Microfinance Guidelines

Danish Forum for Microfinance

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Published by Danish Forum for Microfinance, May 2011
Photo: Peter Blum Samuelsen
Layout: Peter Blum Samuelsen
Cover design: Kim Brostrøm/kimbrostrom.dk

About Danish Forum for Microfinance

Danish Forum for Microfinance is an umbrella organisation of Danish NGOs, private companies, and financial institutions working with microfinance in developing countries. The Forum was founded in 2009 and has 50 member organisations. The objective of the Forum is to facilitate capacity building of the actors within the Danish microfinance sector as well as advocacy and information dissemination to the general public about microfinance.

www.mikrofinans.dk

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Dansk opsummering

Også fattige har brug for finansielle ydelser. De har brug for at kunne spare op, at låne, at forsikre sig, og ofte har de også brug for at kunne sende eller modtage penge. Det traditionelle bankvæsen har dog vanskeligt ved at betjene de fattige, ikke mindst i udviklingslandene. Det medfører, at mange fattige ikke har adgang til traditionelle bankydelser. Mikrofinans bruges derfor i bistanden som en løsning på denne mangel på adgang. Men mikrofinans er et tveægget sværd. Det har hjulpet millioner af fattige med lån, opsparing og forsikring, men der er også alt for mange eksempler på, at det har haft den modsatte virkning. Mikrolån er mikrogæld, og det indebærer en risiko for både udlåner og låntager/kunde[1]. For at mindske denne risiko er der fra forskellig side udarbejdet retningslinjer for og afholdt kurser i brugen af mikrofinans. En gruppe organisationer og virksomheder oprettede i 2009 Dansk Forum for Mikrofinans med det formål at styrke ansvarlig anvendelse af mikrofinans blandt de danske aktører. I 2011 havde Dansk Forum for Mikrofinans 54 betalende medlemsorganisationer.

På baggrund af en bevilling fra Danida har Dansk Forum for Mikrofinans udarbejdet en grundig vejledning på engelsk i brugen af mikrofinans. Forummet anbefaler alle, som seriøst vil arbejde med mikrofinans, at overveje de forskellige muligheder og anbefalinger i vejledningen.

Denne korte introduktion opsummerer de engelske retningslinjer på dansk og er tiltænkt de personer i bestyrelser og sekretariater, som interesserer sig for emnet og måske har ansvaret for projekter med mikrofinans uden selv at være direkte involveret. I noterne til sidst henvises der til steder og publikationer, hvor man kan hente yderligere oplysning og inspiration.

Mikrofinans i Danmark

Forskellige aktører bidrager til at udbrede finansielle ydelser blandt verdens fattigste. I Danmark arbejder følgende typer af organisationer med mikrofinans på den ene eller den anden måde:

- NGOer eller ikke-statslige organisationer udgør den største gruppe og omfatter både små frivillige foreninger og store landsdækkende organisationer. Organisationerne arbejder typisk med kapacitetsopbygning af lokale mikrofinansorganisationer, enten små grupper eller store institutioner.
- Banker og investeringsfonde som især bidrager med lånekapital.
- Firmaer og selskaber som enten rådgiver, planlægger eller bruger mikrofinans som et led i deres CSR-strategi.
- Andre organisationer for eksempel universiteter, fagforeninger, studenterforeninger og lignende.

Som det fremgår af det ovenstående, er der mange måder at arbejde med mikrofinans på. Disse kan dog sammenfattes i tre begreber, som beskrives i det efterfølgende, nemlig: **leverandøren, formidleren** og **beskytteren.**

[1] I dette dokument bruger vi betegnelsen ”kunde”, når vi taler om en låntager i en mikrofinansinstitution; altså de personer, der modtager mikrolånene, og ”medlem” når vi taler om medlemmer af spare-låne-grupper.

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Danida, Civilsamfundsstrategien og NGOerne

Cirka fire ud af fem organisationer, der arbejder med mikrofinans, er NGOer. Danida dækker omkring 80 procent af deres udgifter hertil som et led i Danidas civilsamfundsstrategi. Målet er at fremme og opbygge et stærkt og selvstændigt civilsamfund i udviklingslandene, og mikrofinans ses som et bidrag hertil. Mikrofinans kan danne et godt grundlag for en lokal demokratisk udvikling:

- Gennem mikrofinans kan marginaliserede grupper styrke deres muligheder og evner for samarbejde og fortalervirksomhed.

- Brugen af mikrofinans, for eksempel i lokale spare-låne-grupper kan udvikle forståelsen for og praksis omkring demokratiske valg og ledelsesansvar. Spare-låne-grupper som mange organisationer støtter er i sig selv demokratiske med forskellige poster og demokratiske procedurer.

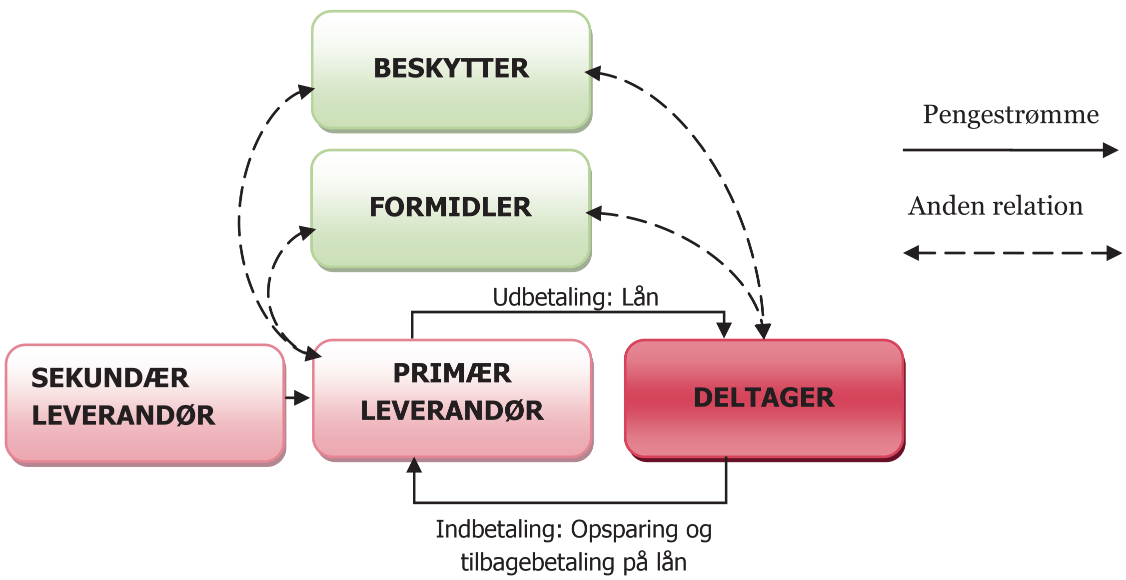
- De fleste mikrofinansinstitutioner er i sig selv aktører i civilsamfundet og udøver dermed en fortalervirksomhed på vegne af deres medlemmer.

- Brugen af mikrofinans blandt kvinder kan bidrage til at styrke deres selvstændighed både i forhold til familien og lokalsamfundet. Der er eksempler på, at spare-låne-gruppe-sammenslutninger kan udvikle sig til indflydelsesrige folkebevægelser med kvinder i spidsen.

I løsningen af denne opgave er det vigtigt, at NGOerne til stadighed har bæredygtighed og selvunderhold som en del af målsætningen. Strategier til, hvordan man opnår dette inden for en kortere periode, bør derfor være en indbygget del af et hvert mikrofinansprojekt. Først ved at lånekapitalen forbliver intakt, og dernæst ved at renterne også kan dække drifts- og kapitalomkostningerne.

Hvem gør hvad?

I grafisk form kan opgaven beskrives sådan, at den faste linje beskriver, hvordan pengene fordeler sig, mens de punkterede linjer beskriver den rolle, som organisationer kan have uden selv at låne penge ud.



Figur A. Fuldt optrukne linjer mellem lyserøde bokse indikerer pengestrømme. De grønne bokse og de stiplede linjer illustrere den rolle organisationer kan spille udenfor den direkte pengestrøm.

