MFIs). Despite recent legislation targeting savings and credit organisations, Mexico still lacks clearly defined microfinance regulation.
- Transparency remains an issue, and the federal government lacks the capacity to enforce accountability measures. Non-governmental organisations (NGOs) are self-regulating and follow various standards.
- Like banks, savings and loan co-operatives and Sociedades Financieras Populares (SOFIPOS, for-profit popular financial partnerships) are allowed to accept deposits. Non-regulated institutions, such as NGOs, cannot capture savings in any form.
- There is a private credit bureau that works with larger MFIs; smaller MFIs rely on their own joint bureau, *Círculo de Crédito*. Many MFIs are reluctant to report information on their clients and such reporting is not legally required, although second-tier funders make it a condition of on-lending. The quality of credit information is much better in central than in southern Mexico (the two regions where MFIs operate most frequently).

### **Key changes and impacts since last year:**

- A 2009 modification of a law on savings and credit aimed to create separate regulatory standards and guidelines for co-operatives and SOFIPOS. About 800 co-operatives submitted the required paperwork by the February 2010 deadline. Specific reforms and further deadlines were not defined for however, leaving them in a regulatory limbo.
- A 2006 decree required that Sociedades Financieras de Objeto Limitado (SOFOLEs, financial companies with limited corporate purposes) be converted to Sociedades Financieras con Objetos Múltiples (SOFOMEs, financial companies with multiple corporate purposes that can either be regulated or unregulated) by 2013. Credit unions and leasing companies have also been converting to SOFOME status.
- In addition to its requirements on co-operatives and SOFIPOS, new legislation in 2009 introduced two new institutional forms, Sociedades Financieras Comunitarias (SOFINCO, community finance companies) and Organismos de Integración Financiera Rural (OIFR, Rural Financial Integration Institutions). These are intended to promote, respectively, the integration of existing rural institution operations and the provision of financial services.



## Nicaragua

### Key characteristics of the microfinance business environment:

- Microfinance institutions have expanded rapidly in Nicaragua in recent years. The lack of interest from the main banks in financing small producers has created a large, unmet demand for rural credit facilities.
- The absence of an adequate legal framework for microfinance continues to make it difficult for the industry to flourish, as most institutions remain unregulated.
- A powerful debtors' movement called the Movimiento No Pago (the Non-Payment Movement) has garnered strong political support in the executive branch and in the legislature, re-shaping both public policy and the attitudes of borrowers in ways that undermine microfinance. A resulting debt moratorium will now drastically reduce the extension of credit to new clients as microfinance institutions see their portfolio risk rise and their funding (which is mainly external) suspended or withheld.
- The microfinance sector is competitive but highly fragmented, with a limited range of available services. Transparency and accounting standards are reasonably good, but governance standards are poor.

### Key changes and impacts since last year:

- The new moratorium law for microfinance debtors further threatens an already reeling microfinance sector—particularly its non-regulated non-governmental organisation (NGO) segment—given artificially low caps on restructuring agreements. The moratorium also creates a moral-hazard effect on the larger borrowing community.
- Hopes for revisions in the existing microfinance law have been dashed in the wake of economic crisis and the debtors' movement. Also dashed are the hopes of NGOs that they would obtain a clear path to becoming regulated financial institutions capable of capturing deposits.
- NGOs are particularly affected by the decline in international funding that began in 2009 and continues in 2010, owing to the debt moratorium. Between US\$60m and US\$90m of international funding lines were not renewed last year, and another US\$70m was at risk as of June 2010.
- Serious governance problems have come to light in some non-regulated microfinance institutions, and the sector in general has suffered under the weight of mounting arrears and defaults.
- Along with other micro-finance lenders, a commercial bank specialising in micro-lending, Banco del Exito (Banex), has been undermined by a combination of the global economic downturn and the impact of the Movimiento No Pago. In late May the institution announced that a group of international creditors had agreed to accept shares in the bank in lieu of repayment of outstanding loans, as Banex owed a total of US\$85m to 28 different creditors in March. The proportion of its loans that had fallen into arrears reached 25% of its total portfolio.



## Panama

### Key characteristics of the microfinance business environment:

- Panama lacks a compelling regulatory framework for microfinance, although the country has made some progress recently toward promoting microenterprise via banks and second-tier lending.
- The Superintendencia del Ministerio de Economía y Finanzas (the Superintendency of the Ministry of Economy and Finance) lacks specific procedures and clear definitions for microfinance. Microfinance institutions (MFIs) for the most part are treated the same as all other regulated financial institutions.
- A banking licence specific to microfinance would allow MFIs to upgrade to so-called special bank status, with lower minimum capital requirements. However, the documentation and requirements to upgrade are costly and burdensome; only a few MFIs operate in the sector and offer a limited range of products.

### Key changes and impacts since last year:

- Funding for microfinance institutions through second-tier government support is set to increase owing to a 2009 law and a 2008 decree. The latter seems to have led some commercial banks to venture into the sector, but only on a limited scale.
- The government now considers micro- and small-enterprises as banking clients if they receive credits for commercial purposes up to US\$200,000. This has opened a window for banks to give microloans.
- A long-established private credit bureau provides accurate, updated information that is both positive and negative, and at low cost. A uniform credit scoring system has been rolled out over the past year, and the bureau is used widely by a range of Panamanian institutions active in microfinance (banks, finance companies, co-operatives, and non-governmental organisations).

## Paraguay

### Key characteristics of the microfinance business environment:

- Non-regulated microfinance institutions do not face restrictive interest rate caps or significant competition from subsidised first-tier government lending.
- While accounting requirements are stricter for regulated MFIs than for unregulated ones, practices among both types of providers vary widely and generally fall short of international standards. Governance and transparency standards and practices are modest at best.
- The quality of information at credit bureaus continues to be a concern; it is neither well consolidated nor very detailed.

### Key changes and impacts since last year:

- Pathways to upgrade from a non-governmental organisation or credit co-operative to a finance company, and from a finance company to a bank, have become better defined. In recent years, it has become more common for finance companies to upgrade to bank status.
- As of June 2010 two institutions were in the process of upgrading their operations. These moves



reflect efforts by the Banking Superintendency to modify existing rules with the support of the Banco Central de Paraguay (the central bank).

- Separate pieces of legislation that would restrict the activities of credit bureaus and strengthen the rights of debtors are pending and may pose problems going forward.

## Peru

### **Key characteristics of the microfinance business environment:**

- The Superintendency of Banking, Insurance, and Pension Funds (SBS) is the principal regulator for the sector and enjoys a good reputation for the quality of its supervisory capacity. Regulations are in place for microfinance institutions (MFIs), such as loan-loss provisioning based on loan status (rather than institution type); increasingly thorough on-site inspection procedures; and stringent requirements for internal controls.
- Subsidised public retail financial institutions offer no direct competition, except the Cajas Municipales de Ahorro y Crédito (CMACs, municipal savings and loan banks, which operate according to market criteria). Under the current government, some institutions, such as Agrobanco, have offered concessional loan terms and interest rates, but these do not appear to have any significant distortionary impact.
- Entidades de Desarrollo para la Pequeña y Microempresa (EDPYMEs) were created as a specialised vehicle for microfinance and are regulated by the SBS. These non-deposit-taking institutions are often owned by non-governmental organisations (NGOs); the difficulty in raising capital, particularly through deposit-taking, has been the one weakness of this otherwise potent MFI vehicle. Upgrading to a finance company can allow institutions to offer a greater range of deposit-taking services and access capital markets more easily, although these institutions still fall short of being able to offer checking accounts, which is reserved for banks.

