PREFACE:

New Partnerships for Innovation in Microfinance

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This publication has a particularly intriguing focus: "New Partnerships for Innovation in Microfinance". Who are the partners we expect to engage for the benefit of microfinance? The universe of microfinance appears to contain a number of different worlds, all of them full of intelligent people, but with very different visions and different cultural backgrounds.

The community-based world of microfinance consists of institutions like the famous Grameen Bank of Nobel Laureate Mohammad Yunus, or BRAC, the Bangladesh Rural Advancement Committee, also based in Dhaka. And there is the fast growing ProCredit Group of professional full-service neighbourhood banks which serve more than 3 million women and men in Africa, Latin America, South East Europe and soon also in Central Asia. In addition, the microfinance world comprises large charitable organisations like the Aga Khan Foundation that establishes and manages institutions that deliver microfinance services in countries like Afghanistan that are shaken by civil war. There is also the universe of commercial banks like Banque du Caire in Egypt, First National Bank in South Africa, or privately owned banks in the Caucasus that have set up microfinance business units with the support of KfW and others. Securitisations and microfinance investment funds are more recent phenomena that support the growth of microfinance institutions by mobilising private capital that can be on-lent to microcredit customers or that provide equity for the foundation and growth of microfinance institutions.

This variety of actors is fortuitous for microfinance. It offers a chance to serve the poor by providing them with adequate financial services. It offers a chance to make an important contribution towards the Millennium Development Goals.

Advances in Microfinance

The International Year of Microcredit in 2005 and the Nobel Prize for Dr. Yunus in 2006 have highlighted the importance of microfinance. Over the last decade microfinance has evolved into an integrated approach that successfully promotes financially viable and stable financial sectors which are accessible and beneficial to low income people and small entrepreneurs. The important contribution of microfinance to poverty reduction and to the realisation of the Millennium Development Goals is now widely recognised. A wealth of studies document that poor people have indeed improved their lives through access to loans, savings and other appropriate financial services.

There are many success stories by institutions supported by KfW that demonstrate how access to financial services helps low income families improve their lives. For example:

- Clients of BRAC, a microfinance institution in Bangladesh, suffered less from severe malnutrition than non-clients.
- In Bolivia, where KfW supported Banco Los Andes ProCredit and PRODEM, micro-entrepreneurs with access to loans doubled their income on average within two years.
- And ProCredit Bank Kosovo helped numerous families to survive post-war crises and rebuild their homes and workshops after the civil war.

To serve clients better and to create access for those who remain beyond the frontier of formal finance, the economic viability of financial institutions is crucial. Without viable institutions, we cannot mobilise the capital necessary for the growth of microfinance. Leading institutions listed in The Microbanking Bulletin[1] demonstrate that financial as well as social returns are produced.

Expanding Outreach

But let us be realistic. Of the ten thousand or so providers of microfinance services only about two hundred are profitable. Many of the ten thousand microfinance institutions are small and reach only a few thousand clients. Yet the market potential is huge, much greater than the current industry can hope to satisfy. Possibly more than 400 million potential clients worldwide still lack access to financial services. According to a recent report by Morgan Stanley, the current worldwide loan portfolios of MFIs amount to about US$ 17 billion, with the potential to grow to US$ 300 billion in the next decade.[2]

This is where the variety of actors in microfinance becomes important. It is imperative to have strong institutions on the ground since only strong microfinance institutions can reach large numbers of clients and gain their trust. It is important to have microfinance institutions that target the urban poor as well as the ones with the know-how and the technology to serve rural clients. Equally important,

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[1] http://www.mixmarket.org/; http://www.mixmbb.org/en/

[2] Ian Callaghan et al. (2007): Microfinance on the Road to Capital Markets, in: Journal of Applied Corporate Finance, Volume 19, Number 1, 2007.

there is a role for "Wall Street Finance" in microfinance. Domestic and international commercial banks must engage more deeply with microfinance in order to expand outreach in both volume and quality. It is most important that this is done in a responsible way. Responsible banking is more than informing customers about a bank's products and services. It means educating them about financial services and improving the financial literacy of the small entrepreneurs and less well off people. Moreover, responsible banking means to price deposits and loans transparently, such as by publishing effective interest rates, and to lend responsibly instead of burdening a client with more debt than they can handle.

Microfinance will reach its full potential only if the private sector invests its capital and know-how. The perception of high risk and transaction costs coupled with low transparency has inhibited greater private sector engagement. New forms of public-private partnerships can facilitate private sector entry and the integration of microfinance into the commercial financial sector. Such partnerships offer both socially and financially rewarding opportunities.