Leverandøren omfatter både mikrofinansinstitutioner, som har den direkte kontakt med kunden/låntageren, men også de institutioner som bidrager med lånekapital enten som donation, lån, investering eller lignende.

Formidleren driver ikke mikrofinansvirksomhed direkte, men formidleren søger at fremme brugen af mikrofinans ved at træne grupper til at administrere interne lån baseret på egen opsparing , uddanne mikrofinansmedarbejdere, etablere kontakt til og mellem mikrofinansinstitutioner og skabe et klima i samfundet, hvor opsparing og lån med videre kan trives.

Beskytteren har som opgave at beskytte kunderne ved at arbejde for størst mulig åbenhed, for eksempel hvad angår renten, gennem oplysning og uddannelse, men også gennem påvirkning af regeringers og myndigheders beslutninger med hensyn til brugen af mikrofinans.

Tre generelle råd

- Mikrofinans er et godt værktøj, men ikke en mirakelkur. Der er fattige, som ikke evner at gøre brug af mikrofinans, og folk helt uden indkomst skal måske hjælpes på en anden måde.
- Husk at undersøge hvad lovgivning og myndigheder siger om brugen af mikrofinans. Det skifter fra land til land. Nogle lande har lovgivning om mikrofinans. Andre har forbud mod mikrofinansinstitutioner, der modtager opsparing som en del af deres virksomhed.
- Det er kunden, som bestemmer hvad der skal ske. Hvis mikrofinansinstitutionen vil bestemme, hvad et lån skal bruges til, tager man ansvaret væk fra kunden, og hvis tingene går galt, kan han/hun lægge skylden på den dårlige rådgivning.

Det er blevet sagt, at en god 'loan officer' skal have en bankmands hjerne, en socialarbejders hjerte og en maratonløbers udholdenhed. Bankmandens hjerne er nødvendig, fordi de almindelige bankprincipper også gælder her, socialarbejderens hjerte er nødvendigt, fordi målet med det hele er fattigdomsbekæmpelse, og maratonløberens udholdenhed kræves, fordi arbejdet foregår ude hos kunderne og ikke hjemme ved et skrivebord.

Leverandørerne

Leverandører er dem, der formidler pengene. Det kan være den veletablerede mikrofinansinstitution selv, som af sit overskud og indlånskapital har midler til at låne ud. Men det kan også være NGOer, der har det som en del af et større projekt, banker eller private investorer, der ser en mulighed for at gøre noget nyttigt og/eller skabe et overskud til sig selv.

Anbefalinger til leverandører:

- En leverandør bør arbejde for at blive en permanent og bæredygtig institution og blive en del af landets finansielle system, hvis det er muligt.
- Leverandører bør altid råde over den nødvendige ekspertise til at måle og justere mikrofinansinstitutionens virksomhed med hensyn til låneportefølje, målgrupper, kundernes behov med videre.
- NGOer med en mikrofinanskomponent bør undgå at drive lånevirksomhed, med mindre de har medarbejdere med indgående viden om mikrofinans, og lånevirksomheden i øvrigt er tænkt som et vedvarende engagement.

- Leverandører bør holde mikrofinansarbejdet skarpt adskilt fra NGOens øvrige arbejde. Det er en vanskelig sag både for NGOen og for de mennesker, man ønsker at hjælpe, at skelne mellem lånebistand og gavebistand.

- Leverandører bør undlade at udkonkurrere det lokale lånemarked ved at tilbyde lån på urimelige lave vilkår med for eksempel donorpenge.

- Leverandører bør sikre at kurs- og inflationsrisiko ikke skal bæres af mikrofinansdelen, med mindre den er udrustet til det.

Formidlerne

Formidlerne omfatter alle de organisationer, som vil fremme brugen af mikrofinans men som ikke selv driver denne virksomhed eller investerer i den. Formidleres opgave er at skabe kontakt mellem målgrupper og eksisterende mikrofinansinstitutioner. De bidrager med oplysning og undervisning eller skaber forudsætningerne for, at uafhængige spare-låne-grupper kan opstå og trives.

Anbefalinger til formidlerne:

- I områder hvor mikrofinansinstitutioner er udbredt, kan formidlere etablere kontakt mellem sunde og etisk ansvarlige mikrofinansinstitutioner, og målgrupper som ikke er inddraget, for eksempel fordi de bor for afsides, udgør en større risiko (HIV/AIDS) eller har finansielle behov, som mikrofinansinstitutionen ikke kan imødekomme. Ved formidlerens mellemkomst kan der måske skabes en kontakt til nytte for begge parter.

- Formidlere bør forstå mikrofinansinstitutionernes særlige arbejdsmåde og funktion, herunder nødvendigheden af relativt høje renter og insisteren på tilbagebetaling af lån for at undgå at låneporteføljen gradvis forsvinder.

- Formidlere bør sikre, at mikrofinansinstitutionens ydelser og værdisæt i videst muligt omfang svarer til formidlerens og målgruppens.

- Formidlere bør fortage en grundig analyse af eksisterende mikrofinansinstitutioner for at finde de bedst egnede med dygtig ledelse.

- Formidlere bør, så vidt det er muligt, sikre, at samarbejdet mellem mikrofinansinstitutionen og målgruppen fortsætter - også når formidlerens rolle er udspillet. Et samspil, der afhænger af formidlerens medvirken, har ingen fremtid.

En særlig type mikrofinans er spare-låne-grupperne, som har eksisteret i mange dele af verden under forskellige navne og uden indblanding udefra. I løbet af de seneste 20 år er grupperne i højere og højere grad blevet sat i gang af NGOer. De er dermed blevet en primær metode for danske organisationer til at udbrede adgangen til finansielle ydelser. De består ofte af 20-30 personer, som kender hinanden, bor i samme by eller bydel og mødes regelmæssigt for hver gang at indbetale et aftalt beløb, der derefter udlånes til en eller flere i gruppen.

Styrken ved disse grupper er deres evne til smidigt og billigt at formidle små lån, men svagheden er, at de typisk arbejder med små beløb, som ikke muliggør større investeringer. Her er det vigtigt, at udefrakommende formidlere overlader det til målgruppen selv at formulere sine behov, og beslutte hvordan de vil imødekomme dem. Formidleren kan så bistå med vejledning og oplæring. At hjælpe gruppen på vej med penge udefra er som regel en meget dårlig idé, fordi incitamentet til at spare op formindskes. Det er også vigtigt, at det er de enkelte medlemmer selv, der beslutter, hvem de ønsker at danne gruppe med.

Et stort antal mikrofinansinstitutioner er nu vokset så meget, eller er blevet sammensluttet med andre, at de er blevet til banker eller banklignende institutioner med de fordele og risici, det indebærer. Formidlerens rolle bliver derfor tilsvarende betydningsfuld. Ikke mindst når det gælder om at fastholde mikrofinans-institutionens oprindelige målsætning om at nå og hjælpe de mest marginaliserede.

Beskytteren

Beskytteren er de organisationer, der søger at beskytte brugerne af mikrofinans ved at fremme principper og lovgivning om forbrugerbeskyttelse, informere og undervise om brugen af mikrofinans og støtte initiativer, der fremmer størst mulig åbenhed hos mikrofinansinstitutionerne.

Anbefalinger til beskyttere:

- Beskyttere bør arbejde for krav til mikrofinansinstitutionerne om ansvarlig opførsel med hensyn til medlemmerne, regler for inddrivelse of gæld, personalets opførsel, klageret, fortrolighed og så videre.

- Beskyttere bør påvirke lovgivningen i lande, hvor mikrofinans er udbredt, så mikrofinansinstitutionerne både får rimelige arbejdsvilkår, herunder retten til at modtage opsparing, og love, der beskytter kunderne mod svindel og åger.

- Beskyttere bør forhindre, at regeringer fastsætter et tilfældigt loft over renten i en mikrofinansinstitution. Det kan politisk være opportunt at fastsætte sådanne grænser, men hvis den tilladte rente sættes for lavt, betyder det at nogle grupper afskæres fra at låne, for eksempel fordi de bor i fjerntliggende områder, og renten derfor er højere. Det skal dog siges, at der desværre også er eksempler på mikrofinansinstitutioner, der har udnyttet den manglende konkurrence til at kræve ublu renter.