### **Key changes and impacts since last year:**

- The most notable changes to microfinance regulations in Peru occurred in 2008, when a June 2008 decree expanded the services of EDPYMEs by allowing them (along with CMACs and CRACs) greater access to capital markets. A few now offer insurance or fund transfers, although most remain limited to credit services.
- The June 2008 decree also outlines which activities EDPYMEs, CMACs, and Cajas Rurales de Ahorro y Crédito (CRACs, rural savings and loan banks) may undertake as a matter of course. Also, CMACs, which are constituted at the municipal level, can now operate in other departments and provinces. These changes reflect a high level of regulatory capacity and flexibility.
- As a result of the economic slowdown, banks' lending portfolios have deteriorated, despite low levels of non-performing loans. Nonetheless, banks are wary of lending to small and medium-sized enterprises and will continue to remain cautious until they build up their capacity to assess credit risks.



## ■ Trinidad and Tobago

### Key characteristics of the microfinance business environment:

- The country lacks a regulatory framework for microfinance, nor does it benefit from a superintendency with sector-specific supervisory and examination capacity.
- There are very few institutions engaged in microcredit, and virtually none engage in classic, non-collateralised microcredit.
- Institutions operating in microfinance suffer from significant deficiencies in accounting, transparency and, above all, governance standards.

### Key changes and impacts since last year:

- The implementation of regulations that would determine the conditions under which credit unions will become regulated entities is expected by the third quarter of 2010. However, it is doubtful that the newly regulated credit unions will be allowed to engage formally in microcredit.
- Reverberations from the 2009 collapse of the nation's largest financial conglomerate, CL Financial, have exposed serious weaknesses in financial regulation and corporate governance in the broader economy.
- In particular, the CL Financial debacle exposed weaknesses in the country's financial reporting standards. International accounting firms have also reported difficulties when trying to evaluate the finances of audited entities.

## ■ Uruguay

### Key characteristics of the microfinance business environment:

- The majority of microfinance institutions (MFIs) in the country are non-governmental organisations (NGOs), non-regulated co-operatives, or non-prudentially-regulated Sociedades Anónimas (SAs, non-bank financial institutions).
- Caps on interest rates for micro- and small-enterprise lending as a result of the country's usury law create distortions. First, the limits are calculated based on the average interest rate of the formally regulated financial system, which includes the interest rates of the Banco de la República Oriental del Uruguay (BROU), a public bank. Moreover, interest rates for consumption loans are higher than those for productive loans, creating an incentive system that favours consumer lending over loans to micro-enterprises.
- It is virtually impossible for NGOs to accumulate capital and a large enough client base to upgrade into an SA, although making the transition would provide NGOs with greater access to capital markets. Only a few have taken this route, but most have a strong social orientation and are not interested in becoming for-profit institutions.
- Uruguay's public registry remains effectively closed to non-regulated institutions. Since most MFIs are non-regulated (except for SAs with regulated parent banks), this means much of the microfinance sector lacks credit bureau access.



### Key changes and impacts since last year:

- In 2008 the BROU announced the creation of República Microfinanzas, a separate non-bank entity specialising in microfinance. Competing MFIs are concerned that República Microfinanzas, once it is operational, will crowd out the market through subsidised interest rates, though so far it seems inclined to keep interest rates at market levels.
- Through an initiative called Programa de Microfinanzas para el Desarrollo Productivo (the Program for Productive Development through Microfinance), the Banco Central de Uruguay (the central bank) is revisiting provisions that limit interest rates under the usury law and the definition of microcredit.
- SAs formally report to the Auditoria Interna de la Nación (AIN, the National Internal Comptroller), which is part of the Ministry of Education and Culture. The AIN has recently strengthened its oversight and enforcement activities for non-regulated co-operatives and NGOs.

## Venezuela

### Key characteristics of the microfinance business environment:

- Government distortion of the competitive environment through interest rate restrictions and subsidised public institutions continues.
- Microfinance suffers amid a deteriorating overall macroeconomic and regulatory environment that affects finance in general. This includes increases in arrears; declines in government consumption subsidies that hurt the poor; bank nationalisations and seizures; and moves to extend state control over the banking system and the bank regulator.
- There is no clear definition of microfinance, nor are there specific supervision and risk-management provisions that would permit a distinction between microfinance, consumption, and small business lending.

### Key changes and impacts since last year:

- Some microfinance-oriented banks have gone out of business or been taken over by the state in the past year. In 2009 the government took over Banco Santander's Venezuelan operations, although the microfinance unit remains in private hands.
- There are regulatory and legislative moves afoot to create a super agency to control the banking system, threatening the Superintendency of Bank's precarious independence from the national treasury. Interest rate restrictions have also been tightened.
- The withholding tax on development banks (which in theory specialise in microfinance) was removed.
- The official credit registry may be reactivated; if this happens, it would represent a positive step forward for the sector.





## In focus

### The price of microfinance in Latin America and the Caribbean

Interest rates are a highly debated topic in microfinance. Discussions centre on what is considered “fair” to charge microfinance clients and to what extent microfinance institutions (MFIs) should set rates according to operational sustainability and profitability needs. Determining a reasonable or sustainable interest rate is also strongly influenced by a country’s broader financing conditions and characteristics (for example population density and the availability of cheap technology, which influence sector lending costs). Comparing what MFIs charge in one country with another can bring clarity to the discussion, but comprehensive and comparable cross-country data on interest rates is sparse. To close this gap, the Multilateral Investment Fund (MIF), a member of the Inter-American Development Bank Group (IDB), assembles a dataset on the cost of microfinance loans and commercial bank loans in each country each year. Since data on interest rates are not directly available, MIF calculates the gross portfolio yield for MFIs and banks as a proxy for the implied, average interest rate charged on the loans. The calculated difference between a country’s gross microcredit portfolio yield (the microfinance ratio) and gross bank portfolio yield (the bank ratio) offers a microfinance premium indicator that can be compared across countries. The microfinance premium for 18 Latin American and Caribbean countries, as well as the microfinance and bank ratios of individual countries, are presented in the table below.



**Nominal financial revenues/Average loan portfolio (as a proxy for interest rates)<sup>1</sup>**  
(Selected countries circa 2009<sup>2</sup>)

Country	Microfinance ratio (a)	Bank ratio (b)	Microfinance premium (a)-(b)
Argentina	60.8	18.6	42.3
Bolivia	20.2	14.9	5.3
Brazil	23.7	15.6	8.1
Chile	32.1	6.4	25.7
Colombia	30.7	12.4	18.3
Dominican Republic	33.1	19.0	14.1
Ecuador	20.4	12.8	7.6
El Salvador	22.9	11.1	11.8
Guatemala	25.3	17.3	8.0
Haiti	51.3	n.a.	n.a.
Honduras	32.2	18.9	13.3
Mexico	74.2	21.0	53.2
Nicaragua	25.9	18.8	7.1
Panama	31.1	8.5	22.6
Paraguay	25.6	16.8	8.8
Peru	29.1	15.1	14.0
Uruguay	41.1	16.8	24.3
Venezuela	24.4	19.6	4.8
<b>Regional weighted average<sup>3</sup></b>	<b>28.6</b>		

Sources: MFI data were collected from MIX Market, microfinance networks, regulators, interviews and data questionnaires, and web sites. Data for MFIs include both regulated and non-regulated institutions.

Bank data includes 375 banks. Data were collected from banking associations affiliated with the Latin American Banking Federation (FELABAN), the FELABAN Financial Bulletin, the central bank of Argentina, Paraguay and Uruguay, the Superintendency of Banks of the Dominican Republic and the Superintendency of Banks of Panama.

(1) Ratios are weighted by total loan portfolio.

(2) Data are for December 2009. Where 2009 data were not available, December 2008 data have been used.

(3) This calculation includes all available data from MFIs whose microcredit portfolio represents more than 30% of their total loan portfolio (349 institutions).

Additional information and data updates can be found at [www.iadb.org/micamericas](http://www.iadb.org/micamericas).