KfW has pioneered financial market development for many years – in Germany, in Europe and beyond. Our commitment is to ensure that financial systems continue to deepen and provide financial services to weaker sections of society without requiring continuous donor support. To build a commercial foundation for microfinance – which is absolutely necessary to secure viability and expansion – we emphasise collaboration with our current partners in the microfinance industry as well as with new stars that may rise.

Combining Forces to Increase Impact

KfW's success in microfinance is to a large extent due to strong support by and partnership with the German Federal Ministry of Economic Cooperation and Development (BMZ). This Ministry is the lead agency for international development setting the strategic agenda and influencing the political trends in this arena in Germany.

Together with our partners, we have pioneered successful initiatives in microfinance around the world KfW has contributed equity and long-term funding to these programmes as well as results-oriented advisory services. Among them are partnerships with widely differing players to combine their respective strengths for optimum impact. Examples of such initiatives include:

- To reach out to the poorest in a war-torn country, KfW worked with the IFC, FMO, and Triodos to transform ACLEDA Bank in Cambodia from an NGO into a full-fledged microfinance institution.
- IPC's know-how and our early support to FEFAD in Albania helped to pioneer a microbanking model which was later taken up by a number of ProCredit banks that today form the ProCredit Group, a network of twenty-one microfinance institutions worldwide. They now serve more than 3 million

microfinance clients. Incorporating private and public investors it is an outstanding example of a public-private partnership.

- In close cooperation with IFC, FMO and other partners, we facilitated the founding of several microfinance investment funds including the Global Microfinance Facility, Access Microfinance Holding, Acción Investments in Microfinance and Advans.
- As a landmark initiative, we have used structured finance techniques to create the European Fund for Southeast Europe (EFSE). This microfinance investment fund provides long-term financing and technical assistance to qualified financial institutions in Southeast Europe. These institutions provide credit to micro and small businesses, and housing loans to small salary earners. Investments by public and private players go hand-in-hand here.
- Last but not least, KfW has supported a number of securitisation transactions of microfinance portfolios. These enabled microfinance institutions to tap international capital markets. Institutions such as BRAC Bank or ProCredit Bank Bulgaria, for instance, are among those that participated and benefited – also stimulating the development of their domestic capital markets.

Recent developments in world financial markets following difficulties in the US mortgage market have demonstrated the importance of transparency and good governance for the stability of financial sectors. The German Federal Ministry of Economic Cooperation and Development and KfW put considerable emphasis on the institutional strengthening of the microfinance institutions we partner with. Furthermore, we support the development of an enabling environment in our partner countries to foster the development of transparent and stable, pro-poor financial systems.

Partnerships for Innovation

"New Partnerships for Innovation in Microfinance" is more than a book title, it is a credo. Let me re-emphasise: Microfinance can reach its full potential only when several conditions converge. Microfinance institutions on the ground must be ready to increase outreach by offering new products in an economically sustainable manner and by going beyond the client groups already served. We must convince the private sector looking for a double bottom line investment that it pays off in the long run to contribute capital and know-how to the microfinance sector. To attract and leverage private capital, public development finance institutions should contribute their risk-bearing capacity, country know-how, banking knowledge and political clout when private actors alone would not yet step forward to meet the challenges we face.

I am certain that this book will engage its readership and will stimulate discussions among microfinance practitioners as well as in academia. The theme of this book stems from the recognition that microfinance innovation and expansion requires three simple but essential ingredients:

- mobilising savings and managing risks,
- technologies that scale up outreach – especially in rural regions of Africa and Asia, and
- mobilising private capital through intelligent use of donor funds.

The chapters in this book are built on the results of a conference which KfW organised in cooperation with our colleagues from the German Federal Ministry for Economic Cooperation and Development (BMZ) together with our partners from the Agence Française de Développement (AFD), the U.K. Department for International Development (DFID), the Netherlands Development Finance Company (FMO) and especially our colleagues in the Consultative Group to Assist the Poor (CGAP). I would like to thank all of them for their contributions.

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Each chapter in this book presents a fascinating perspective for microfinance development. Challenges and potential hindrances are outlined and promising solutions proposed.

We look forward to seeing many more partnerships in microfinance that foster innovation in products, technologies, financing and risk management. The potential demand that can be satisfied by innovative approaches is enormous.

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