- Beskyttere bør arbejde for oprettelsen af kreditbureauer, der kan bekæmpe den overbelåning, der nogle steder finder sted, og som for nogle låntagere ender i en nedadgående lånespiral.

- Beskyttere bør argumentere for, at regeringer bør fremme brugen af mikrofinans, men være yderst varsomme med at drive denne virksomhed selv. Der er eksempler på politisk manipulation, magtkampe om ejerskab og udtalt ineffektivitet de steder, hvor det har været forsøgt.

- Beskyttere bør oplære forbrugerne om deres rettigheder og give dem en forståelse af begreber som pant, kaution, renteberegning med videre.

- Beskyttere bør bevidstgøre forbrugerne om forskellene mellem banker, mikrofinansinstitutioner og andre finansielle institutioner og fordele og ulemper ved de forskellige typer.

Executive summary

Microfinance is a powerful tool to fight poverty. It gives poor households an opportunity to engage in their economic lives and thereby work themselves out of poverty. Microfinance can be defined as the supply of financial services including savings, credits, insurance, and money transfers to microenterprises and poor households. Working with microfinance requires a specialised skills set.

- Microfinance is an important development tool, but should not be considered a panacea.
- Organisations looking to engage in microfinance should study the regulation and the enforcement of the regulation before engaging.
- Microfinance should be demand driven and when relevant involve the intended clients in project design.

Provide

A provider of microfinance supplies financial services either directly to the client at the retail level or via wholesale loans and equity investments. Specialised providers, also called microfinance institutions (MFIs), are formal financial or semi-formal institutions offering financial services. The specialised microfinance industry is a professional and increasingly commercial industry. It requires professionalism and specialised skills to operate as a competitive provider in the industry.

- A specialised provider must strive to become a permanent and financially sustainable institution.
- A specialised provider must have appropriate systems to monitor portfolio performance as well as key financial and social indicators.
- A specialised provider should strive to become integrated into a country's mainstream financial system.

A non-specialised provider is an organisation providing financial services as an addition to their main focus area. It should be carefully considered if the organisation has the adequate capacity before integrating microfinance into projects via for example a revolving fund or a credit component.

- Organisations without specialised competencies in financial services should not provide microcredit.
- In case both financial and non-financial services are provided the two should be kept separate and people with specialised skills should be employed to manage the microfinance component.

Engaging in microfinance at the wholesale level, means providing credit to MFIs with the purpose of on- lending to their clients. An equity investment is the purchase of shares either via public markets or as private equity investments.

- Wholesale lenders should be aware of the risk of crowding out local commercial capital by competing on subsidised terms.
- Wholesale loans should not subject the institutions to currency risks if they are not equipped to manage it.
- When making equity investments strive to enhance impact and value by supporting incorporation of consumer protection and by collaborating with organisations offering capacity building.

Promote

Promoters seeks to build on existing structures by collaborating with an MFI to reach a specific target group, or by improving service provision through capacity building and training, or by establishing community based structures where financial services are offered by independent savings and loan groups. Linking the target group to a specialised microfinance provider often presents a good solution for offering financial services to an otherwise excluded group, especially in countries where the microfinance industry is relatively well-established.

- Understand the business model practiced by the specialised provider including methodology, products, and services.
- Ensure that the products and services offered match the needs for the target group and that the provider's values correspond with yours.
- Selection of a microfinance partner should be based on a thorough evaluation of performance, durability, and capacity.
- Ensure that incentives are aligned - both in the short and long term.

Savings and credit groups represent a banking method at the community level, where members can easily save and periodically receive a lump sum of money. Savings and credit groups are driven and owned by the people themselves and make use of their own resources, they help develop both financial and social capital.

- Groups must be self-managed and membership should always be based on self-selection.
- Project design should be easy to replicate and include strategies for long-term sustainability.
- Providing external loan capital as grants to savings and credit groups should generally be avoided.

Today one of the biggest challenges to the microfinance industry is weak institutions and lack of management capacity. An important promoter role is to support capacity building towards a strong civil society as well as capacity building of the next generation of high performing microfinance providers. This is a challenge of selecting the organisations with the best foundations and supporting them through the long process of expansion and transformation.

- Support the continuous upgrading of competencies and capacities as the organisation expand.
- Support capacity building towards a strong civil society via federation of savings and credit groups.
- Support capacity building of existing institutions to improve access to financial services at a general level.

Protect

To protect refers to organisations seeking to protect microfinance clients by advocating and supporting implementation of consumer protection principle, providing information and education about the costs and benefits of financial services, and advocating for establishment of proper national regulations of the sector. The rapid growth of the industry; the commercialisation trend; and the increased competition in urban areas, have resulted in an increasingly complex industry, where loopholes in legislation and lenient enforcement, have created developments, which expose the clients to additional risks.

- Advocate implementation of consumer protection principals at the institutional level.

An increasing number of countries are adopting national policies and strategies for microfinance. A country's regulatory authorities have an important mission of developing appropriate prudential regulations to protect the solvency of large institutions that collect deposits from poor people.

- Advocate for the establishment of a credit bureau to protect clients against over-indebtedness.

- Advocate for the perceptive that the job of government is to enable financial services, not to provide them directly.

- Advocate for the understanding that interest rate ceilings hurt poor people by making it harder for them to get access to financial services.

While knowledge of microfinance and users' rights and responsibilities has grown over the past decade, consumer education is still needed.

- Educate consumers in financial literacy and consumer rights

Danish Forum for
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Introduction

Microfinance is a powerful tool to fight poverty. Financial market failures in developing countries lead to exclusion of the poor, but bankable, who do not have access to traditional financial services. Microfinance gives poor households an opportunity to engage in their economic lives and thereby work themselves out of poverty. Microfinance may be defined as the supply of financial services including savings, credits, insurance, and money transfers to microenterprises and poor households. They use financial services to manage their cash flow more efficiently, to enable investments, or to cushion themselves against external shocks. At the very low levels, community-managed microfinance contributes to community mobilisation. Despite the development of the industry the demand for financial services is still largely unmet.

Danish Forum for Microfinance (DFM) is a network of Danish organisations working with microfinance in developing countries. DFM was established in 2009 with the objective of strengthening the capacity in the Danish sector as well as increasing the awareness about microfinance in Denmark. Today DFM has 46 member organisations counting NGOs; public institutions; and private companies, including a few commercial banks. With these guidelines, we aim to contribute to an increased capacity among the Danish players.

Why do we need a new set of microfinance guidelines? There are several guidelines available to practitioners, making this a reasonable question. We believe that the available guidelines do not sufficiently meet the demand of Danish players in microfinance. A large proportion of the Danish organisations involved in microfinance are active in *promoting microfinance*: They build capacity; start village banks; and create infrastructure, rather than actually lending out money. Many existing guidelines, including CGAPs 11 Good Practice Guidelines for Funders of Microfinance, focus on providing finance, i.e. lending out funds either to clients directly or indirectly through microfinance institutions. Furthermore, the microfinance sector in Denmark might be small in size, but is developing rapidly. The first ever launch of a Danish managed investment fund for microfinance took place in 2010 when PKA and IFU announced a DKK 400m fund. At the same time, several Danish NGOs have expanded their work with savings and credit groups, and finally, access to finance is mentioned specifically in the Danish governments' strategy on Foreign Aid.   For these reasons, we believe a new set of uniform guidelines aimed at the Danish organisation engaged in microfinance is needed.

Guidelines should first and foremost be useful. They should give directions and inspire practitioners to reflect on their current practice. To strengthen the usefulness of these guidelines, a comprehensive survey of the Danish microfinance sector has been used as starting point. Furthermore, several existing guidelines have been used as inspiration.[2] Good future practice comes from improvements in present practice. Working with guidelines is an important process, just as much as they are a piece of paper. In that respect, what follows is only one result of the on-going work of developing the Danish microfinance sector and qualifying the debate on the topic.