*This article was prepared by MIF.*



## Middle East and North Africa

### ■ Lebanon

#### Key characteristics of the microfinance business environment:

- Microfinance is lightly regulated in Lebanon. All but one of the microfinance institutions (MFIs) operate as non-governmental organisations (NGOs) and have freedom to set the terms and interest rates on their loans, although they are not able to take deposits.
- The mainstream MFI sector is dominated by two organisations that each have portfolios of around US\$10m: Ameen, which is registered as a financial services company, and Al Majmoua, which is an NGO.
- Many other MFIs are extensions of political/sectarian movements, focusing their efforts on their particular communities, and do not operate on a commercial basis.
- Lebanon is a regional centre for banking, and its local banks provide a wide range of services that are broadly accessible, reducing the need for some aspects of microfinance, such as deposit-taking. The major mainstream MFIs partner with a number of local banks, which help process the disbursement and repayment of loans.

#### Key changes and impacts since last year:

- Lebanon was in a state of paralysis for much of 2009. The parliament that was elected in June was not able to form a functioning government until November, and the new cabinet did not meet until March 2010. This meant that no legislation was developed over the last year, and many ministries were unable to develop new initiatives. It is, therefore, unsurprising that there were no official developments in the microfinance sector.
- Although the Banque du Liban (the central bank) is independent and largely insulated from Lebanon's turbulent politics, it has not issued any new regulations or circulars regarding microfinance.
- The public credit registry is growing gradually, and now covers 8.3% of the adult population, up from 6.8% in 2009.
- A new MFI, Emkan, has begun operations with a large capital base and offers interest rates subsidised by the Hariri Foundation, a charity associated with the prime minister, Saad Hariri. This has served to distort further the market for those MFIs that offer loans on commercial or cost-recovery terms.



## Morocco

### Key characteristics of the microfinance business environment:

- The sector is dominated by a few large microfinance institutions (MFIs), and this market concentration has increased over the last year.
- Microcredit is the only financial service currently offered by MFIs.
- There has been considerable growth recently in non-performing loans (NPLs) as MFIs have expanded and engaged in excessive cross-lending. This is a significant threat to the sector's sustainability, although it will be mitigated by the new credit bureau.
- The major MFIs (representing over 90% of the market) comply with good governance and accounting practices and are fairly transparent.

### Key changes and impacts since last year:

- The Ministry of Finance is currently discussing ways of transforming MFIs from non-governmental organisations (NGOs) into commercial, legal entities. This would allow formal financial institutions to enter the market through direct affiliates, which would benefit from interest rate cap exemptions. It might also allow institutions to offer deposits to microfinance clients.
- In 2009, Zakoura, the second-largest MFI, faced major difficulties arising from its high-risk portfolio and was absorbed by FBP, previously the third-largest MFI.
- The overall number of borrowers fell in 2009, for the second consecutive year, owing largely to the growth in NPLs. MFIs have also been exchanging information about those with poor payment records, which has halved the number of common borrowers.
- A new credit bureau is now operational, and although MFIs reportedly submit information to the bureau, transaction costs and other operational issues are still being addressed. According to one commentator, the transaction cost was set at Dh5 (60 US cents), as opposed to Dh0.5-1, as had been anticipated by MFIs.

## Yemen

### Key characteristics of the microfinance business environment:

- Only 7% of Yemenis have a bank account. The latent demand for accessible financial services would seem to make the country an ideal market for microfinance.
- The Social Fund for Development (SFD), an ostensibly independent body that relies on foreign donor aid, has historically led efforts to promote microfinance in the country, with assistance from the World Bank and the UNDP.
- In 2009 the Central Bank of Yemen introduced the Microfinance Law, which is intended to provide a clear set of rules for regulated and formalised microfinance institutions (MFIs).
- The first MFI to be licensed under the new law is Al-Amal, which has expanded quickly since its inception.



**Key changes and impacts since last year**

- The Microfinance Law is now fully implemented, with a dedicated and trained team operating within the Central Bank of Yemen.
- Al Kuraimi, a large exchange and money transfer company with branches and agents across the country, has applied for a licence under the Microfinance Law.
- A new electronic regulatory system has been introduced, which will allow both the banks and the Central Bank to better keep track of their loans.
- The security situation, which has deteriorated as a result of a series of internal conflicts, has delayed plans to merge the Aden and Abyan MFIs, since the SFD has struggled to find a consultant willing to work in the area.



## Sub-Saharan Africa

### Cameroon

#### Key characteristics of the microfinance business environment:

- The sector is fairly concentrated, with CamCCUL holding the largest share of the total loan portfolio. However, a handful of other institutions also represent between 7% and 15% of the total loan portfolio, and new market entrants (such as EB-ACCION) may help increase market dynamism.
- A law on microfinance was passed in 2005, and was amended with further prudential requirements in 2007. However, supervision is still weak owing to a lack of capacity.
- Most microfinance institutions (MFIs) fail to comply with reporting requirements of the Commission Bancaire de l'Afrique Centrale (COBAC, the Central African Banking Commission), a regional body that accredits MFIs. Few are familiar with prudential ratios or operating norms introduced by the microfinance law, and electronic reporting requirements are not enforced.
- The sector is seriously jeopardised by a lack of transparency and the absence of a credit bureau or any process for exchanging information on those with poor payment records.

#### Key changes and impacts:

- The launch of a comprehensive microfinance accounting framework by COBAC was delayed beyond the planned date of June 2010. Most MFIs will need time, extensive training and capacity-building to fully comply with the new accounting rules.
- COBAC has been discussing ways to hand over supervision of small MFIs to local divisions within finance ministries in the six member countries in the Central African region.
- Some MFIs have met to discuss creating a private credit bureau to exchange borrower information.

### Democratic Republic of Congo

#### Key characteristics of the microfinance business environment:

- The Banque Centrale du Congo (the central bank) regulates the financial sector, including microfinance institutions (MFIs), under a 2002 law and a 2005 guidance directive. However, key MFI-related legislation is pending, and a number of MFIs are waiting for the approval of operating licences.
- Microfinance services are concentrated in urban areas, with little provision in remote rural locations.



- Co-operative and mutual organisations dominate the provision of microfinance, but there are a few large players, particularly ProCredit.
- The country is still re-establishing itself after a civil war that ended in 2003, and the skills needed to develop the microfinance sector are only being developed gradually.
- There is a need to improve accounting practice, governance, credit referencing and independent ratings of MFIs.

#### **Key changes and impacts since last year**

- Sixteen new microfinance programmes have been approved in the last year and nine more are subject to further approval.
- Two new laws are planned and being debated in parliament: one to regulate governance and accounting practice in MFIs, the other to enable mobile banking (m-banking) services.
- One of the largest MFIs, FINCA, has received approval to become a non-bank financial institution (NBFI), enabling it to take deposits.

## **Ghana**

#### **Key characteristics of the microfinance business environment:**

- The microfinance sector in Ghana is vibrant and active, offering an increasing range of services. It developed, however, in an ad hoc way and is highly decentralised.
- While the sector is currently self-regulated quite effectively, the apex bodies—the Cooperative Credit Unions Association (CUA), the Co-operative Susu Collector's Association (GCSCA), the Association of Financial Non-governmental Organisations (ASSFIN) and the Co-operative Council (GCC)—are not well co-ordinated.
- The Bank of Ghana (the central bank) does not have the resources to supervise the entire sector, although it is directing substantial resources toward strengthening its regulatory capabilities.

#### **Key changes and impacts since last year:**

- The 2008 Non-Banking Financial Institutions Act 774 (NBFI Act) has begun to be implemented. It regulates all microfinance activities and is intended to improve co-ordination in the sector.
- The new law expands the range of activities allowed to microfinance institutions (MFIs) to encourage innovation and development. It is too early to know how the sector will react, but positive changes are expected.
- The global financial crisis created a liquidity crunch for microfinance operators and revealed problems with capital adequacy, which prompted the central bank to increase dramatically the minimum capital requirements.
- There has been discussion about regulating the informal savings services provided by "Susu Companies", which sometimes lack the capacity to manage the deposits they take in. This sector has, however, been tolerated and unregulated for decades.
- Under the 2008 NBFI Act, all non-deposit-taking financial institutions must have GH¢1m



(US\$688,000) as minimum capital instead of the previous GH¢150,000 and GH¢4m for deposit-taking from 2011, and GH¢7m from 2012 (up from GH¢1.5m). The new minimum capital requirements have led to a round of consolidation discussions among MFIs, as many of them are under the minimum.

## Kenya

### Key characteristics of the microfinance business environment:

- There is a strong regulatory environment for deposit-taking microfinance institutions (MFIs). However, most MFIs are still working to establish the required operational systems and controls and comply with ownership and capital requirements established by the 2008 Microfinance Regulations. As of June 2010 only two MFIs had successfully qualified to become regulated deposit-taking institutions. The hundreds of smaller non-deposit-taking MFIs are not regulated or supervised under specific microfinance laws.
- The financial sector and the microfinance environment are concentrated. There is, however a robust and steadily improving business environment, owing in part to the efforts of non-governmental organisation (NGO)-MFIs to comply with Microfinance Regulations (2008) and convert into deposit-taking microfinance institution (DTMs).
- Kenya continues to be a global leader in mobile banking (m-banking) thanks to the innovative M-PESA service, close co-ordination with regulators, good customer service and provider transparency. All major Kenyan mobile operators are now working to establish mobile banking platforms.
- Innovation around new delivery channels and especially mobile payments are ongoing in the microfinance sector.

### Key changes and impacts since last year

- The Central Bank of Kenya licensed the first credit bureau in early 2010 and now requires all Kenyan banks to submit customer information to it. Consequently, two commercial banks with micro-lending operations will report to the bureau. MFIs are not yet required to submit client information, but their participation likely will be mandated during 2011.
- The first DTM was licensed under the Microfinance Act in May 2009 and the Kenya Women's Financial Trust (KWFT) received a licence in April 2010. Other MFIs are in the process of obtaining a DTM licence, though it is unclear how long the process will take.
- As in other African countries, the microfinance sector suffers from a lack of transparency on the all-in cost of credit. Microfinance interest rates are often quoted by the month, rather than annually, and frequently include additional fees that mask the true and full cost of credit. On a positive note, Kenya was the first African country to participate in MF Transparency's country survey in 2009. Pricing data was collected from 21 MFIs and the total APR was found to range from 10% to 73%.
- The savings and credit co-operatives (SACCOs) segment has experienced rapid growth. The corresponding increase in fraud prompted regulators to develop the supervisory regulations outlined in the SACCO Society Act of 2008; this framework is expected to come into full force in late 2010. In preparation, the government of Kenya also created the SACCO Regulatory Authority (SASRA) to





supervise SACCOs with front-office operations.

## ■ Madagascar

### **Key characteristics of the microfinance business environment:**

- The microfinance sector is split between the long-established informal co-operative and mutual sector and the more recently established professional microfinance institutions (MFIs).
- There is a sophisticated national strategy for microfinance and a highly structured legal framework and national promotion unit, which makes it easy to establish and upscale MFIs.
- Political instability has inhibited the expansion of MFIs as development aid has been suspended. Poor accounting standards also constrain MFIs.

### **Key changes and impacts since last year:**

- MFIs had mixed fortunes in 2009, which was a turbulent year politically and economically. Some MFIs experienced delayed loan repayments, while others grew steadily.
- A new credit information system has the potential to improve credit checking, though at present efforts centre on commercial bank reporting and linking data from new and old systems.
- Larger financial institutions offering microfinance facilities are increasing the variety of products provided to clients.
- There are early indications that efforts to improve the regulatory capacity of the Banque Centrale de Madagascar (the central bank) are bearing fruit.

## ■ Mozambique

### **Key characteristics of the microfinance business environment:**

- The microfinance sector, along with the general financial sector, is still very underdeveloped, with almost 80% of the population unbanked. In addition, the financial sector is still based on commercial banking, and regulated microfinance institutions (MFIs) only have a small share of the market.
- Mozambique's economy is quite small and very poor, consisting of a handful of mega-projects (coal and gas mines) and 30,000 small and medium-sized enterprises (SMEs). As a result, MFIs tend to be small, mission-driven organisations led by donor programmes, rather than commercial profit seeking institutions.
- The Bank of Mozambique (the central bank) is conservative and is still contending with other challenges, such as focusing on the use of local currency instead of the previous prevalence of foreign currency. (Business transactions conducted in foreign currency now constitute around one-third of the total, down from two-thirds in 2003).
- The financial sector is highly concentrated and lacking in competition. This reduces deposit-mobilisation and contributes to high borrowing costs.



### **Key changes and impacts since last year:**

- A new reporting framework for supervision of microfinance will finally be announced in 2010, after being developed by many international organisations over the past three years.
- Mobile banking is beginning to develop at a broader level, as the first telecommunications provider has been approved to partner with financial institutions and offer services.
- IFRS has been adopted as the official accounting reporting standard and is expected to be implemented in MFIs by the end of 2010.
- A private credit registry is being developed with the International Finance Corporation, which is expected to facilitate the development of the microfinance sector.

## **Nigeria**

### **Key characteristics of the microfinance business environment:**

- There is an established regulatory framework for microfinance banks (MFBs). Many MFBs, however, do not comply with the regulations and the Central Bank of Nigeria lacks the capacity or sector expertise to supervise the banks effectively and enforce regulation.
- Many MFBs are undercapitalised, owing in part to low capital requirements for local operations, and have poor management and governance. The sector has grown very rapidly, with laws being passed before appropriate regulatory capacity has been put in place. More than 900 MFBs were created in a very short space of time during 2008 and 2009.
- Many of the microfinance providers established as Unit Microfinance Banks struggle to penetrate fully urban markets and establish a strong base from which to expand to rural areas. Moreover, regulations dictate that Unit Banks are only allowed to expand into more than one state after they own two-thirds of market share in their original state. Many rural areas and states remain underserved.
- The lack of reliable identification documents is a challenge for developing credit information registries, as various forms of personal identification exist. All forms have limited coverage and none is fully reliable regarding name, date of birth and address.

### **Key changes and impacts since last year:**

- The rapid emergence of hundreds of credit institutions and the onset of the global financial crisis have led to fraudulent and opportunistic behaviour. This has caused a considerable decline in public confidence.
- The CBN has reconsidered its microfinance policy in light of the failure of numerous MFBs. The revised framework is expected to be developed by the end of 2010, and is likely to employ a three-tiered structure: a national-level microfinance licence; a state-level licence; and a rural licence.
- The operating costs of microfinance institutions (MFIs) have risen, owing to infrastructure challenges (lack of consistent access to water, electricity, and Internet connectivity) and high and rising capital costs.



## Rwanda

### Key characteristics of the microfinance business environment:

- The regulatory and policy environment for microfinance is very strong, but has outpaced the capacity of microfinance institutions (MFIs) to understand and comply. This is particularly true for accountancy and governance standards.
- The majority of MFIs are located in urban centres, and competition in rural areas remains limited. The government has prioritised access to financial services to the rural community. This may lead to some distortions in the short term, particularly owing to the large flows of donor subsidies directed at the sector, but ultimately should benefit the industry by increasing financial literacy.
- Following the collapse of several MFIs in 2006 and in light of uncertainties regarding the tax regime, many Rwandans distrust financial institutions and are reluctant to bring savings into the regulated economy.
- Rwanda does not have a credit reference bureau (although there is a national credit registry within the National Bank of Rwanda (the central bank), which is seldom used by MFIs). Procedures for determining credit worthiness are generally informal.