Ole Dahl Rasmussen, Chairman, Dec. 2010

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[2] Including: CGAP (2006), *Good practice guidelines for funders of microfinance*. EUROPEAN COMMISSION, EuropeAid (2008), *Guidelines for EC Support to Microfinance*. SIDA (2004), Guidelines on Microfinance. DanChurchAid (2008), *Microfinance Guidelines*. NDN Thematic Group Microfinance (2004), *Promising practices microfinance.*

Definitions and terms

Microfinance:

Microfinance is the supply of financial services including savings, credits, insurance, and transfers to microenterprises and poor households.

Microfinance institutions (MFIs):

MFIs are specialised financial institutions that focus on providing financial services to microenterprises and poor households. MFIs may both be formal financial institutions structured as traditional banks and regulated by the central bank, and semiformal institutions such as NGOs; None Bank Financial Institutions (NBFI); or member based organisations such as SACCOs.

NBFI:

Non-bank financial institutions are companies, registered under the countries companies act, offering credit.

Non-governmental organisations (NGOs):

NGOs are non-profit, civil society organisation not affiliated with any government and devoted to managing resources and implementing projects, with the goal of addressing social and socio-economic problems. NGO-MFIs are NGOs specialised in provision of microfinance.

Revolving fund:

A revolving fund is a source of money typically provided by a donor for the purpose of funding a loan portfolio on a continuous basis. A revolving fund does typically not accrue interest and is not meant to be repaid. From the revolving fund loans are made to clients and repaid with interest, so that the fund is maintained and money can continuously to be lent out.

SACCO:

Savings and Credit Co-operative (SACCOs) are member-based organisations offering financial services to their members.

Savings and Credit groups:

Savings and Credit group is an umbrella term including both traditional and newer community based group methodologies for providing microfinance.

Wholesale loans:

A wholesale loan is a loan extended to a microfinance provider for on-lending to clients.

Organisation of microfinance in Denmark

Different actors work with microfinance in different ways. Companies, NGOs and others who work with microfinance will find that certain sections of these guidelines are particularly relevant to them. Describing and agreeing on who does what in microfinance is a central objective in drafting these guidelines. The following sections provide an overview of the different types of Danish organisations involved and their modes of engagement as well as specific comments on microfinance and the civil society strategy.

Danish organisations involved in microfinance include:

- The largest group of organisations by number is NGO's. These include small voluntary NGOs as well as NGOs with hundreds of staff. A common characteristic of these NGOs is that they are likely to receive funding under the Danish Government's Civil Society strategy. As such, the fit or misfit between this strategy and the present guidelines are of particular interest and is commented on below. The sections most relevant to this group are likely to be the sections on promoting microfinance. Moreover, the protect section will be relevant, in particular to organisations involved in rights-based work.

- Banks and investment funds. These organisations are involved in microfinance either via investments in MFIs or debt provided at a wholesale level. These organisations will find the sections on wholesale investments and consumer protection particularly relevant.

- Companies providing investment infrastructure or working with microfinance as part of their Coperate Social Responsibility strategies, will find the sections on specialised providers and linking particularly relevant.

- Other organisations including universities and student organisations.

To facilitate the discussion about who does what in microfinance, it is useful to distinguish between the different roles of Danish organisations. The background for doing that is three different modes of engagement, which are explained in the following section, but firstly a few comments on microfinance in the context of Danida's civil society strategy are made.

NGOs under the civil society strategy

Support from Danida to Danish NGOs' initiatives in developing counties is framed within the civil society strategy. 79% of the Danish organisations working with microfinance in 2010 are civil society organisations (NGOs). According to *Microfinance in Denmark, state of the sector 2010*, more than 80% of their funding comes from Danida and is extended under the civil society strategy. Therefore, it is relevant to pinpoint how microfinance is perceived in the context of the civil society strategy. The long-term objective of the strategy is to contribute to the development of a strong, independent and diversified civil society in developing countries. Support to microfinance may contribute to the aim of the strategy in four primary ways:

- Many microfinance providers, particularly community-based savings and credit groups, are themselves civil society actors. Building their capacity contributes to building a stronger civil society. Particularly, federations of savings and credit groups have the potential to become local political factors e.g. in questions relating to access to land and services. Under certain circumstances, larger microfinance institutions such as

SACCOs might also fulfil a similar civil society role.

- Several microfinance methods, for example savings and credit groups, include free, fair and secret democratic elections at a very small scale. As such, microfinance serves as an effective laboratory for democratic accountability.

- Promoting microfinance targeted at marginalized groups contributes to economic empowerment enabling people to participate in local organisational and advocacy activities.

- Promoting microfinance in a gender sensitive way can contribute to empowerment of women. Access to credit can increase the room of manoeuvre for women within their families and communities. It is crucial, that the mode of engagement e.g. self-help groups organised around savings and credit, is designed in a way that takes the needs and interests of men into account.

In order to utilize microfinance as a tool in building civil society, Danish NGOs can contribute with activities that promote, provide and protect clients. Regarding provision of microfinance, for example through funds for microfinance, it is important to distinguish the civil society strategy's general discouragement of service delivery from provision of microfinance services. The difference is sustainability; following the civil society strategy, service provision should in general be avoided or minimized because of the obvious problem with sustainability. However, microfinance should always work with a clear ambition of operational self-sufficiency.[3] As such, this provision of services is sustainable and can be used to contribute to building a strong and independent civil society.

Modes of engagement

These guidelines are structured into three sections: provide, promote, protect. They describe the different roles a Danish organisation can play when working with microfinance. The figure below is a visualisation of this.

Provide

A provider of microfinance supplies financial services either directly to the client at the retail level or via wholesale loans and equity investments. Providers of microfinance include all types of organisations providing financial services to clients as well as the institution providing loan capital to these organisations in terms of grants, revolving funds, loans, or equity investments.

[3] Operational Self-Sufficiency (OSS) is a measure of how well a microfinance provider covers costs through operating revenues. The calculation is: Financial Revenue/(Financial Expense + Impairment Losses on Loans + Operating Expense). An organisation that is Operational Self-Sufficient covers all operational costs through operating revenue.

Danish Forum for
Microfinance

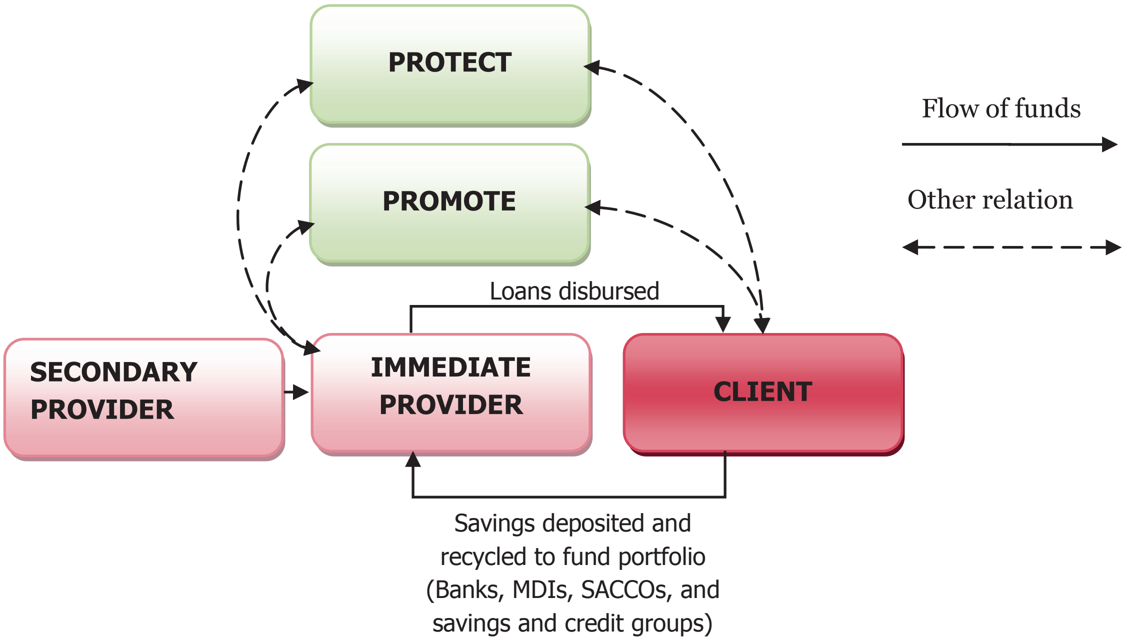

Figure 1. Solid arrows between the pink boxes indicate flow of funds. The green boxes and the broken lines illustrate the roles an organisation can play outside the direct capital flow.