### Key changes and impacts since last year:

- In May 2009 the central bank issued microfinance regulation No. 02/2009. It has also formed a new Directorate for Financial Stability with a microfinance-specific department to supervise MFIs. The directorate has hired and trained 20 inspectors.
- A new payments system law has been approved by parliament, and provides scope for mobile banking.
- The government has launched a new initiative, Umurenge SACCO, to ensure that every local district has a savings and credit co-operative (SACCO) to hold deposits and provide micro-loans. Under the programme, the government will finance a declining proportion of the operating costs of 416 new SACCOs for a period of three years.
- Rwanda was the top reformer in the World Bank's Doing Business 2010 report, moving from 143rd to 67th out of 183 countries. Among the reforms, investor protection improved substantially, from a score of 2 to 6.3 out of 10.
- The Association of Microfinance Institutions in Rwanda (AMIR) has received financial support from the government and several donors, and has launched a capacity-building campaign to improve the governance and reporting capacity of smaller MFIs.

## Senegal

### Key characteristics of the microfinance business environment:

- The microfinance sector remains highly concentrated, with 85% of lending assets held by three major networks. Senegal is also home to many small mutual organisations and non-regulated microfinance institutions (MFIs), which have limited growth potential.
- Senegal has laws regulating MFIs, but there is a lack of regulatory capacity. Although the banking commission regulates the larger MFIs, the authorities have limited capacity to supervise the many small MFIs.



- A recent change in the legal framework is expected to be conducive to the formation of commercial MFIs and bank downscaling.
- Transaction costs are high, making it difficult to extend services on a large scale, especially to remote and rural areas. Mobile banking presents an opportunity to reduce the costs of network expansion.

**Key changes and impacts since last year:**

- The prospects of full implementation of the new MFI regulatory framework are being weakened by delays in issuing new licensing instructions by the responsible regional body, the Banque Centrale des États de l’Afrique de l’Ouest (BCEAO, the central bank for the West African region). As a result, new microfinance licences may be withheld.
- A new law requires unregulated microfinance organisations—termed Groupements d’Épargne et de Crédit (GECs)—to either convert into regulated MFIs or merge into existing networks within two years.
- The deadline for full compliance with new accounting standards has been too ambitious, especially for those MFIs not affiliated with a major network (about 15% of the market as of June 2008).
- The government is actively investigating opportunities for mobile banking (m-banking) as a way of expanding microfinance to remote, rural areas.
- The authorities are also looking at ways of improving credit bureaus, although fees can reach as high as 9% per transaction, and pilots have yet to achieve popular acceptance.

## ■ Tanzania

**Key characteristics of the microfinance business environment:**

- Tanzania has a very diverse market for microfinance, involving commercial banks, community banks, dedicated microfinance institutions (MFIs), co-operatives and non-governmental organisations (NGOs).
- Although regulations covering the creation of deposit-taking microfinance entities (DTMs) have been in place since 2005, no NGO or co-operative MFIs have yet made this transition. This can be explained in large part by the complex funding structure and high capital requirements.
- The microfinance sector has begun to expand beyond lending and deposit-taking into insurance, leasing and transfers. Mobile banking technology has also emerged.
- The reporting standards and general performance of savings and credit co-operatives (SACCOs) remains under considerable scrutiny. The government launched The Co-operative Reform and Modernisation Program 2005-15 to improve performance and accountability, although it is unclear how successful this has been.

**Key changes and impacts since last year:**

- There has been an increase in the availability of insurance, leasing and transfer services. This includes a substantial deal signed between the First MicroInsurance Agency and the Savings and the Credit Co-operative Union League of Tanzania (SCCULT, a representative body for over 1,000 SACCOs and their members).



- Tanzania has seen an increase in training and education about accounting and audit standards, delivered through formal and informal groups of MFIs.
- Institutions in the sector, and microfinance banks in particular, have taken steps to strengthen their capital structures in the past year.
- A number of players from the telecommunications and financial sectors have begun to develop and offer mobile telephone banking services during the last year.

## ■ Uganda

### **Key characteristics of the microfinance business environment:**

- The IMF rates Uganda's financial system as one of the most developed in the region. However, the microfinance sector is dominated by commercial banks, such as Centenary Bank and Equity Bank. Dedicated microfinance institutions (MFIs) are concentrated in urban and semi-urban centres, charging relatively high interests rate and suffering from relatively low levels of efficiency.
- Uganda's tiered approach to microfinance regulation and supervision has created flexibility and a solid framework for institutional development.
- That said, the regulatory requirements for institutional transformation are quite strict. As a result, most MFIs choose to continue operating as non-governmental organisations (NGOs) or savings and credit co-operatives (SACCOs) and are not permitted to take deposits.
- A shortage of qualified and well-trained staff has weighed on non-bank microfinance institutions; MFIs with commercial bank and deposit-taking status tend to attract the most skilled microfinance employees.

### **Key changes and impacts since last year:**

- MFIs are struggling to compete with established commercial banks that have recently begun scaling down and attracting small savers.
- Uganda's first credit bureau has started operating, and is expected to have an impact on the microfinance sector. (Borrowers with multiple loans is a growing concern, and there is no uniform client identification system.) All regulated financial institutions, including Microfinance Deposit-taking Institutions (MDIs), will be expected to report negative client information to the Credit Reference Bureau.
- The acquisition of Uganda Microfinance Limited by Equity Bank in late 2008 is likely to influence the microfinance market, which had been dominated by Centenary Bank. Equity Bank is expected to introduce stronger competition and bring microfinance best practices from Kenya.
- Microfinance has recently begun to emerge in the northern part of the country, owing to improved political stability following agreements with rebels.
- As in other East African countries, many reports of misconduct surfaced in the past year in the SACCO segment, mostly arising from the global financial crisis. There has been increased pressure on the government to regulate this sector, which has now become a priority. The Ministry of Finance is expected to develop a SACCO regulation framework soon.



## In focus

### Current issues in microfinance

The microfinance market has grown enormously during the past decade. The sharp rise in lending has been driven by a huge influx of external funding from donors and social investors, and by the commercialisation of the market through initial public offerings (IPOs) from some of the larger microfinance institutions (MFIs). The impact of the increased availability of funding for MFIs has been a rapid growth in MFI portfolios in terms of the number of borrowers reached and the quantity and value of loans disbursed.

The microfinance market has been mostly isolated from the current financial crisis, which has profoundly affected mainstream finance globally. That said, the microfinance market is experiencing its own set of growing pains, driven in part by the breakneck speed at which it has been expanding. Indeed, many commentators see a need for a system of checks and balances to curtail irresponsible lending practices that have emerged in recent years. In the second half of 2009 the inability of some MFI borrowers to meet repayments on their loans led to community revolts against MFI lenders in Nicaragua and in the southern state of Karnataka, India. Several other countries continue to experience rising numbers of portfolios-at-risk (PAR)—loans that are more than 30 days overdue—including Bosnia, Morocco, and Pakistan, with PARs as high as 7% to 13% in some cases.<sup>1</sup>

What is driving this rise in borrower defaults in a sector that traditionally has enjoyed the best repayment rates in the credit industry? Evidence from the locations listed above, and from other parts of the world, shows that some MFI customers are requesting and receiving more loans than before. This trend has been fuelled by the increase in financing available for MFIs to on-lend, coupled with lax credit-management practices. Recent news coverage shows that some MFI customers were borrowing from multiple sources simply because they could, as well as for consumption purposes. For instance, a 2009 sector report on microfinance<sup>2</sup> shows that one-quarter of MFI clients in Karnataka's Kolar district have as many as five loans, with three loans being the average.<sup>3</sup> An examination of the four countries currently experiencing repayment crises showed that 20-40% of borrowers had loans from more than one MFI.<sup>4</sup> Anecdotally, this is confirmed by interviews conducted by the Economist Intelligence Unit, which show that indebtedness is a growing problem, affecting locations throughout the developing world.

1. Chun, G., Rasmussen, S. and Reille, X. (February 2010), "Growth and Vulnerabilities in Microfinance", CGAP Focus Note, No. 61.

2. Srinivasan, N. (October 2009), *Microfinance India: State of the Sector Report 2009*, SAGE Publications.

3. Cited in "Quest for fast growth lands India's microfinance institutions in the soup", *The Economic Times*, March 8th 2010.

4. Chun et al. (2010).



### Microfinance credit reporting

Extreme responses, such as the revolts in Karnataka, the No Pago movement in Nicaragua, and regulatory restrictions on MFI lending, do not address the underlying issues that create conditions for over-indebtedness. In a market devoid of information-sharing, MFI lenders do not have the ability to identify customers that borrow from multiple sources, nor do they have a view of the overall level of indebtedness of their existing or potential clients. This information asymmetry characterises most principal-agent relationships, and its effects are now being felt in the microfinance sector. As long as the economy is doing well and most people are gainfully employed, multiple borrowing is not a problem; loans are generally paid on time, keeping non-payment rates low and microfinance portfolios strong. But when a business-sector slump leads to job losses and a decline in wages, borrowers often have little choice but to default. The inability to identify and curb indebtedness increases the risk of non-repayments, non-performing loans (NPLs) and deteriorating portfolios.

The fundamental case for credit reporting in microfinance is to alleviate the credit risk arising from information asymmetries. This is where credit bureaus come in. A credit bureau collects information from lenders and available public sources on a borrower's credit history. Information on individuals and small firms is compiled into a comprehensive credit report that is then sold to creditors. Credit bureaus typically support the retail lending business by providing objective information on the creditworthiness of individual customers or small businesses. They allow lenders to make faster and more accurate credit decisions, thereby lowering default rates by 30-40% and increasing lending volumes.<sup>5</sup> While credit reporting for retail and small business lending has evolved over the past century, uptake in the microfinance sector has been relatively slow.

Experience from Ecuador shows that credit reporting allows MFIs to monitor the portfolios of existing borrowers, assess their overall level of indebtedness, and make more informed lending decisions. This may involve renewing a credit line, denying an existing borrower more credit, devising flexible pricing based on borrower credit histories and repayment characteristics, or developing flexible product terms to better suit the borrower's capacity to repay. In India, for example, the largest MFIs participate in a credit reporting system (under development) and use shared information to identify borrowers with multiple loans, capping the maximum exposure per borrower at Rs50,000 (around US\$1,000) at any given time.<sup>6</sup> Credit reporting can also have a disciplinary effect on borrowers.<sup>7</sup> One study showed that educating borrowers of a major MFI in Guatemala about the existence and use of a credit bureau improved borrower repayment rates.<sup>8</sup>

Credit reporting clearly has benefits for MFI lenders, and could lead to cost savings and operational efficiencies that have been demonstrated at regular financial institutions. Even so, implementing microfinance credit-reporting systems is challenging. Fundamentally, many MFIs are simply unaware of the potential benefits of credit reporting and how it can support their operations. Moreover, many MFI lenders are wary of "information-sharing mechanisms," both within and outside of their niche. In addition to issues of awareness and trust, several technical challenges impede the development of microfinance credit reporting. These include equipping MFIs with the right mix of technology and skills to capture borrower data and transmit such data to a credit bureau, and training MFIs to use information from the credit bureau in their lending processes.

5. Barron, J. M. and Staten, M. (2003), "The Value of Comprehensive Credit Reports: Lessons from the U.S. Experience", in *Credit Reporting Systems and the International Economy*, MIT Press.

6. Ng, J. (April 2010), "A Detailed overview of Microfinance Institutions Network (MFIN)", Microfinance Focus online. Available at: [www.microfinancefocus.com/news/2010/04/24/special-report-a-detail-overview-of-microfinance-institutions-network-mfin/](http://www.microfinancefocus.com/news/2010/04/24/special-report-a-detail-overview-of-microfinance-institutions-network-mfin/)

7. Padilla, J. A., and Pagano, M. (July 1999), *Sharing Default Information as a Borrower Discipline Device*, Centre for Studies in Economics and Finance, Working Paper no. 21.

8. De Janvry, A., McIntosh, C. and Sadoulet, E. (June 2007), "The Supply and Demand Side Impacts of Credit Market Information", in *Journal of Development Economics*, Volume 93, Issue 2.



Yet another challenge lies in finding the right “price point” for MFI users of credit bureau products. MFIs typically make smaller loans (by value) than traditional lenders, with greater repayment frequencies. Standard credit bureau products are therefore neither suitable nor affordable for MFIs. The credit bureaus, for their part, grapple with being able to offer MFI-tailored products at prices that would be sustainable for the credit bureau’s own business model. These challenges notwithstanding, better integration of microfinance and credit reporting holds the promise of improving risk management and overall financial stability for MFIs.

### **Risk management and deposit mobilisation**

While the microfinance sector has side-stepped the major consequences of the global financial crisis, awareness of them has made risk management a priority for MFIs, donors and investors. As a result of its past focus on aggressive growth and expanded outreach, the MFI sector is now faced with overstretched and outdated systems, inadequate control mechanisms, and a lack of qualified staff to manage complex new lending products targeting individuals and small and medium-sized enterprises (SMEs). MFIs and donors recognise the need to design and implement risk management strategies to protect against large-scale financial losses, as well as the loss of reputation among clients, competitors, donors, and regulatory agencies. This in fact is the board of directors’ fiduciary role: to provide oversight and investment advice to management, in addition to recommending sound risk management practices.

Risk management traditionally has been structured around four types of risk: credit risk; liquidity risk; market risk; and operating risk. For MFIs, however, there may be a need for an additional framework that captures other factors. These include fostering a “risk culture”, in which MFI employees and stakeholders understand the institution’s main sources of risk and the consequences of decisions for the MFI’s risk profile. It also involves ensuring that appropriate risk structures and policies are in place to monitor the risks of the institution and designing and adhering to a risk-reporting schedule, including the dissemination to management of documents that lay out the identification of risks, as well as their measurement and management on a continual basis. This last item deserves particular attention by MFIs, considering that the lack of consistent and adequate risk management reporting may have aggravated the problems that some MFIs experienced in 2009.

MFIs that are committed to regulatory improvements and the mobilisation of deposits face even greater challenges. MFIs that wish to become licensed as regulated deposit-taking institutions must not only meet capital, equity and financial performance objectives, but must also comply with regulatory requirements for management and governance capacity, development of robust infrastructure, including appropriate data and information processing systems, and internal controls. In some countries MFIs are required to invest in building a system to implement a deposit programme before they can obtain approval to accept deposits, with no guarantees that the institution will receive the licence.

The role of governance in the evolution of a strong risk management function goes beyond better policies and reporting; it also means developing staff who are well-trained in deposit products and services. A strong knowledge of the distinctions between deposit mobilisation and credit, as well as the unique risks associated with each, must begin with the board and management and be integrated at each staff level. The ability to build a professional staff committed to serving the public is key to the success of an institution.





Risk management in all its forms is becoming increasingly important in the microfinance sector, both for credit and savings products. As more and more MFIs mobilise deposits to provide a wider spectrum of financial products to their clients—while also diversifying their sources of funding—a well-tailored and practical risk management system will be essential. Governance with credibility and integrity is the cornerstone of building an institution capable of providing financial access to the under-banked. It is also essential to developing a pool of knowledgeable, highly trained personnel in deposit services. In the end, institutions that strengthen risk management practices should find it well worth the cost and effort, as sound risk management will ultimately be rewarded by customers' trust and by the confidence of the central bank.