Promote

An organisation promoting microfinance does not provide financial services neither directly at a retail level nor indirectly as wholesale loans. Promoters seek to give beneficiaries access to financial services by building on existing structures; by linking with an MFI to reach a specific target group; by improving service provision through capacity building and training; or by establishing community based structures, where financial services are offered through independent savings and credit groups.

Protect

To protect refers to organisations seeking to protect microfinance clients by advocating and supporting implementation of consumer protection principles; by providing information and education about the costs and benefits of financial services; and by advocating establishment of proper national regulations and support systems.

The table below illustrates examples of how provide; promote; and protect work in practice, and seeks to create a link between the target group and their demand; the local suppliers; and the role the Danish organisations can play. This is further described in the following sections.

It should be noted that microfinance is not only for entrepreneurs, but also for employed or unemployed people needing to smooth and secure income, for consumption such as school fees, lifecycle needs such as weddings, and emergencies. However, as these needs are more or less similar to all targets groups, they have for simplification been left out of the table.

DEMAND FOR MICROFINANCE		LOCAL ORGANISATIONS	DANISH ORGANISATIONS INVOLVEMENT		
TARGET GROUP	**DEMAND**	**SUPPLIERS**	**PROVIDE** *(an example)*	**PROMOTE** *(an example)*	**PROTECT** *(an example)*
Subsistance and Income Generating Activities	**Savings, insurance, small short-term loans**	**Savings and credit groups, money lenders, and MFIs**	Engagement: *For example revolving funds as sub-components in NGO projects* Recommendation: *Organisations without specialised competencies in financial services should not provide microcredit*	Engagement: *For example setting-up and training savings and credit groups* Recommendation: *Groups must be self-managed and membership should always be based on self-selection*	Engagement: *For example consumer education* Recommendation: *Educate consumers in financial literacy and consumer rights*
Micro entre-preneurs **(self-employed with 0 – 5 employees)**	**Deposit accounts, insurance, medium sized loans**	**MFIs, banks and money lenders**	Engagement: *For example providing portfolio funding for MFIs (wholesale)* Recommendation: *Wholesale loans should not subject institutions to currency risks if they are not equipped to manage it*	Engagement: *For example lining MFI to target group* Recommendation: *Ensure that incentives are aligned - both in the short and long term*	Engagement: *For example Advocate for national policies for microfinance* Recommendation: *Advocate for the establishment of a credit bureau to protect clients against over-indebtedness*
Growth oriented micro entre-preneurs	**Deposit accounts, insurance, larger loans with flexible terms**	**MFIs and banks**			

At the lowest level of society the demand is primarily for services enabling the poor to redistribute income, meaning moving income across time, either from the present to the future (savings) or from the future to the present (credit). People in this target group often live in rural areas, their income is generated from subsistence agriculture; petty trade; salary from working as day-labourers; or transfers from family members. Their demands for services include savings, insurance, and small short-term loans. These services enable poor families to take care of life cycle needs, emergencies, manage volatility in income, and to take advantage of opportunities. In other words, the purpose of financial services at this level is primarily to improve livelihood and support subsistence businesses. The typical providers are savings and credit groups and local money lenders. MFIs are often not able to reach this target group on sustainable terms, especially in remote areas or if the target group is particularly risky. However, it should be noted that some MFIs offer financial services to these groups, regardless of it being unsustainable, either as part of their long-term strategy or due to a strong social objective.

Savings and credit groups are often not able to support microentrepreneurs above the subsistence level. Microentrepreneurs have small stable businesses that make up the foundation for household income. They need access to larger loans with longer repayment periods, and they need loans fast when an opportunity presents itself. As a result, MFIs are the typically the most relevant service provider for microentrepreneurs.

Growth oriented entrepreneurs have small manufacturing, trading, or service businesses. The entrepreneur has the motivation and skills to expand the business. They need a good relation to a stable and professional financial service provider, who can support their long term growth. They need access to business loans on flexible terms including grace periods[4], long repayment periods, and bullet payments[5]. Often Banks or MFIs are the best providers of financial services for this target group. However, it should be noted that traditional savings and credit groups can be found at all levels of society, and that there are examples of groups working with significant pools of savings, thus offering large flexible loans supporting these entrepreneurs.

[4] A grace period is a period where no payment of principal or interest has to be made. It is particularly relevant in agriculture or when investing in productive assets.

[5] Bullet payments are repayments made in instalments adapted to the business cashflow. Often, the majority of the principle is repaid as a lump sum at end of the loan period.

Recommendations for good microfinance

Working with microfinance requires a specialised skills set. This is best described by a saying often mentioned by practitioners stating that "*a good loan officer has the mind of a bank, the heart of a social worker, and the stamina of a long distance runner*". The mind of a banker, because the fundamental principles of banking applies also to microfinance. The heart of a social worker, because the purpose of microfinance is to alleviate poverty, and the loan officer has to understand the needs of the poor. The stamina of a long distance runner, because relations in the local community are necessary to succeed and the job of a loan officer is in the field, not behind a desk. In the following the recommendations are divided into the roles of provide, promote and protect, but firstly a few general recommendations are made.

Microfinance is an important development tool, but should not be considered a panacea. Other efforts may be more relevant, and microfinance is not always the appropriate tool. For example, if the household cashflow is negative i.e. earnings are structurally lower than cash outflows, microfinance risks resulting in perpetual indebtedness and poverty. If there is no income to redistribute, the poor cannot benefit from microfinance.

Organisations looking to engage in microfinance should study the regulation and the enforcement of the regulation before engaging. The legal framework regulating and supervising microfinance differ across the world. In many countries deposit services can only be provided by institutions regulated and supervised by the central bank. In others, semi-formal institutions such as member-based cooperatives (e.g. SACCOs) and NGOs operate under a special regulation and are allowed to offer savings services. However, it is important to familiarise oneself with the regulations and the enforcement of the regulations in each particular country before deciding to engage in microfinance.

Microfinance should be demand driven and when relevant involve the intended clients in project design. Microfinance projects can be designed for a specific target group, but must not be discriminating. It is important to keep in mind that microfinance is often subject to economies of scale; therefore the more narrow and multilayered the targeting, the greater the risk of insufficient demand, which can make it impossible to offer the services sustainably. Furthermore, the financial services provided should not be earmarked for a predetermined purpose, but should be managed by the client. If the provider earmarks the purpose of a loan or provides advice alongside the loan, it takes the responsibility for success away from the client, who in case of default can refer to faulty advice.

Provide

A provider of microfinance supplies financial services either directly to the client at the retail level or via wholesale loans and equity investments (see *Figure 1*). Providers of microfinance include all types of organisations providing financial services to clients as well as the institution providing loan capital, as grants; revolving funds; loans; or equity investments, to these organisations.

PROVIDE
Specialised MF provider (MFI)
Non specialised provider
Wholesale loans and equity investment

Only a few Danish organisations are involved in the direct provision of microfinance. Especially after the 2007 survey recommended discontinuing NGO programmes providing revolving funds as integrated components of existing projects, a practice that often fails due to unclear ownership of funds and lack of specialised skills. Nevertheless, there are some Danish NGOs who have set-up specialised microfinance providers and upon exit left a permanent, sustainable and independent institution. Also, two small Danish banks have for many years provided wholesale loans to MFIs via international organisations, and lately a couple of interesting provider-initiatives have been introduced. Organisations acting as providers and organisations linking to providers will find this section and section on linking found on page 21 relevant.

Specialised provider

Specialised providers are also called microfinance institutions (MFIs), and can be both formal financial institutions structured as traditional banks and regulated by the central bank; and semiformal institutions such as NGOs, None Bank Financial Institutions (NBFI), or member based organisations such as SACCOs. The specialised microfinance industry is a professional and increasingly commercial industry and it requires professionalism and specialised skills to operate as a competitive provider in the industry.