*This analysis was prepared by IFC and MEDA.*



## Principles for the effective regulation and supervision of microfinance operations

Microfinance has been one of the great business success stories of the last decade. But the sector's impressive growth and outreach has not been matched by a comprehensive supervisory and regulatory structure that reflects its unique characteristics and risks. To close this gap, the Association of Supervisors of Banks of the Americas (ASBA) and the Multilateral Investment Fund (MIF)—with support from the Swiss Trust Fund managed by the Inter-American Development Bank—engaged in a two-year consultation in Latin America and the Caribbean to prepare practical guidelines for regulating and supervising microfinance.

These guidelines seek to complement the standards and laws under which a country's financial institutions operate. Microfinance institutions (MFIs) are subject to national standards and, in the majority of cases, international standards that allow for sound management of the financial system. But international standards are not always applied with sufficient rigour, and neither international nor national standards always consider the special nature of microfinance operations. There is, for example, a need to broaden the application of the Basel Core Principles (BCP) to create a legal framework that effectively regulates MFIs—but without imposing conditions that would impede their operations. Yet guidelines must also build on existing standards because MFIs and traditional financial providers have a lot in common. With some adjustments, the majority of the Basel principles are applicable to the microfinance sector.

The need to regulate and supervise banks rigorously is rarely challenged; the same cannot be said of the need to regulate MFIs. Although the majority of MFIs are not large enough to threaten a country's overall financial stability, they play an important role in providing financial services to underserved populations with the potential to contribute to the economy. To do so effectively and appropriately, however, MFIs must align their activities with BCP principles. Proper microfinance regulation is also important for protecting consumers (depositors and borrowers) and correcting market imperfections (by increasing information to improve transparency and efficiency). In sum, sound regulation helps ensure that microfinance clients are served by stable financial institutions. Like all regulation, however, there is a cost; to be worthwhile the benefits must outweigh those costs.

As microfinance is intended for those who would not otherwise have access to financial services and involves small sums of money, it is easy to believe that the costs of regulation are too great. This perception is mistaken. Without proper regulation, MFIs might be tempted to take excessive risks, leading to, for example, over-indebted borrowers. Excessive debt creates losses that restrict the microcredit supply and eliminates a significant credit source for an important segment of the population, reducing their ability to generate wealth. It also undermines a culture of timely payments, which supports the sector's profitability and sustainability.

The guidelines developed by ASBA and MIF are based on the principle that countries should have specialised expertise for monitoring microfinance and that regulations should be tailored for that sector and not merely copied from traditional banking regulation. The supervisor should have sufficient sector knowledge to evaluate the strength of an institution and its plans, establishing appropriate minimal



capital standards. The supervisor must have a trained, specialised unit to ensure the regulatory framework functions properly. There should be sufficient resources to monitor over-indebtedness in the system, to continuously analyse risks, to identify warning signs and to implement policies in a timely manner.

The regulatory framework should also incorporate risk management concepts, as these apply directly to microfinance. Strategic and reputational risk management is particularly important, since many institutions begin as non-profits entities targeting a specific client segment and eventually enter new market segments that they are less well equipped to serve. Credit risk management is essential because most clients are not part of the formal economy, limiting the lender's access to useful client information and collateral. Operational risks must also be addressed to ensure proper lending methodologies are employed that are not overly prone to human, procedural or external flaws. Although market risk is less of a factor, regulatory risk frameworks should also address foreign exchange risk and interest rate risk, which stem from the unique financing structures these institutions employ. MFIs should adhere to policies that combat money- laundering and terrorism.

Finally, the guidelines suggest defining micro-loans (or microcredit) explicitly in regulations, so that required client characteristics and the credit methodology utilised to service them are clearly defined. For example, a long-known element of success is ensuring that credit methodologies involve personal contact with clients. This should be standard practice. Policies for loan loss provisioning need to reflect the short loan terms and high repayment rates that characterise microcredit portfolios. Specific rules for the treatment of interest rates, fees and penalties in case of arrears should also be included.

*This article was adapted from a publication by MIF and ASBA. The full document can be accessed at [www.iadb.org/micamericas](http://www.iadb.org/micamericas).*

# Appendix

## Methodology and sources

This index is the second year of a study that evaluates countries across regions despite poor data and often incomplete information. Much effort has been made to combine available secondary sources and primary legal texts with insights and information from sector stakeholders in each national context. Interviews were conducted with microfinance practitioners, experts, policymakers and consultants around the world between March and June of 2010 to inform the analysis in this study. Experts' interview availability varied widely by region, and, in some cases, by country. A qualitative survey based on the microscope criteria was also administered to microfinance practitioners, consultants, and regulators worldwide between March and April 2010. Two hundred and twenty six stakeholders responded to the survey. The results were used to inform, challenge and confirm scores and evaluations, as well as to provide additional contacts for interviews.

The study criteria and methodology were developed in 2007 by the Economist Intelligence Unit research team in close co-ordination with MIF and CAF. The real-world relevance of these indicators was initially evaluated through in-depth interviews conducted with country experts and microfinance practitioners from the region. They have been further validated in 2007 and 2008 by their high, positive correlation with microfinance penetration figures. In 2009, these indicators were expanded to an additional 34 countries around the globe in co-operation with IFC.

Based on consultations with senior MIF and CAF staff in 2007, the categories "Regulatory Framework" and "Institutional Development" were each weighted 40% toward the 100 point score while "Investment Climate" was weighted 20%. However, it is important to point out that, even with alternative weighting schemes that assign more weight to the last category (such as weighting each of the 13 variables equally, or weighting each of the three categories equally), the relative importance of the investment climate in shaping overall microfinance environments consistently emerged as secondary to that of the regulatory framework and institutional development.

**To score the indicators in this index, we gathered data from the following sources:**

- Personal interviews with regional and country experts, as well as microfinance practitioners and regulators
- A global microfinance survey for sector stakeholders based on the Microscope study
- Economist Intelligence Unit proprietary country rankings and reports, especially Country Finance, Country Commerce and monthly Country Reports
- Scholarly studies
- Texts of laws, regulations and other legal documents
- Websites of government authorities and international organisations
- Websites of industry associations
- Local and international news media reports

A new goal for this year's Microscope was to increase the number and scope of practitioners interviewed. A large proportion of these were drawn from in-country sources, especially local microfinance institutions (MFIs), national microfinance networks, and local offices of multilateral organisations. These additional consultations have allowed for a more nuanced portrait of the business environment for microfinance than was previously possible. As a result, scores were re-evaluated and changed for some countries, even in cases where there were no actual changes in formal laws and regulations.

*For a full list of sources and interviewees, please refer to the full bibliography, available free of charge at [www.eiu.com/sponsor/GlobalMicroscope](http://www.eiu.com/sponsor/GlobalMicroscope), [www.iadb.org/micamericas](http://www.iadb.org/micamericas), [www.caf.com/mipyme](http://www.caf.com/mipyme) and [www.ifc.org/microfinance](http://www.ifc.org/microfinance).*

MIF staff provided the necessary data to measure the level of competition in Latin American and Caribbean countries. They began with MIX Market data, but complemented it with country-specific sources to improve data coverage and quality. This is used to calculate the Hirschmann-Herfindahl Index (HHI).<sup>1</sup> HHI calculations are based on microfinance portfolio size, rather than number of clients.

HHI data for the rest of the world also came from MIX Market. In some select cases, 2008 data were used because 2009 data for these countries were not yet available. An extensive effort was made to assemble the latest available data for 2009, however, and the data in the model represent the most current information at the time of publication.

**Scoring criteria**

Indicators in the Microscope index are qualitative in nature, and scoring criteria for these are defined through a set of questions. These questions seek to measure not only the laws and standards governing the sector, but also their enforcement and practice. The criteria are open-ended, rather than formulaic or prescriptive. Consequently, scores are best understood after reading indicator justifications in the Excel model, as well as the scoring criteria.

1. The HHI is a specific measurement of market concentration, that is of the extent to which a set of firms accounts for a proportion of output in a sector. The HHI is used as one possible indicator of market power or competition among firms. It measures market concentration by adding the squares of the market shares of all firms in the sector. Where, for example, in a market five companies each have a market share of 20%, the HHI is  $400 + 400 + 400 + 400 + 400 = 2,000$ . The higher the HHI for a specific market, the more output is concentrated within a small number of firms. In general terms, with an HHI below 1,000 the market concentration can be characterised as low, between 1,000 and 1,800 as moderate and above 1,800 as high.

For purposes of this study, MFIs are defined narrowly as those that provide “microcredit”; that is, loans to non-salaried workers that are typically less than or equal to 250% of gross national income per capita (GNI per capita) in size. *Microcredit operations* are carried out by different types of institution, some regulated by financial authorities and some not.

The indicator scoring criteria for the Global Microscope are as follows:

### Regulatory Framework

(1) Regulation of microcredit operations: “Are regulations conducive to microcredit provision by banks and other established financial institutions? For instance, are banks free to set market interest rates, can they avoid excessive documentation and capital-adequacy ratios, and are they free from unfair competition from subsidised public programmes and institutions?”

- Scoring: 0=No such regulations exist or regulations are prohibitive; 1=Regulations create serious obstacles; 2=Regulations create at least two such obstacles for MFIs; 3=Regulations create minor obstacles; 4=Regulations present no significant obstacles

(2) Formation and operation of regulated/supervised specialised MFIs: “Is the legal framework conducive to the formation and operation of ‘specialised MFIs,’ such as greenfield MFIs and upscaling NGOs transforming themselves into MFIs? For example, are specialised MFIs free to set market interest rates, can they avoid excessive documentation and capital-adequacy ratios, and are they free from unfair competition from subsidised public programmes and institutions?”

- Scoring: 0=No such regulations exist; 1=Regulations exist, but multiple obstacles make formation very difficult; 2=Regulations exist, although there are significant obstacles; 3=Regulations exist with relatively few obstacles; 4=Regulations facilitate formation

(3) Formation and operation of non-regulated and non-profit microfinance institutions (MFIs): “Is the legal framework conducive to the formation and functioning of microcredit operations by unregulated non-governmental organisations (NGOs)?”

- Scoring: 0=NGOs are barred; 1=NGOs face many obstacles; 2=NGOs face some obstacles; 3=NGOs face only minor obstacles; 4=NGOs face no significant obstacles

(4) Regulatory and examination capacity: “Do regulatory institutions possess a specialised capacity for the examination and regulation of microfinance provision?”

- Scoring: Open-ended, as specific markers are not obvious and emerge from the interviews

### Investment Climate

(5) Political stability: “How important are the internal and external threats to the stability of the serving government or the political system in general?”

- Scoring: The Economist Intelligence Unit’s Political stability rating is a category score in its Risk Briefing. It is the average of five individual scored indicators: Social unrest; Orderly transfers;

Opposition stance; Excessive executive authority; and International tensions. 0=Extreme instability; 1=Considerable instability; 2=Moderate instability; 3=Stable; 4=Very stable

(6) Capital market development: “Are local capital markets developed?”

- Scoring: This score is based on the average of five scores in the Economist Intelligence Unit’s Risk Briefing: Depth of financing; Access to local markets; Marketable debt; Banking sector health; and Stock market liquidity. 0=Capital markets are undeveloped; 1=Capital markets exist, but lack depth and breadth; 2=Capital markets are lacking in either depth or breadth; 3=Capital markets are moderately well developed; 4=Capital markets are deep and broad

(7) Judicial System: “Does the judicial system allow for speedy, effective, and consistent resolution of disputes?”

- This score is based on the average of three scores in our Risk Briefing: Fairness of the judicial process; Enforceability of contracts; and Speediness of the judicial process. 0=Judicial system is extremely poor, corrupt or politicised; 1=Judicial system has several important faults; 2=Judicial system has strengths and shortcomings; 3=Judicial system is basically sound; 4=Judicial system is solid, incorruptible and free of political influence

(8) Accounting standards: “Are accounting standards in line with international norms (that is, US GAAP, IAS, IFRS)?”

- Scoring: 0=There are no generally established accounting standards; 1=National standards exist, but are weak and ineffective; 2=National standards are established, but fall short of international best practices; 3=National standards are similar to or moving toward international standards; 4=International standards are followed

(9) Governance standards: “Do governance standards of accountability and independence exist for corporations and institutions?”

- Scoring: 0=Standards do not exist; 1=Standards exist, but are weak; 2=Modest and unevenly effective standards; 3=Significant, if imperfect, standards exist in law and practice; 4=Standards of high accountability and transparency are followed in law and practice

(10) MFI transparency: “Do microfinance institutions routinely disclose their effective interest rates, conduct external audits and receive external ratings?”

- Scoring: 0=MFIs rarely or never engage in such practices; 1=MFIs follow at best one such practice, and with uneven results; 2=MFIs follow some of these practices, with modest results; 3=MFIs follow most of these practices, with generally favourable results; 4= MFIs follow all these practices

**Institutional Development**

(11) Range of MFI Services: “Do MFIs offer a wide range of financial services to low-income populations in addition to microcredit (e.g., insurance, savings, transfer of remittances, etc?)

- Scoring: 0=MFIs do not generally offer additional services; 1=MFIs generally offer only limited services beyond microcredit; 2=MFIs generally offer a modest range of services; 3=MFIs offer a wide range of services; 4=MFIs offer a full, extensive range of services

(12) Credit bureaus: “Are there effective, reliable credit bureaus?” For instance, how comprehensive is the information on prospective borrowers that they provide, how widely accessible is that information (particularly in light of privacy restrictions), does it cover transactions with both regulated and non-regulated financial institutions, and does it provide more than just “negative” information about prospective borrowers (that is, defaults and arrears)?

- Scoring: 0=Credit bureaus do not exist; 1=Credit bureaus are weak and unreliable in most of these ways; 2=Credit bureaus are weak in some of these ways; 3=Credit bureaus are weak in one of these ways; 4=Credit bureaus provide comprehensive information on the whole range of transactions and also include positive information about borrowers (on-time payment history, etc)

(13) Level of competition: “How competitive is the MFI sector? Do micro-borrowers have a wide range of institutions from which to choose?”

- Scoring: 0=There is little or no competition, with two or three institutions representing the majority of the total market portfolio, and the HHI value is over 2,600 ; 1=There is limited competition, and the HHI value is between 2,600 and 1,800; 2=There is a moderate level of competition among MFIs, and the HHI index falls between 1,800 and 1,000; 3=There is substantial competition and the HHI falls between 1,000 and 500; 4=There is a high degree of competition and the HHI value is 500 or lower



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LONDON

26 Red Lion Square  
London  
WC1R 4HQ  
United Kingdom  
Tel: (44.20) 7576 8000  
Fax: (44.20) 7576 8476  
E-mail: london@eiu.com

NEW YORK

750 Third Avenue  
5th Floor  
New York, NY 10017  
United States  
Tel: (1.212) 554 0600  
Fax: (1.212) 586 0248  
E-mail: newyork@eiu.com

HONG KONG

6001, Central Plaza  
18 Harbour Road  
Wanchai  
Hong Kong  
Tel: (852) 2585 3888  
Fax: (852) 2802 7638  
E-mail: hongkong@eiu.com

GENEVA

Boulevard des Tranchées 16  
1206 Geneva  
Switzerland  
Tel: (41) 22 566 2470  
Fax: (41) 22 346 93 47  
E-mail: geneva@eiu.com