A specialised provider should strive to become integrated into a country's mainstream financial system. Microfinance means building financial systems that serve the poor. The fundamental principles of finance apply widely and must be observed by all institutions if they are to succeed. Where and when the financial market regulation and supervision is well managed by the central bank, a specialised microfinance provider should strive to become integrated into the traditional financial market. This will allow the institution to offer savings services and recycle the deposited capital into loans, thereby in creating a self-sufficient national financial market.

A specialised provider must strive to become a permanent and financially sustainable institution.
Establishing an MFI requires specialised competencies, a good business plan, and a clear product offering matched to the demand of the target group. Typically, an MFI reaches operational efficiency, defined as covering all administrative costs and loan losses with client revenues, within 3-7 years and thereafter financial self-sufficiency, defined as covering all administrative costs, loan losses, financing costs including opportunity cost and inflation, within 5-10 years.

A specialised provider must have appropriate systems to monitor portfolio performance as well as key financial and social indicators. Performance indicators should cover at least the following core areas: breadth of outreach, depth of outreach, portfolio quality, efficiency and sustainability (see appendix page 29). Monitoring social performance is important to avoid mission-drift and to adapt the products to the clients' changing needs[6].

[6] Several organisations are seeking to develop generic impact assessment tools for example http://sptf.info, http://www.imp-act.org/, and

Non-specialised provider

A non-specialised provider is an organisation providing financial services as an addition to their main focus area, for example, via a revolving fund or a credit component. It can be relevant to alleviate a known target groups' exclusion from the financial market by providing them with credit or to achieve synergies by integrating a credit components into e.g. business training schemes or agricultural projects. However, experience shows that such projects often perform poorly and are unsuccessful. Therefore, it should be carefully considered if the organisation has the adequate capacity before integrating a revolving fund or a credit component. A good alternative is promoting microfinance by linking to a specialised provider or facilitating the establishment of savings and credit groups where the organisation is not directly involved in provision of financial services (see page Linking21).

Organisations without specialised competencies in financial services should not provide microcredit. Financial services, which cannot be expected to be permanent, are much less likely to instil trust in the financial sector; or to offer reliable savings and deposit facilities; or to promote an improved credit culture. Also, administering credit is difficult and expensive and falls outside the competence and strategies of most non-specialised institutions. This presents several risks not just to the organisation, but also to the beneficiaries, who risk being driven into deeper poverty if a proper evaluation of the repayment capacity has not been conducted. Lastly, a mix of donations and loans often confuse the organisation and the client.

In case both financial and non-financial services are provided the two should be kept separate and people with specialised skills should be employed to manage the microfinance component. Provision of financial services is a highly specialised activity that is not easily incorporated into an organisation with other purposes and a different professional background. Therefore, microfinance projects should be operationally and financially autonomous initiatives. Whenever it is a part of a larger integrated development programme, the microfinance initiative has to be operated on a separate and clearly distinct basis with separate accounting, governance structures, and dedicated management. Furthermore, it should always be evaluated if the programme is likely to leave permanent and sustainable structures in place.

Wholesale and equity investments

Engaging in microfinance at the wholesale level, means providing credit to MFIs with the purpose of on- lending to their clients. The credit can be provided directly to the MFI or via existing international intermediaries. An equity investment is the purchase of shares either via public markets or as private equity investments. Few MFIs are traded in public markets and therefore most investments are private. In the past decade intermediating loans and investments in MFIs has grown to become a billion dollar industry.

Wholesale lenders should be aware of the risk of crowding out local commercial capital by competing on subsidised terms. The majority of foreign direct investment in microfinance is made by quasi-commercial

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http://www.progressoutofpoverty.org/toolkit investors or DFIs[7], sometimes on subsidised terms. This has been heavily criticised by industry professionals for crowding out local private capital where it is available. Wholesale loan capital should not compete with local commercial sources on unfair terms or make savings less relevant for the institution. Rather it should promote access to local markets by removing obstacles for such investments and by seeking to leverage private capital as part of the investment. Quasi-commercial wholesale lenders seeking to enhance financial market inclusion should provide wholesale loans when local commercial capital is not available or when the subsidised terms enable the MFI to reach an otherwise excluded target group.

Wholesale loans should not subject the institutions to a currency risk if they are not equipped to manage it. The majority of wholesale loans are made in hard currency, leaving the MFI to manage the currency risk, which they are not always equipped to do. When offering hard currency loans organisations should certify that the MFI has the capacity to manage the risk either by hedging or by incorporating the risk into their fund management structures. If the MFI is not equipped to manage the currency risk it may easily translate into a credit risk and the risk of default increases.

When making equity investments strive to enhance impact and value by supporting incorporation of consumer protection and by collaborating with organisations offering capacity building. As the microfinance industry becomes increasingly efficient and commercial there is a risk of mission-drift as well as a risk of loopholes making it possible to abuse the good reputation and favourable legislation for microfinance. By introducing consumer protection principles (see page 24) in the MFIs there is a possibility to influence the industry positively. Furthermore, there are several examples of investors and donors collaborating to offer capacity building for the MFI alongside an investment or donors offering capacity building at the policy level to support the creation of a strong and healthy industry.

Promote

An organisation promoting microfinance does not provide financial services neither directly at a retail level nor indirectly as wholesale loans (see Figure 1). Promoters seeks to build on existing structures by linking with an MFI to reach a specific target group; by improving service provision through capacity building and training, or by establishing community based structures, where financial services are offered by independent savings and loan groups.

PROMOTE
Linking the target group to specialised provider
Set_up and train savings and credit groups
Capacity build MFIs

[7] Development Finance Institutions (DFIs) are specialised financial institutions – bilateral or multilateral - providing long-term finance for private sector enterprises in developing and reforming economies. They are often state funded, and generally, have the mandate to provide finance to the private sector for investments that promote development.

Linking the target group to a specialised provider

Linking the target group to a specialised provider often presents a good solution for offering financial services to a group otherwise excluded from the financial markets; especially in countries where the microfinance industry is relatively well-established. Typically the target group is excluded either because it is expensive to establish the capacity needed to reach the target group (e.g. remote areas), because the target group posses a particularly risk (e.g. HIV/AIDS infected), or because products offered do not match the demand from clients. However, the specialised provider might be interested in working with the promoter to reach a particular area or to develop special products; especially if the target group represents an attractive future customer group.

Understand the business model practiced by the specialised provider, including methodology, products, and services. A successful linking strategy requires a good understanding of the business model practiced by the specialised provider. This includes understanding that high interest rates often stem from the costs of handling many small loans, and that strict enforcement of repayment is necessary in order to avoid a deteriorated loan portfolio.

Ensure that the products and services offered match the needs for the target group and that the provider's values correspond with yours. It is important that the values of the MFI correspond with the promoters' values, and that the products provided matches the needs of the target group. The promoter should consider training the MFI to understand the special target group or supporting the MFI to implement consumer protection principals.

Selection of a microfinance partner should be based on a thorough evaluation of performance, durability, and capacity. It is important to link to the best possible MFI and evaluate their performance, durability and capacity including governance and management structures, financial and risk management procedures, products and methodology, and management information systems. When linking to a smaller and less experienced MFI, evaluate if they have the capacities and structures needed to manage the new target group and to become a lasting institution. When linking to semiformal MFIs such as a SACCO, an NGO-MFI, or a NBFI be aware that they often fall outside central bank legislation and supervision, thereby leaving their services including management of the depositors' money unregulated. Policies and structures should be set-up to manage and monitor this. Microfinance rating agencies[8] provide evaluations and ratings of MFIs; the ratings reports are often publicly available and may present a good starting point when searching for a partner MFI.

Ensure that incentives are aligned - both in the short and long term.
Ensure that incentives and interests are aligned, and that the MFI will continue to offer products to the target group after the promoters' support has been discontinued. For example supporting an existing MFI financially to enable them to establish a branch in a remote project area, where the local population

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[8] For example Planet Rating, MicroRate, CRISIL, MicroFinanza

is excluded from financial services, may be feasible; but only if the institutions believes in the long-term sustainability of the branch and is likely to continue offering financial services to the target group after the promoters support and involvement has ended.

Savings and credit groups

A common provider of microfinance is different types of groups where the members regularly, often weekly or monthly, pool savings and distribute these as loans to members. These systems have been practiced for centuries[9] and are often referred to as Accumulating Savings and Credit Associations (ASCAs)[10] or Rotating Savings and Credit Associations (ROSCAs) [11]. Increasingly, donors and NGOs are becoming involved in organising savings and credit groups similar to ASCAs or ROSCAs, but with the aim of being more transparent, better managed, and more efficient than the traditional groups. Savings and credit groups represent a banking method at the community level, where members can easily save and periodically receive a lump sum of money. Savings and credit groups are driven and owned by the people themselves and make use of their own resources; therefore they can reach remote rural areas and poor target groups. Additionally, savings and credit groups often help to mobilise the local community, enhance social capital, build leadership skills, and create economic empowerment.

Groups must be self-managed and membership should always be based on self-selection. Set-up and management must be done by the group members themselves, who design the products according to their needs and elect their group leaders. The promoter's contribution must be limited to advocacy, training, and support until the group has built the capacity to continue autonomously. Furthermore, it is of utmost importance that the members themselves decide on whom to include in a group, and that they are all socially connected and 'peers'. Since membership of a group is based on self-selection, it is important to address negative attitudes and behaviour to prevent exclusion of disadvantaged groups for example young people, the poorest of the poor, or people living with HIV/AIDS. Groups should never be forced to include certain groups or people, but they should be informed to take a positive decision.

Project design should be easy to replicate and include strategies for long-term sustainability. A savings and credit group is a relatively simple tool for providing access to basic financial services. However, paying attention to the detail in project design[12] is

[9] These groups have different names in different countries: Likilimbas, Merry Go Round, Tontines, and Bishies.

[10] An ASCA is a group where each member saves an amount for a pool at every meeting. The money saved up in the group and can then be lent to members.

[11] A ROSCA is a group where each member pays a fixed amount to a group pool at each meeting. The entire pool is shared out to members in turn and there is no money saved in the group.

[12] Several models have been developed and are very

extremely important to building sustainable structures that can be replicated and can develop into strong local community organisations. Strategies for long-term sustainability should be included in the project design, for example it is advisable to train local resource persons during the intervention phase or to federate well-established savings and credit groups. Resource persons can establish a business around setting-up and supporting groups. Federations can help consolidate saving and credit groups and when the initiating NGO draws back, the federation can supervise and train new groups, and thus secure sustainability.

Providing external loan capital as grants to savings and credit groups should generally be avoided. External loan capital makes it possible to give members access to bigger loans and invest in more advanced business ventures. However, experience shows that access to external capital creates a credit focus in the groups, diluting the sense of ownership and accountability, and reducing the members' incentives to save. Additionally, external loan capital provided as grants unavoidably result in to unclear ownership of funds. Therefore, promoters and non-specialised providers should generally refrain from giving loan capital to savings and credit groups as grants. When a group is strong and has proven its ability to save, it could link up to a specialised provider. Whereas this is the general experience, there are examples of project designs, where topping up the savings pool of an existing group has worked for many years and the groups have, despite the added funds, proved to be sustainable.

Capacity building

There are several examples of microfinance initiatives starting as small projects or groups at the community level and growing into strong civil society organisations or large financial institutions with several thousand of clients. However, this is a long and difficult process, and today one of the major challenges to the microfinance industry is weak institutions and lack of management capacity. An important promoter role is to support capacity building towards a strong civil society as well as capacity building of the next generation of high performing microfinance providers. This is a challenge of selecting the organisations with the best foundations and supporting them through the long process of expansion and transformation.

Support the continuous upgrading of competencies and capacities as the organisation expand. In an expansion and transformation process capacity building is a continuous requirement. For example, a well-established savings and credit group can federate with other savings and credit groups to become a SACCO. Or a local NGO providing microfinance as a sub-component of a project can, because of success or failure of the project, decide to separate the microfinance component into a new organisational structure. This is a move from the informal sector to the semiformal sector, as well as a move towards specialisation of financial services provision. At this level, it is no longer initiated by the clients themselves, but a service provider offering a product to a client. This presents other benefits and other risks e.g. over-lending, and therefore it requires a different skill and mindset.

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well-described, one of them is the VSLA model: http://www.vsla.net/

Support capacity building towards a strong civil society via federation of savings and credit groups. Microfinance, particularly in the form of savings groups can be good platforms for mobilising and building the capacity of the civil society. This has particularly been the case in South Asia, where savings groups or self-help groups have joined in federations, thereby forming civil society organisations from the grass root level. This process takes place at the individual and at the institutional level. At the individual level, the democratic educational processes taking place in the self-help groups enable people to become politically aware and address local authorities. At the institutional level, federations of savings and credit groups have the potential to become local political factors e.g. in questions relating to access to land and services.

Support capacity building of existing institutions to improve access to financial services at a general level. If the objective of the promoter is to improve access to financial services at a general level, a good option is to support capacity building of existing institutions that represent the next generation of high performing MFIs. For example semi-formal organisations typically operate at the threshold of commercialisation and strive to become self-sufficient in order to survive as independent organisations that are not dependent on continued donor funding. Often this includes an objective of obtaining central bank approval, as this will allow the organisation to take deposits, offer more sophisticated products, and build shareholder value. Achieving Central Bank approval requires professional boards and management, sophisticated systems for monitoring and reporting, branch connectivity, capitalization etc. A promoter should carefully choose the providers it wishes to support, clearly specify the objective of the capacity building, establish milestones in collaboration with the MFI, and be prepared for the long haul.

Protect

To protect refers to organisations seeking to protect microfinance clients by advocating and supporting implementation of consumer protection principle, providing information and education about the costs and benefits of financial services, and advocating for establishment of proper national regulations of the *sector*.

PROTECT
Advocate implementation off consumer protection
Advocate for national policies
Consumer education in financial services

Consumer protection principles

In the later years several initiatives seeking to establish a general set of consumer protection principles designed specifically for microfinance has been introduced. The rapid growth of the industry; the commercialisation trend; and the increased competition in urban areas, have resulted in an increasingly complex industry, where loopholes in legislation and lenient enforcement, have created developments, which expose the clients to additional risks.

Advocate implementation of consumer protection principals at the institutional level. Consumer protection principles should specify the microfinance provider's code of conduct on issues relating to target groups, collection practices, deposit and lending practices, staff behaviour, client complaint mechanisms, privacy of data, pricing etc. The protector can play a role both in advocating consumer protection principles to MFIs (push) and to clients (pull), and may also consider supporting the implementation and training in the principles. The Smart Campaign is one of the initiatives advocating a general set of consumer protection principles (see appendix page 28).

National policies for microfinance

An increasing number of countries are adopting national policies and strategies for microfinance. National policy and regulation strongly influence the nature and development of the industry. A country's regulatory authorities have an important mission of developing appropriate prudential regulations or adapting existing banking regulations to protect the solvency of large institutions that collect deposits from poor people and, ultimately, to protect the savings of the poor. However, over-regulation of for example interest rates inhibits the development of the industry, because it makes it impossible to reach large consumer groups on sustainable terms. A protector can advocate implementation of proper national policies and support structures such as a credit bureau.

Advocate for the understanding that interest rate ceilings hurt poor people by making it harder for them to get access to financial services. Making and collecting on many small loans or administering many small transactions on deposit accounts, is much more costly than making a few large loans or administering a deposit account with a few larger transactions. If microfinance is to be sustainable providers must charge interest rates and administration fees that cover their operational, administration, and financial expenses including loan loss, inflation, capital costs. Interest rate ceilings prevent microfinance providers from covering their costs, and thereby choke off the supply of credit for poor people. Generally, it is better to have access to expensive financial services, than not to have access at all. However, there are examples of institutions charging exorbitant interest rates to cover defaults occurring due to over-lending, and therefore one should always use information from the local sector and common sense when evaluating interest rates[13].

Advocate for the establishment of a credit bureau to protect clients against over-indebtedness. Over-indebtedness is increasingly a problem in microfinance. It presents a large risk to the industry, the MFIs, and the individual clients, who risk ending up in a negative debt spiral. As mentioned above implementation of consumer protection principles provides a good guideline for MFIs. However, without a credit bureau it can be difficult to obtain objective and reliable information about the client's credit history. A credit bureau tracking clients' overall indebtedness and credit histories helps to protect clients against over-borrowing.

Advocate for the perceptive that the job of government is to enable financial services, not to provide them directly. The failure of state-implemented credit schemes has been more the rule than exception. There are significant risks for undue political influence, confusion about future ownership, and

[13] MF transparency offers data on interest rates in various countries and generally advocates transparency in interest rates www.mftransparency.org

inefficiencies in the transfer of funds. Protectors can seek to influence the government to limit their role to setting up a supporting policy environment.

Financial literacy training

The rapid growth of the microfinance industry, the commercialisation trend, the increasing competition, and innovation in product offering has resulted in an increasingly complex industry. While knowledge of microfinance operations and users' rights and responsibilities has grown over the past decade, consumer education is still needed.

Educate consumers in financial literacy and consumer rights. Educating consumers in financial literacy is an important element of consumer protection. Microfinance providers have a responsibility to, but also conflicting interests in, educating their clients. Therefore, educating consumers about their rights, responsibilities, types and uses of different financial products, and the difference between various types of financial institutions, should be considered a public good and an important element in protecting consumers of microfinance. Important elements of education include:

- **Terms and conditions of financial services:** Contractual elements including facts of providing collateral for example pledging household items and being a guarantor to a loan.
- **Understanding interest rates and fees:** In most developed countries financial service providers must inform the borrower about the cost of the loan in predefined and comparable terms. In developing countries this is mostly unregulated, and interest rates and fees are quoted in multiple different ways making comparison virtually impossible for a consumer to compare costs of loans.
- **Differences between various types of institutions:** Consumers often do not understand the differences between types of institutions and regard all types as banks. They can therefore not assess the risks related to depositing savings or taking a loan with informal, semiformal or formal institutions.

Appendices

Appendix: CGAPs 11 Good Practice Guidelines for Funders of Microfinance

1. Poor people need a variety of financial services, not just loans. In addition to credit, they want savings, insurance, and money transfer services.
2. Microfinance is a powerful tool to fight poverty. Poor households use financial services to raise income, build their assets, and cushion themselves against external shocks.
3. Microfinance means building financial systems that serve the poor. Microfinance will reach its full potential only if it is integrated into a country's mainstream financial system.
4. Microfinance can pay for itself, and must do so if it is to reach very large numbers of poor people. Unless microfinance providers charge enough to cover their costs, they will always be limited by the scarce and uncertain supply of subsidies from donors and governments.
5. Microfinance is about building permanent local financial institutions that can attract domestic deposits, recycle them into loans, and provide other financial services.
6. Microcredit is not always the answer. Other kinds of support may work better for people who are so destitute that they are without income or means of repayment.
7. Interest rate ceilings hurt poor people by making it harder for them to get credit. Making many small loans costs more than making a few large ones. Interest rate ceilings prevent microfinance institutions from covering their costs, and thereby choke off the supply of credit for poor people.
8. The job of government is to enable financial services, not to provide them directly. Governments can almost never do a good job of lending, but they can set a supporting policy environment.
9. Donor funds should complement private capital, not compete with it. Donors should use appropriate grant, loan, and equity instruments on a temporary basis to build the institutional capacity of financial providers, develop support infrastructure, and support experimental services and products.
10. The key bottleneck is the shortage of strong institutions and managers. Donors should focus their support on building capacity.
11. Microfinance works best when it measures—and discloses—its performance. Reporting not only helps stakeholders judge costs and benefits, but it also improves performance. MFIs need to produce accurate and comparable reporting on financial performance (e.g., loan repayment and cost recovery) as well as social performance (e.g., number and poverty level of clients being served).

Appendix: The Smart Campaigns consumer protection principles[14]

Smart Microfinance is being fully transparent in the pricing, terms and conditions of all financial products. Smart Microfinance is working with clients so they do not borrow more money than they can repay or use products that they do not need. Smart Microfinance employs respectful collection practices and adopts high ethical standards in the treatment of clients. Smart Microfinance gives clients a way to address their complaints so they can be served more effectively. Smart Microfinance ensures client data remains private. Smart Microfinance protects clients, businesses, and the industry as a whole.

Smart Microfinance encompasses core Client Protection Principles to help microfinance institutions practice good ethics and smart business. The Client Protection Principles are the minimum standards that clients should expect to receive when doing business with a microfinance institution. These principles were distilled from the path-breaking work by providers, international networks, and national microfinance associations to develop pro-client codes of conduct and practices. There is consensus within the microfinance industry that providers of financial services should adhere to these core principles:

Avoidance of Over-Indebtedness. Providers will take reasonable steps to ensure that credit will be extended only if borrowers have demonstrated an adequate ability to repay and loans will not put the borrowers at significant risk of over-indebtedness. Similarly, providers will take adequate care that only appropriate non-credit financial products (such as insurance) are extended to clients.

Transparent and Responsible Pricing. The pricing, terms and conditions of financial products (including interest charges, insurance premiums, all fees, etc.) will be transparent and will be adequately disclosed in a form understandable to clients. Responsible pricing means that pricing, terms, and conditions are set in a way that is both affordable to clients and sustainable for financial institutions.

Appropriate Collections Practices. Debt collection practices of providers will be neither abusive nor coercive.

Ethical Staff Behavior. Staff of financial service providers will comply with high ethical standards in their interactions with microfinance clients, and such providers will ensure that adequate safeguards are in place to detect and correct corruption or mistreatment of clients.

Mechanisms for Redress of Grievances. Providers will have in place timely and responsive mechanisms for complaints and problem resolution for their clients.

Privacy of Client Data. The privacy of individual client data will be respected in accordance with the laws and regulations of individual jurisdictions, and such data cannot be used for other purposes without the express permission of the client (while recognizing that providers of financial services can play an important role in helping clients achieve the benefits of establishing credit histories).

[14] http://www.smartcampaign.org/about-the-campaign/smart-microfinance-and-the-client-protection-principles

Appendix Selection of partners

Financial services providers should demonstrate the following characteristics:

Institutional strengths

- Institutional culture, structures, capacities, operating systems that can support sustained service delivery to a significant and growing number of low income clients.
- Sound governing structure, freedom from political interference, good fit to local context.
- Strong business plan, vision and mission to create purpose of and sense of ownership
- Accurate management information systems that are actively used to make decisions, motivate performance, and provide accountability for funds.
- Operations that manage small transactions efficiently. Measured by loans per staff member, operating cost as percentage of annual portfolio.
- Meaningful, transparent financial reporting that conforms to international standards.
- Competent and stable staff.

Quality of services and outreach

- Client-appropriate lending
  1. Product fit - in terms and conditions of credit and collateral substitutions
  2. Credit methodology - typically character-based lending for smaller loans, simple cashflow and project appraisal for larger and longer terms loans. Sound credit evaluations are important to avoid overindeptness.
  3. Savings services, where legally possible and economically feasible
- Growth of outreach

Financial performance

- Appropriate pricing policies. Cost-covering, cost includes financial costs (cost of capital, opportunity costs, and inflation), loan loss provision, operational costs, and a minimum profit margin.
- Portfolio quality – and monitoring building to day-to-day operations via sound systems
- Operation/Financial Self-sufficiency reached within acceptable timeframe, with a clear target of becoming a sustainable MFI
- Note! If programmes also provide none-financial services such as business advisory services. Health, or education, they should account for such services separately.

Appendix Performance measurements

Standard performance indicators (see www.mixmarket.org and www.themix.org for performance reporting and benchmarks):

1. Breath of outreach
   a. Number of active clients or accounts
2. Depth of outreach
   a. Average outstanding balance per client or account (often as % of GNI per capita)
3. Portfolio quality/collection performance
   a. Portfolio at risk (PAR)
   b. Loan at risk (LAR)
   c. Current Recovery rate (CRR) together with Annual loan loss rate (ALR)
4. Efficiency
   a. Operating expense ratio (OER)
   b. Cost per client
5. Financial sustainability (profitability)
   a. For commercial institutions:
      i. ROA
      ii. ROE
   b. For subsidised institutions
      i. Financial self-sufficiency (FSS)
      ii. AROA

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